Knightsbridge Asset Management

division of Canterbury Capital Services, Inc.

July 1996

SECOND QUARTER COMMENTARY

"It is easier to get a favor from fortune than to keep it."

-Publilius Syrus, 1st Century B.C.
Greek Philosopher
Moral Sayings, No. 282

No sooner had the April 15th cover of Fortune Magazine pronounced "Market Mania" than second thoughts were in order. Perhaps the "favor from fortune" referred to by Publilius Syrus can be taken as a metaphor on several levels… not just a reminder that this bullish market has been ongoing for seventy (70) months, a historical record equaled only by the bull market ending in 1929……..but also a reference to the magazine cover which warns us that the market euphoria may have reached its zenith. Magazine cover recognition of a trend or phenomenon is frequently an indication of imminent reversal… it seems that such recognition is many times a reflection of thinking of the crowd, a mirror of the collective consciousness of the investment world. An important inflection point. In short, investor "group think" revealed. Beware!

On July 5th, the release of government jobs data demonstrated an economy that may be stronger than many had assumed, bringing with it the specter of the Federal Reserve taking sterner interest rate action to cool things off. In fact, many economists are looking for second quarter GDP (gross domestic product) annualized growth in the 4% to 5% area. Typically 2% is thought to be a safely non-inflationary growth rate. Hourly labor rate rose at their highest rate in thirty (30) years and unemployment is at a six (6) year low. Since inflation is more sensitive to labor rate increases than commodity price increases,

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some observers now expect inflation rate upticks previously unexpected. Nor did it take the bond market long to adjust to the new realities. Thirty (30) year treasuries popped up to a 7.20% yield from 6.85% in almost a day, bringing with it corresponding declines in bond portfolio values. Certainly all participants will be especially interested in Mr. Greenspan;s Humphrey-Hawkins testimony before Congress (which will probably be completed by the time you receive this) as he is inclined to "prepare" the markets for his incipient action.

However, the rise is long term interest rates us probably much closer to an end than a beginning. Rates have been rising already since January and have moved generously from 5.8% to 7.2%. These moves rarely exceed 1.5% so we may be very near a peak… perhaps not yet but very close (see chart #1). Furthermore, much of the aggregate demand data is pointing to future weakness rather than a continuation of strength. Therefore we are beginning to be much more bullish on the bond market….but not the stock market.

Evidence at hand suggests a peaking of earnings on the Standard & Poors 500 (see Chart #2). Furthermore, both non-defense capital goods backlogs and commercial & industrial loans continue to drop from their year-ago peaks (see charts 3&4). Increasingly, it is a reasonable bet that 1997 will be a recessionary year, the first since 1990.

Our most recent portfolio addition is Earthgrains (NYSE ticker symbol EGR). This is a baking company that was spun off from Anheuser-Busch this spring in Budweiser's effort to get back to the basics of brewing. In 1982 Anheuser-Busch acquired what was then known as Campbell Taggart Baking Co., and most recently carried it on their balance sheet at $701MM in equity value. Renamed Earthgrains, it's 10.1 million shares trade at 34 or so for a haircut in equity value of about 50%. Grain prices have almost doubled in the past two years, depressing earnings. At zero earnings, EBITDA (earnings before interest, taxes, depreciation and amortization) is some $8.00 per share. If a few things go right, earnings could be $5.00 (this would present just 3% after tax on revenues of about $160 per share), and EBITDA $13.00. At these levels, the stock should be worth substantially more. Positive are: (1) increased plantings of grain worldwide due to high prices, particularly in Argentina, Australia, and Canada, are

offering the prospect of lower ingredient costs, (2) their two (2) largest competitors just merged… Continental Baking and Interstate Bakeries, and are refusing to enter into the traditional competitive dog-eat-dog price wars, (3) industry wide territory swaps are increasing industry efficiency, and 4) prior to spin-off, Earthgrains shut down their least profitable plant capacity approximating 15% of total capacity, and (5) EGR executives have generous quantities of stock options to help align their interests with ours. Earthgrains is the second largest publicly owned baker in the U.S. with $1.5 billion in revenues, 15,000 employees worldwide and 27 baking plants.

Our overall equity strategy continues to be defensive in nature. We continue to hold cash reserves of at least thirty (30) percent and look for issues that are either powerfully undervalued in the U.S. market or issues that are tied to non-domestic markets in order to reduce exposure to what we view as a generally overvalued domestic market. We have elaborated in past issues on the rationale for our beliefs and will not repeat them with this writing. We reflect on the fact that eighty (80) percent of all monies invested in mutual funds today have come into the market in the past six (6) years. Although some of this capital may have been invested in the stock market in forms other than mutual funds prior to 1990, the facts are abundantly clear… many have experienced only the appreciation of this long bull market. What will this money do in less friendly circumstances? As this is being written, the Dow Jones Industrial Average is off about nine (9) percent from its 5833 peak value on May 23rd. The average bear market move is a decline of twenty-six (26) percent. Therefore, we might expect to have experienced already more than a third of the potential of an entire bear market.

Now is a time to keep steady hands at the proverbial helm, and look forward to the opportunities that will inevitably be created by the current turmoil. We thank you for your understanding, wisdom and support.

Very truly yours,

Alan T. Beimfohr

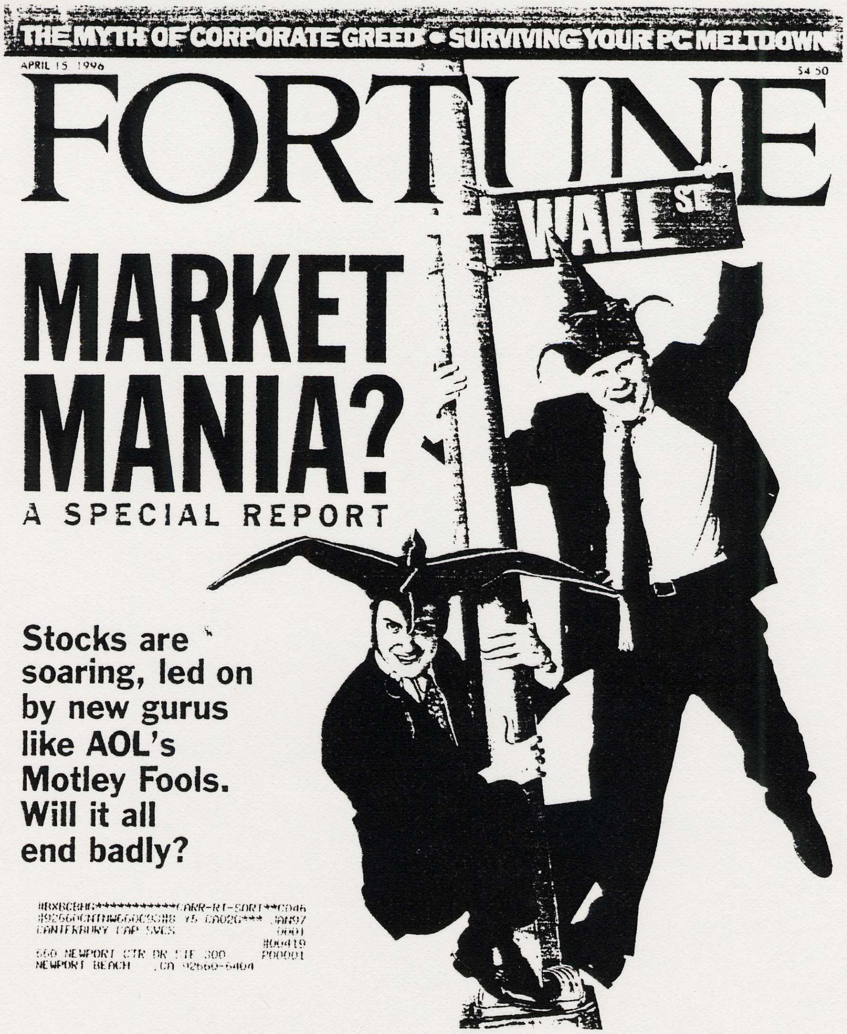
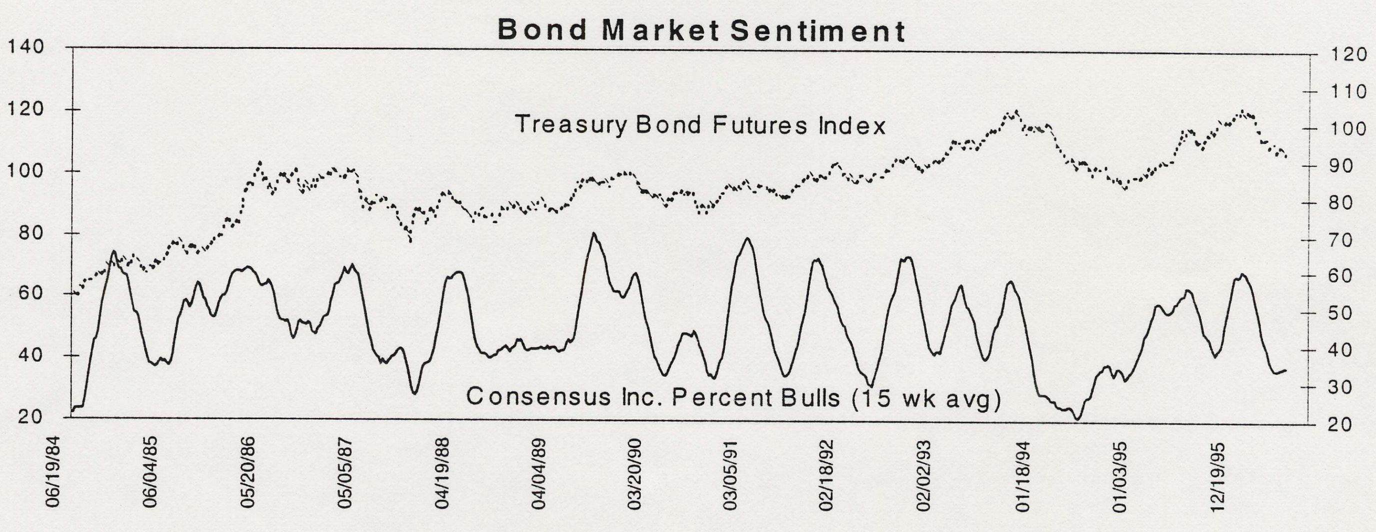


Chart # 1



We believe that the sentiment background at this time is at least supportive of an intermediate recovery in the bonds.

Chart # 2

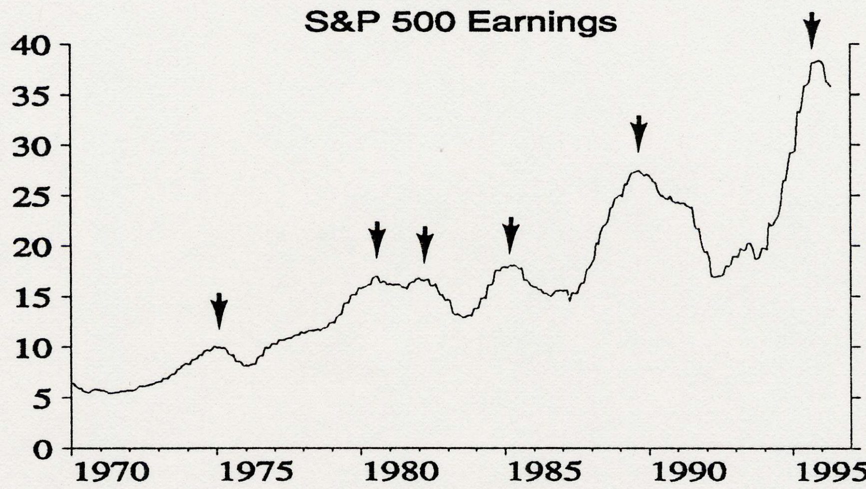


Chart # 3

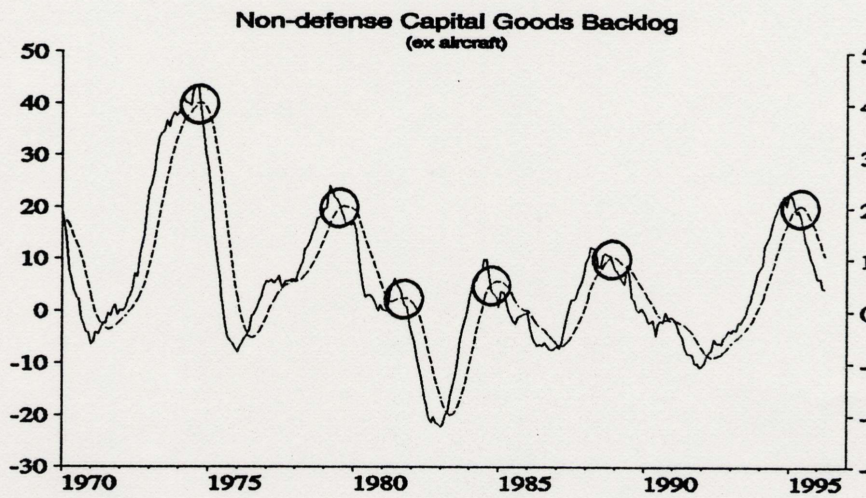


Chart # 4