

JUNE 1996

## Selective Profit Taking

*Why Sell? Since our clients' equity portfolios have appreciated significantly since the beginning of 1995, we have taken some profits in order to bring targeted equity allocations back in line. In addition, our predictions for higher interest rates have come to fruition, but have yet to negatively influence equity markets. We want to tread carefully whenever interest rates rise. Finally, speculative investing is rampant in the United States, fueled by internet stocks (the information "buyway"?) and a simplistic complacency that stocks will outperform bonds. We too believe that stocks will outperform bonds, but certainly not all stocks.*

**WHICH STOCKS HAVE WE SOLD?** We invest in well managed companies with reasonable valuations. The following stocks were sold, simply because their valuation became excessive relative to their prospects for growth.

**CROMPTON AND KNOWLES** - We began purchasing Crompton and Knowles in 1995 in the price range of \$13.00-\$15.00/share. Crompton paid an excellent 3.8% dividend and was expected to do well when consumer spending increased on apparel and carpeting. Last month, the company cut their dividend and announced an acquisition financed primarily with debt. Although the acquisition may prove successful, we preferred the debt-free Crompton and therefore sold the stock at \$17.50.

**INTERNATIONAL FLAVORS AND FRAGRANCES** - IFF is a global specialty chemical company. Pressure on

IFF's customers to cut costs has resulted in a drop in our earnings growth projection from 12% to 10%. At \$48.00/share, the company was selling at a hefty 21x price to earnings ratio (P/E), or twice its projected growth rate. Slow growth, combined with a high P/E, is not the formula for good investment returns.

**ADT, LTD.** - ADT is the nation's largest commercial and home security company. We added ADT to our Buy List in 1995 at \$13.00-\$14.00/share when we noted a refocusing of the company on the growing alarm business in the U.S. With potential to grow earnings 15% per year, the stock was undervalued at only 10 times earnings. In the last year, the stock appreciated over 40%. Based on the rising stock price and recent changes in the company's accounting principles, we believed the remaining appreciation potential was minimal and sold at \$18.75.

**WHICH STOCKS ARE WE HOLDING/BUYING?** We remain confident in our Conservative Core Equities as each has excellent management and most have global growth opportunities. Evidence of their reasonable valuation is the fact that some are repurchasing their own shares. Two of the twenty-five which remain on our Buy List are described below.

**J. P. MORGAN** - Undeniably one of the best names in banking, J. P. Morgan has shown the ability to leverage their outstanding management team across new and profitable businesses. Though not a large lender, J. P. Morgan has a substantial international trading franchise which leads to high, but volatile profits. J. P. Morgan is also a dominant player in the investment banking business and posted a 76% increase in these revenues for the first quarter of 1996. At \$85.00, the stock trades at a P/E of roughly 12 times 1997 earnings estimates and pays a healthy 3.8% dividend yield. Although subject to different and perhaps higher risks than most banks, we find J. P. Morgan an excellent Conservative Core holding.

**NORFOLK SOUTHERN** - This railroad is at the right place at the right time. Their tracks run through 20 states, primarily in the Southeast. Industrial growth in the South has been largely along Norfolk Southern's tracks. Examples include a new BMW plant in Greenville, South Carolina, and Toyota's recently expanded Kentucky plant. Completing their record of attracting seven of the last ten new auto plants to their region, a Mercedes plant will open in 1997. Growing at 10-12% a year and trading at a P/E of 13 times estimated earnings, Norfolk Southern has the wind at its back.

**CONCLUSION** - To place today's speculative juices in perspective, we have noted that some emerging technology companies, with essentially no historical earnings have been valued as high as \$6-7 billion in the last year. Amazingly, this is the same value currently placed on Wachovia Bank, a 100+ year old bank which posted a net income of \$600 million in 1995. While we are clearly comparing apples to oranges, we would never recommend that someone buy a \$52.00 apple.

Our current recommendation for balanced accounts is 10% Cash, 30% Fixed Income and 60% Equities. We expect interest rates to drift higher and would view a correction in the equity market as an opportunity to increase our clients' equity exposure.

**Andrew C. Burns**

*President/Chief Investment Officer*

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Hamilton Point Investment Advisors, LLC is a fee-based investment advisory firm suitable for high net worth individuals, not-for-profits, retirement plans and corporations. We welcome comments or questions and can be reached at (877) 636-3765, or e-mail us at [aburns@hamilton-point.com](mailto:aburns@hamilton-point.com).

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