Knightsbridge Asset Management
division of Canterbury Capital Services, Inc.

April 25, 1994

FIRST QUARTER COMMENTARY

"To buy when others are despondently selling and to sell when others are greedily buying requires the greatest fortitude, even while offering the greatest reward."
-Sir John Templeton, 1983

"More humbling is the fact that… humans are not very much different from the chimpanzee with whom we share 99.6% of our active genes."
-Carl Sagan, 1993

The first quarter's market was like watching a roman candle on the Fourth of July… whose ashes were being blown back in the expectant faces of skyward observers.

It was a rocky one for the markets, fixed income and equity alike. Markets were spooked by Mr. Greenspan's successive raisings of the Federal Reserve Discount Rate. The popular press seems to be accusing him of ruining the party. After all, where's the inflation? A cursory glance at the last two decades of consumer price index and producer price index data (see chart #1 and #2) seem to indicate no cause for alarm. Closer inspection reveals, however, that:

1. Factory capacity utilization has accelerated strongly in the last six months, from 81.5% to 83.5%... this is a quite dramatic rise in this statistic (see chart #3), and

2. Raw industrial prices measured by the "producer price index (PPI) for crude goods less food and

energy" have advanced at 17.6% annual rate over the past six months, and

3. As regards "food and energy", grain warehoused is at a 15 year low, and oil prices at 5 year lows, meaning the longer term potential for these components to aggrevate rather than ameliorate the situation is ever present, and

4. The annual rate of housing starts (see chart #4) has doubled from the lows of 1990, 800M to 1.6MM.

If there is to be a resurgence of inflation, it is unlikely to be due to a reversal of the 21 year slide in real average hourly earnings (see chart #5). It is much more probable that there will be worldwide pressure on commodity production requiring long-run sustained yield policies… e.g., lumber and fishing at the moment… wherein price levels will be bid up by the most prosperous nations to be the level of unavailability for the aspiring second and third world economies.

No reason to slash our wrists just yet though. The rise in thirty year treasury bond yields from 5.75% to 7.40% since October has given rise to a more balanced appraisal of market prospects. Loosely translated, not everyone is quite so bullish anymore. Evidence is strong that we have seen an important market low. First, both Newsweek and Time Magazine have run cover feature articles on the "new bear market". Marty Zweig tells us that when these two popular magazines have run bear market covers simultaneously in the past, there has been on average a 17% increase in the market in the following twelve (12) months. Secondly, the April 18th edition of Barrons reports that the Consensus, Inc. percentage of Bullish opinion is 11%, down from 31% two weeks earlier! This is good. It provides us with a reduced-risk entry point for establishing new positions like Cytec, the basic chemicals business spin-off from American Cyanamid. Thirdly, 65% of letter writes are either outright bearish or looking for further correction. This has, in the past, marked important market lows (see chart #6).

Since our portfolios hold positions whose fortunes would appear to be greatly influenced by political outcomes namely RJR Nabisco and Caremark, I would like to take this opportunity to digress on the twin subjects of health care reform and tobacco legislation. In short, here's what I expect to be achievable legislatively, in Congress:

1. **A 50c to 60c increase in cigarette excise taxes. Clinton has proposed 75c to 99c, but this has only the remotest of chances of being passed by Congress. Why? Because southern Democrats whose home states grow tobacco need to get reelected in November. Of 56 House members up for reelection in November from the six southern tobacco growing states, 35 are Democrats. That's 64%! The "sturm und drang" of politicians like Henry Waxman holding hearings on the evils of smoking is just a smoke screen (pardon the pun… Louis Rukeyser, move over!) to create an environment wherein Democrats from these southern states can politically vote for such a tax. All the baloney (or is it bologna?) about the FDA regulating nicotine as a drug is just that… baloney. After all, the FDA would be required to declare smoke unhealthful and ban tobacco products. What would we tax then? These sin taxes are needed to finance the ambitious Mrs. Clinton's health care reform, who gave up a lucrative commodity trading hobby to bring us better healthcare. Since Mrs. Clinton was "able" to turn $1,000 into $100,000 in one year, why not just one more year… she could have turned $100,000 into $10,000,000. Can't beat that!**

2. **The Stark proposal for 0.8% payroll tax to finance health care reform is not grounded in political reality and cannot pass Congress.**

3. **The Rostenkowski primary victory makes the powerful House Ways and Means Committee Chairman indispensable to Clinton in crafting a health care plan. Since Rostenkowski is on record opposing the expansion of health entitlements without revenues in hand, it is likely a final bill will be greatly watered down from its original form, with implementation stretched far into the future.**

In the final analysis, it is highly likely that stocks ultimately affected by the above have overreacted to fears of the worst coming to pass… as Sir John Templeton suggests in the opening quotation. Our success may, in fact, rest upon our ability to source on that 0.4% of non-chimpanzee genetic material, as Prof. Sagan implies.

Best regards,

Alan T. Beimfohr

Chart 1

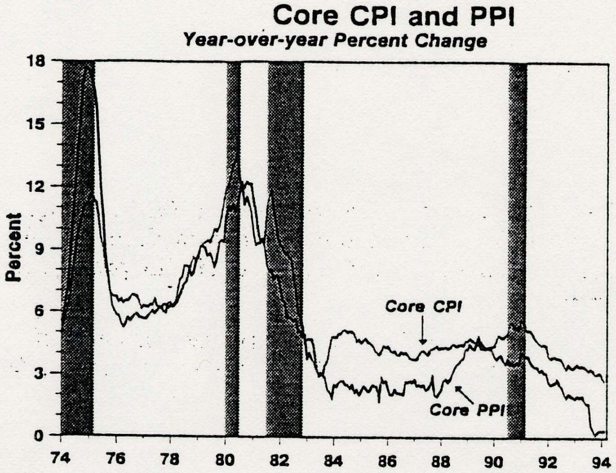

Chart 2

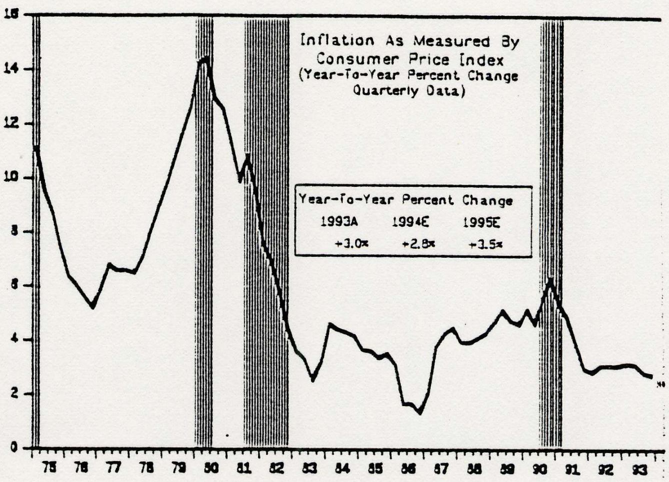

Chart 3

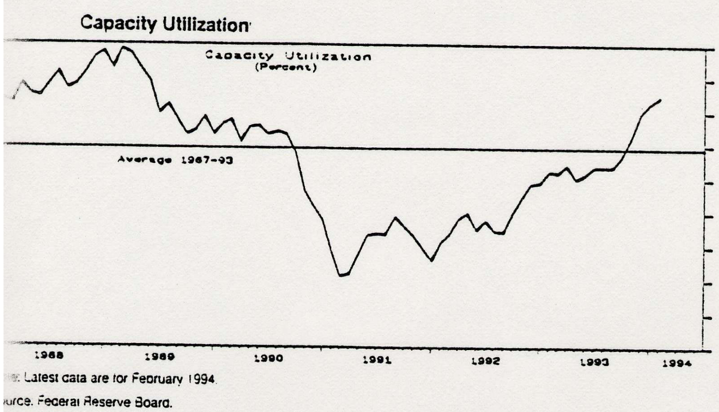

Chart 4

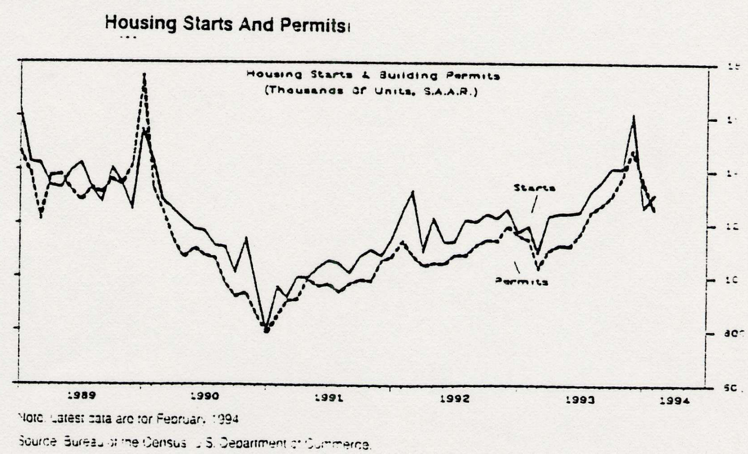

Chart 5

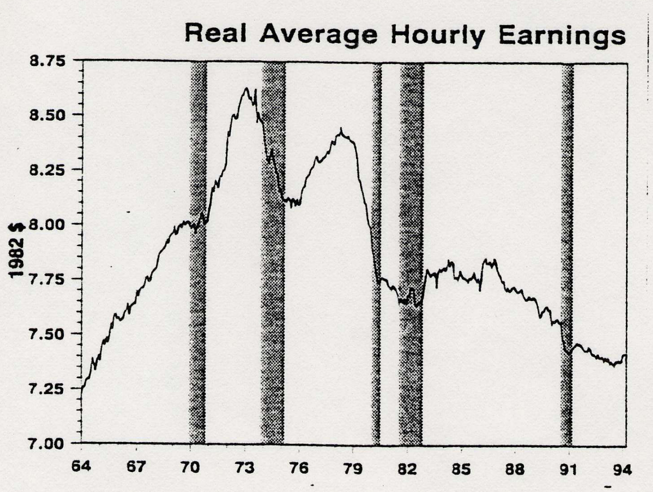

Chart 6