Knightsbridge Asset Management
division of Canterbury Capital Services, Inc.

October 17, 1994

THIRD QUARTER COMMENTARY

"It is not battle plan; it is the execution on the field that matters"
-Napoleon Bonaparte, 1769-1821

The battle plan of the Federal Reserve has not changed, namely,… keep raising interest rates until there is evidence of a flattening of the economic statistics. After a year of rising rates and an increase in 30-year treasury yields from 5.75% to 8.00%, there is no visible indication of an economic plateau, let alone downturn (see chart #1). Leading indicators, factory orders (see chart #2), employment (see chart #3) and capacity utilization (see chart #4 and #5) statistics are all at post-recovery highs. Annual rates of change, year over year, for commercial and industrial loans (see chart #6) and changes in business inventories are telling the same story. No longer is "just-in-time" inventory control so in vogue…taking its place is "can-we-get-it-any-time?" Clearly some inventory hedging has been taking place (see chart #7) on anticipation of strength in final demand.

It is difficult to believe the trade weighted value of the dollar is down 44% since its peak in 1985 (see chart #6). This should provide for strong earnings gains for both companies that are big exporters or have foreign operations whose earnings will be translated into dollars… the likes of IBM, Boeing, Caterpillar, GE, Coca-Cola, Ingersoll Rand, Merck, etc.

Stronger earnings from these multinationals will lower the P/E ratio of our markets, particularly the

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capitalization weighted S&P 500. This will be particularly true of those with a strong Japanese and European presence (see chart #8) as their respective economies recover in tandem. Japan is importing more then ever, contrary to what the media has conditioned us to believe (see chart #9) I wish not to be misunderstood on this emotionally charged topic… the playing field is not yet level between the U.S. and Japan, and probably never will be… just that the relative balance is shifting noticeably. Therefore we are at a particularly critical juncture where yet further rises in rates, not anticipated to be necessary last spring, will be deemed necessary. We will need to be careful to protect capital, solidify gains and yet maintain exposure to value, as usual.

Our stock selection has been fair and saved us from experiencing the current malaise. That rising interest rates pose a serious and ongoing threat to overall market health cannot be denied, but is commonly feared and universally recognized therefore reducing its potential negative impact. In fact, the early October declines seemed to be discounting the aforementioned facts… that Fed action so far appears for naught.

Digressing for a moment, I would like to restate my goals as they relate to equity performance. The stock market over long periods of time historically delivers 10% total returns with occasional 26% bear market downdrafts. Most people have no problem with the 10% return part. It's the 26% downdraft that tends to deproselytize the recent converts. My goal is to produce 15% returns with downdrafts of no more than 15% (peak to trough measured quarterly). This is an ambitious goal as it relates to equity investing. Cash balances will drag the 15% returns lower until such time as they may be more safely employed close to a market bottom at which time their deployment will make the 15% returns more easily achieved. Awaiting that time, these cash balances allow for risk reduction if the general market declines, thus serving two (2) useful purposes. So much for the first part of the Napoleonic battle plan. The second part, resides in the execution of the stock selection process… this is where the rubber meets the road, so to speak… where Napoleon made his mark… battlefield execution. And so hopefully can we.

We will be our slow and deliberate selves in taking on new positions towards year-end as tax-loss selling will be

helping us to buy cheaply and the negative advance/decline action in calendar '94 has enlarged the universe of potential purchase candidates, even as the DJIA is off only 3% or so from all time highs. The average discount on closed-end funds is now 10% versus 2% just a year ago. Normally this would indicate an extreme level of bearishness. And so this is difficult to reconcile against the DJIA being only off 3% from all time highs. But it is more reflective of the average stock's lackluster performance, with 50% of the NYSE down 25% or more, and the craze in country funds which seems to be tapering off. Just look at those 15% to 20% discounts on some of those country funds like First Iberian, Europe Fund, Clemente Global, Future Germany, India Fund, Morgan Stanley Africa, and Pakistan Investors, averaging a discount of over 17%. It's almost enough to make one want to buy them.

The increasing relative strength of the drug stocks and tobacco stocks, traditionally considered very defensive groups in the market, may be giving us important information. The bull lives, but is long-in-the-tooth. It is time to be careful and defensive, and the bullish underpinnings of sentiment indicators I discussed last quarter are not as extremely bullish now. This coupled with an increase in the monetary heat dictates our caution. Still, it is not wise to jerk our equity exposure left or right or to rely too heavily on market timing… market timing has such superficial intellectual appeal but is so deficient in its application. Recent earnings announcements also provide clues to the attitude of the market. The General Motors announcement was disappointing and it was pounded down 6+ points last week. Yet companies with superb reports barely budged to the upside. Another good reason for caution.

Once again, I thank you personally for your support and prematurely wish you the best for the soon-upon-us holiday season.

Sincerely,

Alan T. Beimfohr

Chart 1

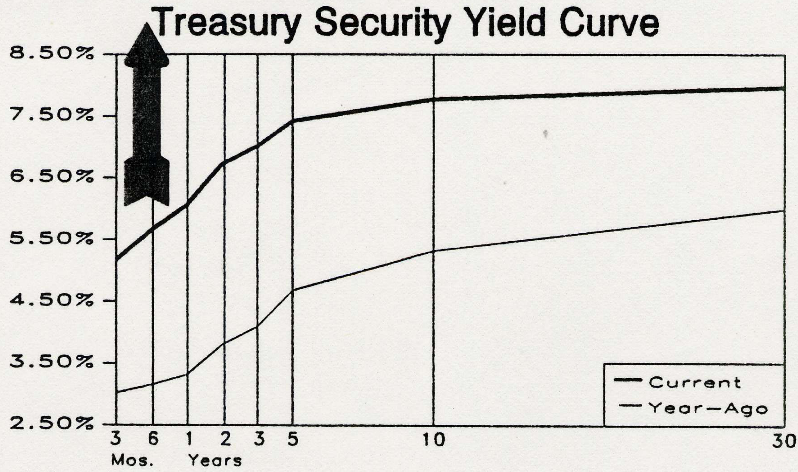


Chart 2

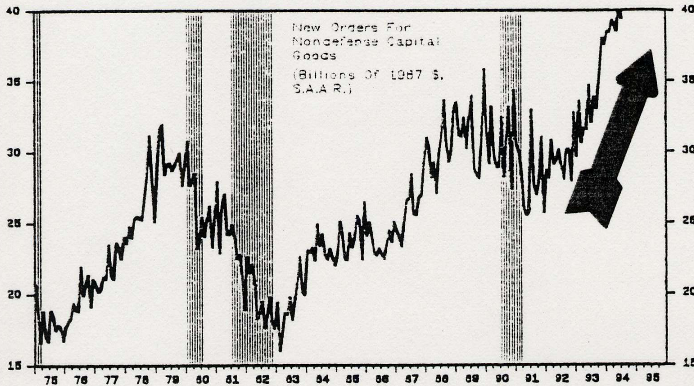


Chart 3

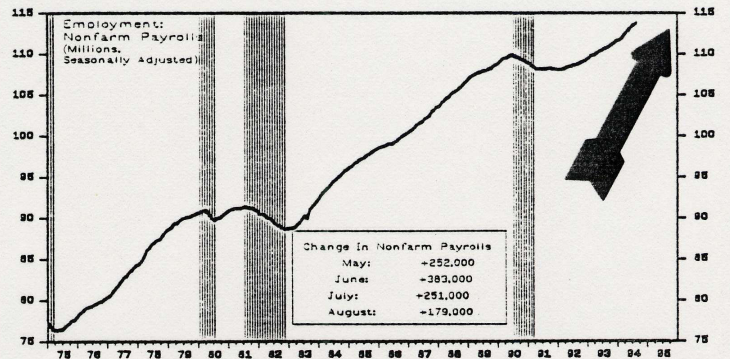


Chart 4

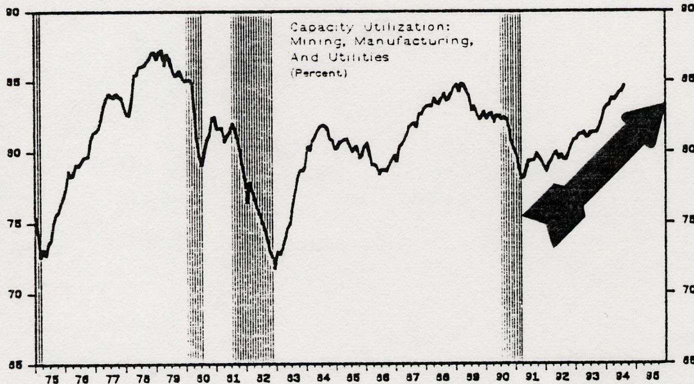
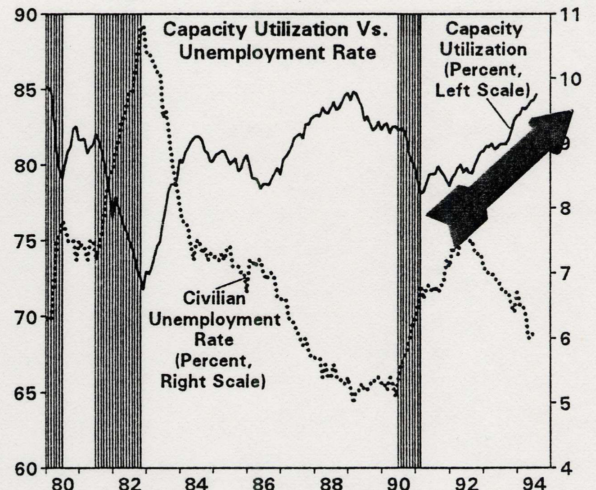


Chart 5



Note: Latest data are for August, 1994.

Source: Federal Reserve Board; Bureau of Labor Statistics, U.S. Department of Labor.

Chart 6

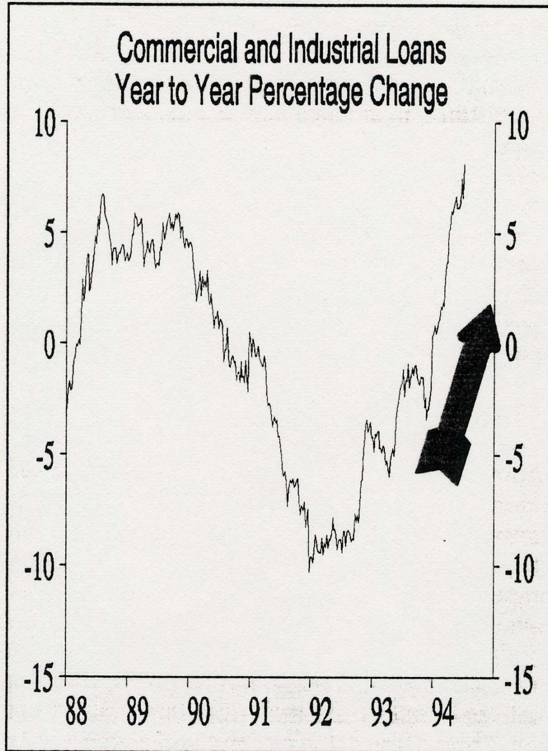


Chart 7

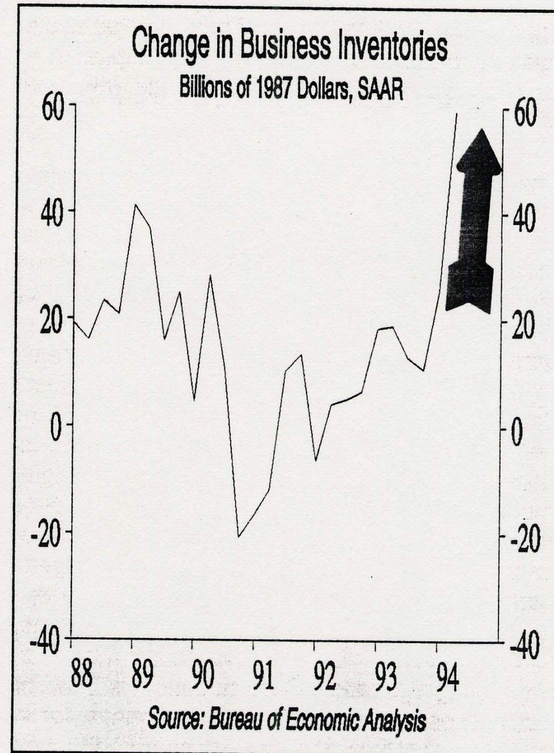


Chart 8

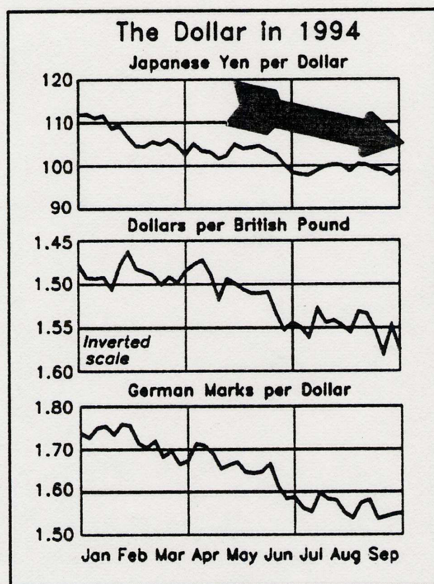
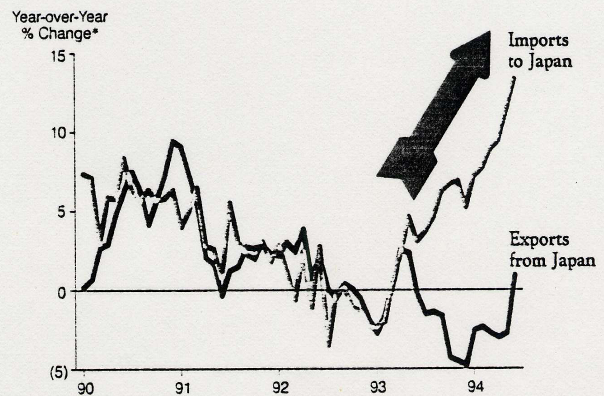


Chart 9

IMPORTS INTO JAPAN *are booming, while exports barely grow, a radical change...*



...engendered by a soaring yen that's making Japanese goods dear even in their home market

Cost in Japan ($)

	Domestically Produced	Imported
Men's Suit	$476.00	$290.00
1 Lb. Chuck Beef	12.69	5.09
Coca-Cola (16 oz.)	0.91	0.62

*Changes based on three-month moving averages
Source: Datastream and Bernstein estimates