Knightsbridge Asset Management
division of Canterbury Capital Services, Inc.

January 25, 1997

FOURTH QUARTER COMMENTARY

"The greatest lesson in life is to know that fools are right sometimes."

-Sir Winston L.S. Churchill, 1874-1965
British Statesman, Solider and Author
1953 Nobel Laureate, Literature

The 1996 market turned out to be a "great lesson in life". That the market could be up over 50% in the two year period just ended is almost beyond belief to the sane and rational thinking among us. But bearishness and caution seem to have gone "mainstream" to the point where one has to wonder if yet higher prices are not an inevitability. We've waited for the fat lady to sing for a long time, and it seems she isn't even on the stage yet. The average equity-only mutual fund was up 19.5% this past year, and so far in 1997, it appears the market may be headed higher.

We ask ourselves, is there no end to this sublimely positive-only performance? Although we know there is, our clouded crystal balls are no better than others'. We have been prematurely prepared and intend to continue prepared. Fortunately, our stock selection has been reasonably good, and we have benefited accordingly.

The bearish case is gathering adherents. We take little solace in this observation, as we would prefer to be part of a distinct minority rather than a growing crowd. No lesser a figure than the patrician Fed Chairman Alan

660 Newport Center Drive • Suite 460 •Newport Beach • California 92660-6405
(949) 644-4444 • Fax (949) 717-5030 • www.knightsb.com

Greenspan admonished market participants in a December 5th speech to consider whether they might be falling victim to "irrational exuberance". Prior to that speech, many felt that "irrational exuberance" referred to Wal-Mart shoppers stampeding the aisles to grab the Tickle-me-Elmo doll! No such luck. Mr. Greenspan's reference, buried in a long winded oratory, it turns out, merely needed to ask the question. Careful wordsmith that he is, it was enough to send the Dow Jones Industrial Average 100 points lower following day. However, we do not believe the Federal Reserve will enact policy in ways to deliberately temper "irrational exuberance" in the stock market. Rather, jawboning is a much less costly option for the Fed. And it puts the markets on alert that the Fed is concerned that future policy actions could be negatively constrained by reactive market behaviors.

We remind ourselves of valuation levels relative to historical experience; data since 1923 (73 years) is as follows:

	Current, Year End 1996	Historical Average
Market Price-Earnings Ratio	19.7x	13.5x
Market Dividend Yield (see chart #1)	2.0%	4.5%
Market Price to Cash Flow Ratio	12.6x	7.8x

Also bearish are data pertaining to mutual fund cash balances. At 6.7%, this is very low relative to the normal 9.0%. Ratios of prices to book values are also at all time highs at 4.3 times. And very importantly, stocks appear expensive to bonds (see chart #2).

Moreover, evidence mounts that investors in general throwing caution to the wind. A Merrill Lynch survey measures what percentage of total buy orders are "limit orders" versus "market orders". The theory is that as market participants become less cautious, they use more

"market orders" and fewer "limit orders". This survey shows the greatest degree of complacency in a decade (see chart #3).

On the fiscal policy front, the difficulty of balancing the budget by 2002 without attacking entitlement spending is obvious. We are now being presented with the Boskin study that purports to show that the Consumer Price Index (CPI) is actually "overstating" inflation. This alone was sufficient to send would-be buyers of inflation index bonds scurrying back to their calculators forcing a postponement of the much heralded government offering. Since politicians cannot individually remain in office while voting "against" entitlement issues, it will be easier to functionally accomplish the same job by government decree rather than the ballot box. Fait accomplii!

Bear in mind that these events are deflationary in nature. So too is the creation of the European Monetary Union (EMU) a deflationary event. Since deficit spending in each member nation may not exceed a certain stipulated percentage of gross domestic product (GDP), reduced governmental spending is in order. If that is insufficient, then sales of gold billion are always possible to buy time. Therefore, gold prices are under pressure not only from recognition of worldwide deflationary forces, but also from central bank sales. The facts remain that gold mine production and scrap salvage have lagged gold consumption for several years, and this will not continue indefinitely without upward price pressures coming to bear. Expectations for gold, currently $355/oz., are very low (see chart #4). In fact, gold futures traders are the most bearish in four (4) years.

In late October we added a position in Allegiance Corp. (AEH) at $18.82/share. Allegiance Corp. was a spin-off from Baxter Int'l., and consisting mostly of assets acquired by Baxter in the 1985 acquisition of American Hospital Supply. This is a $4.5 billion revenue company, and the largest company in the business. This is also a low expectation enterprise that has been under margin pressure from the medical cost containment practices of the managed care industry. Indications are, however, that pressures may be abating. Moreover, Allegiance has adopted an internal strategy that, if successful, will add $60 million pretax to the bottom line ($1.10 per share pre-

tax). Allegiance has 54 million shares outstanding, $421 million EBITDA (earnings before interest, taxes, depreciation and amortization), $1200 million in long term debt, and will earn perhaps $1.55 to $1.60 per share in 1997. We believe Allegiance may trade to the mid 30's by 1999, at which time it would be anticipating earnings in the year 2000 of $2.25/share or so. We believe that a 5.5 EBITDA multiple is way too low and compares to EBITDA multiples of 9.0 for its competitors, Bergen Brunswig, C.R. Bard and Becton Dickinson.

Relative to the risks we took, 1996 was a very good year. Please understand that we are not always comfortable taking full market risk with your capital, especially during times of "irrational exuberance". And while Winston Churchill reminds us fools may be right sometimes, there will come a day when this ceases to be the case. It is only a question of when. Again, we thank you for your sponsorship, your referrals to us, your wisdom and understanding, and wish you peace and love in the new year.

Very truly yours,

Alan T. Beimfohr

Chart #1

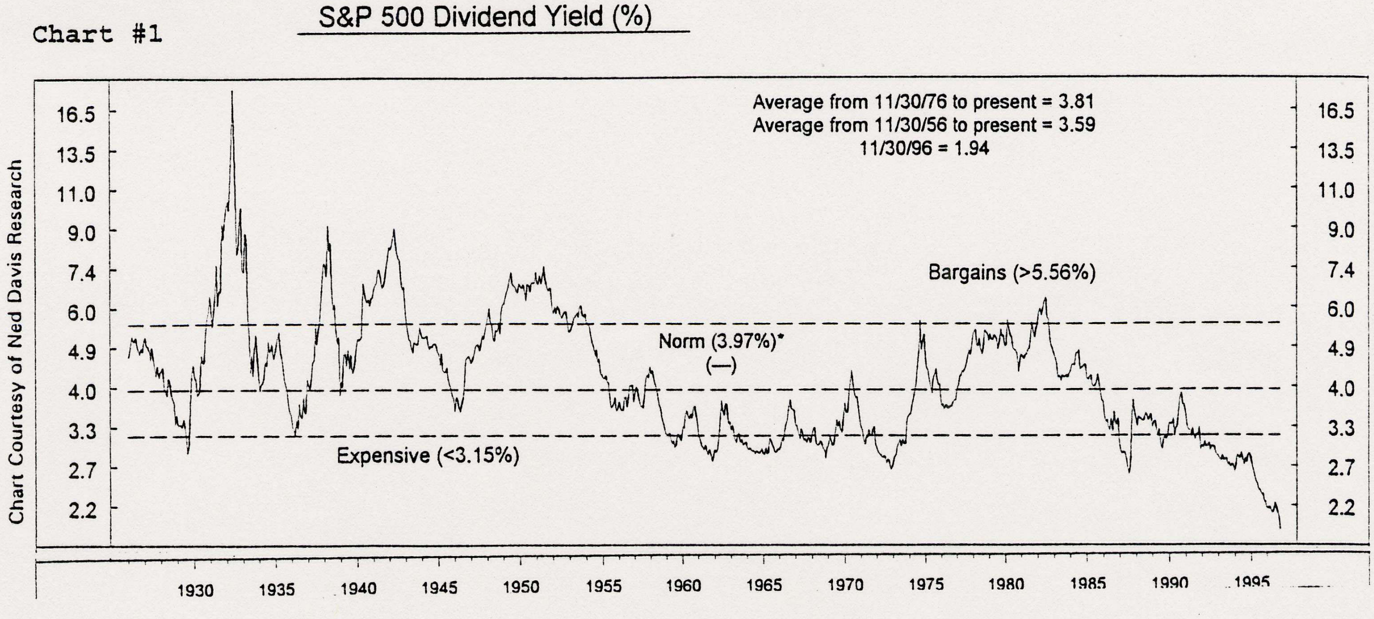


Chart #2

Stocks Appear Overvalued Relative to Bonds

The ratio of ten-year treasuries to the dividend yield has been stuck near 3.0 since April. The last time the ratio was this high was in the summer of 1987. With S&P dividend yield at only 2% stocks appear overvalued relative to bonds.

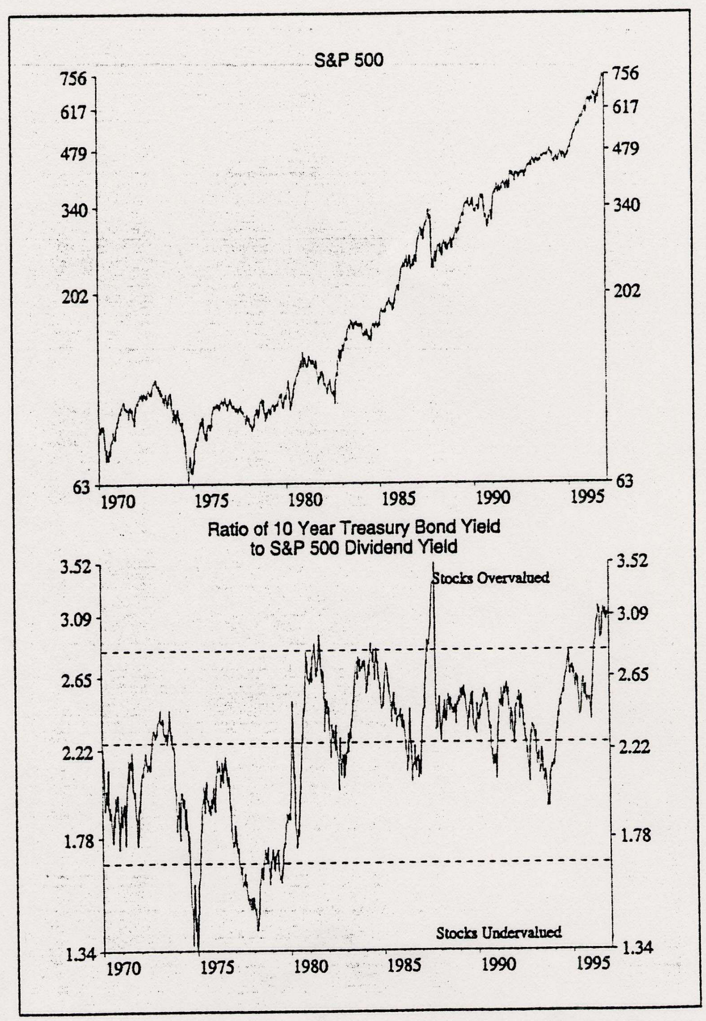
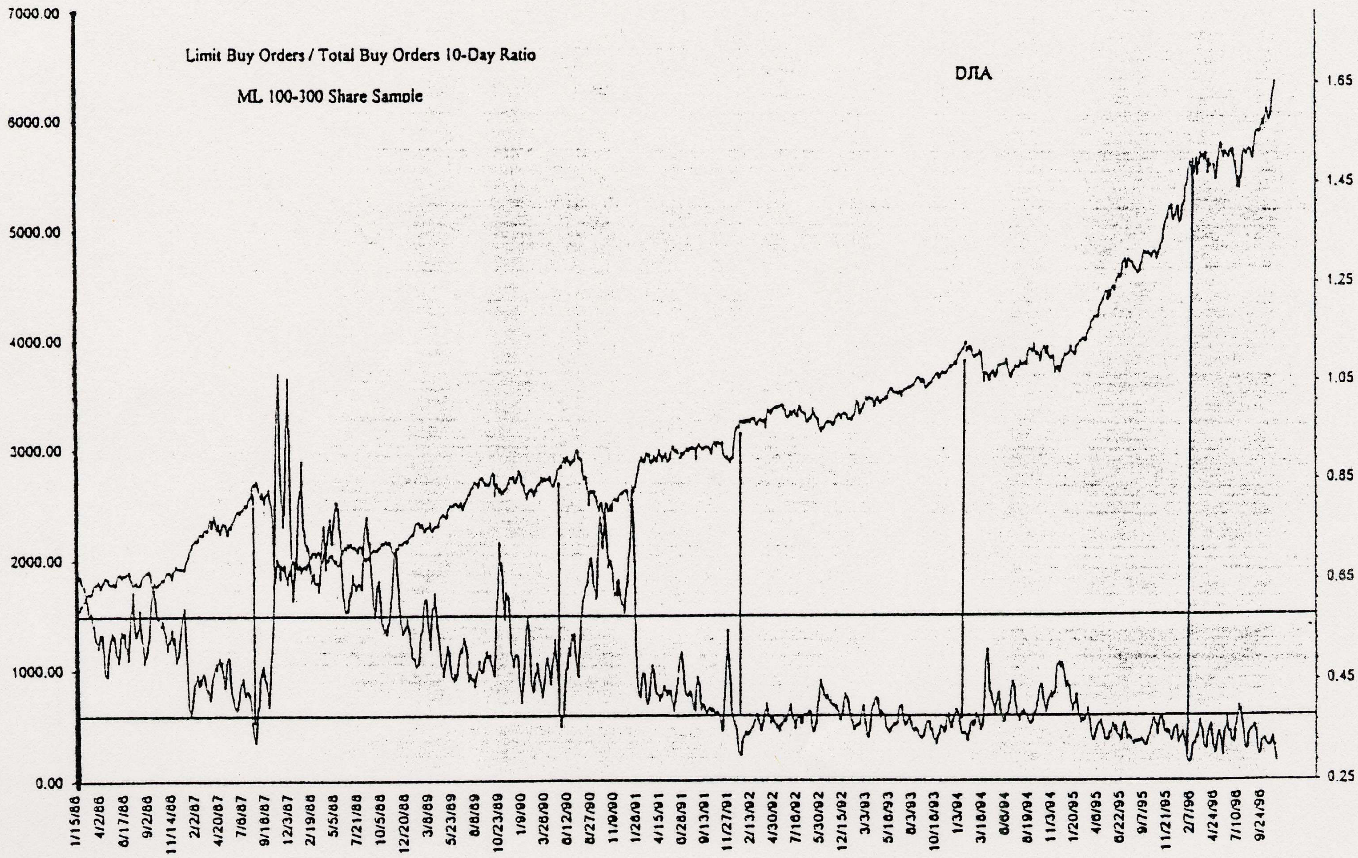


Chart #3



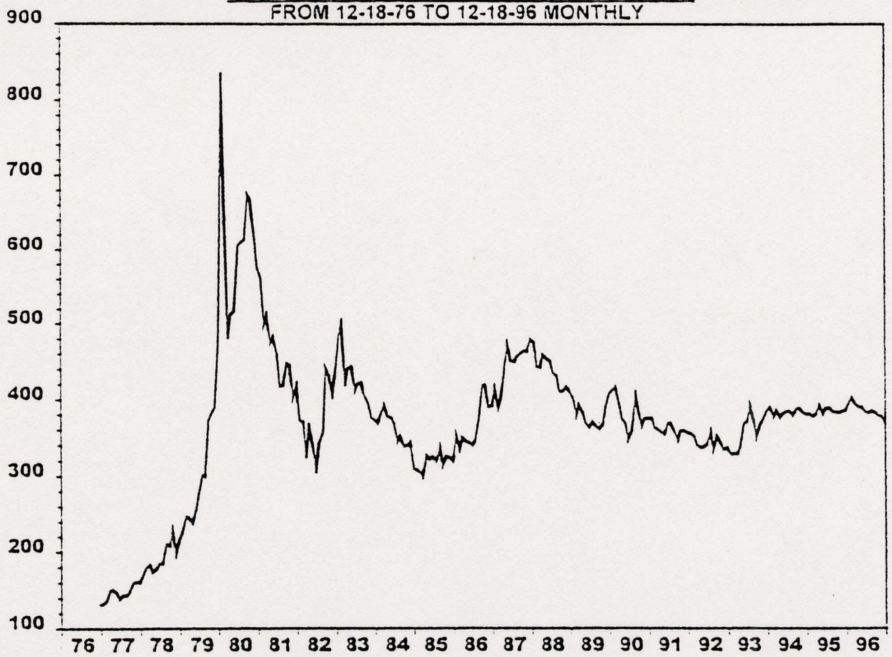
LIMIT ORDERS VS. MARKET ORDERS

The Limit order to Market order indicator is a measure of investor euphoria or complacency. Numerous market orders show that stocks are being bought at their respective offering prices with no attempt at strategic entry by the investor. A low ratio of limit to market order indicates excessive enthusiasm in the market. At the end of November, possibly set off by the presidential election results, the ratio was the lowest in 10 years. As seen on the chart, a pause of some degree usually followed such a reading.

Chart #4

GOLD BULLION $/TROY OUNCE

FROM 12-18-76 TO 12-18-96 MONTHLY



Gold Traders Find Little to Glitter About

Wall Street Journal - 11/11/96