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Outstanding Investor Digest

PERSPECTIVES AND ACTIVITIES OF THE NATION'S MOST SUCCESSFUL MONEY MANAGERS.

Volume VII Numbers 1 & 2 February 14, 1992

Investors featured in this Issue:

Other Investors in this Issue:

Companies & Investments in this Issue:

BAUPOST GROUP'S SETH KLARMAN...
"RETURNS DON'T BEGIN TO JUSTIFY THE RISK....
WE'RE KEEPING OUR POWDER DRY & BUYING INSURANCE."

Baupost's Seth Klarman sees disturbing similarities between today's stock market and frothy markets of the past. And since he handled the '87 market quite nicely — up 20%± — we thought you might be interested in his thoughts today.

Incidentally, since its inception on February 1, 1983 through year end 1991, Baupost's limited partnerships have achieved a compound return of approximately 27% per year

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SOGEN INTERNATIONAL FUND'S
JEAN-MARIE EVEILLARD
"WE'RE NEGATIVE GENERALLY ON U.S. STOCKS & BONDS.
BUT WE ARE FINDING A FEW THINGS HERE & THERE."

During Jean-Marie Eveillard's 13-year term at the helm, SoGen International Fund has reportedly never had more than 75% of its assets in stocks. And as you might suspect, a relatively conservative posture caused his fund to sharply underperform the S&P 500 last year — earning "only" 17.9%.

For the full 13 years, however, the Fund has managed to outperform the S&P 500 with little more than a third of its volatility earning 18.2% per year after all fees and expenses

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TEMPLETON GROWTH FUND'S
JOHN TEMPLETON & MARK HOLOWESKO
"SOME WONDERFUL, CHEAP AND GROWING COMPANIES
ARE ON THE BARGAIN COUNTER IN HONG KONG."

We've described in past issues how $10,000 invested in Templeton Growth Fund at its inception November 11, 1954 would today be worth approximately $1-1/2 million after fees and taxes at the fund level — without which it would have grown to $2-1/2 million. And we've told you about the many accomplishments of founder John Templeton.

However, by emphasizing Templeton himself and the long term, we've inadvertently neglected the contributions of

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FIRST PHILIPPINE FUND'S KIT RODRIGO
"CHEAP, RAPIDLY GROWING STOCKS AT A 25%± DISCOUNT."
DON'T PINCH ME IF I'M DREAMING, PLEASE....

Kit Rodrigo is not your typical *OID* interviewee. His track record's quite brief — less than three years. And he manages a closed-end fund investing primarily in one country.

However, in contrast to the ebullient U.S. stock market where bargains are few and far between, the Philippines is apparently one of the cheapest stock markets in the world. Rodrigo's portfolio is full of the fastest growing companies available at mostly single digit P/Es. And, best of all, First Philippine Fund's shares are selling at a 25%± discount.

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TEMPLETON GROWTH FUND'S
JOHN TEMPLETON ET AL.
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others at Templeton Funds whose accomplishments — while they've been achieved over a much shorter time period — are equally impressive. This issue, we're pleased to bring you an interview with one of those individuals — Templeton Director of Global Research Mark Holowesko.

As Holowesko describes, *Lipper Analytical* ranked Templeton Foreign Fund the number one global fund in America for the five years ended December 31, 1991. What he doesn't mention is that Foreign Fund was also ranked number one among all international funds by *Morningstar*'s *Mutual Fund Values* for that same five years — a period, incidentally, which according to *Morningstar* coincides with Holowesko assuming primary responsibility for the fund's portfolio management.

Holowesko's position as director of global research combine with Templeton's extensive research network to give him an almost unmatched view of worldwide events and opportunities. Holowesko made time in a frenetic schedule for a series of conversations with your editor to give us a bird's eye view of some of the most important current developments that he's seeing and some of the places where they're currently finding bargains.

The following excerpts were selected from those conversations. We hope that you find his ideas and insights as interesting as we did.

THE RESULTS MAY LOOK FAMILIAR.
BUT IT AIN'T JUST TEMPLETON ANYMORE.

OID: Congratulations. I understand that your fund has the best 5-year record among international funds.

Mark Holowesko: Thanks. It's been a fabulous year for the Templeton Foreign Fund and an excellent five years. Forgive me for tooting our own horn a bit.

OID: Toot away.

Holowesko: But I don't think it's any mistake that we've been running the best international fund in America over the last five years. It's because the Templeton approach is learnable. He teaches it well. And we know it.

It's no mistake that Mark Mobius has been the best performing emerging markets investor in the world. It's because he's using the Templeton approach. He's learned it, he knows it and he does it well.

It's no mistake that our private account performance places us in the top 5% of all private account managers in America over the last five years.

And I believe it's no mistake that Tom Hansburger's MD Fund in Canada is one of the best performing funds in Canada of any kind of fund over the last 10 years.

According to Lipper Analytical, we ended the year with the number one global fund in the U.S. And I believe that we also had five of the top ten global funds for the year.

OID: It's been suggested to us that no one has ever dominated the Wall Street Journal list of top funds as much as you did last year.

Holowesko: We're not going to do that all the time. In fact, it was a very unusual year. I seriously doubt you'll see another year like it in terms of the way we dominated the charts. It was very unusual.

We want to communicate the fact that we've done a good job. At the same time, we want to make sure that people don't believe we can generate this sort of performance relative to competitors on a continuous basis — although our goal is to be the best. And, hopefully, we'll come close to that.

OID: It sounds great. But you guys always emphasize the long-term. What's the story there?

Holowesko: The '88 and '89 periods were tough at Templeton. Value investing seemed to have lost favor — and it was a difficult period.

But in 1990, despite the fact that we lost money, you could see that the value style was coming back into vogue. The value style of investing really works terrifically well when there's a high level of emotion in the market — and we've had that for the last 18 months.

But despite these difficulties, *Money Magazine* recently lists the Templeton Foreign Fund as the #1 overseas fund over the last five years. And the Templeton Growth Fund, World Fund and Smaller Company Fund were all in the top 20 over the same period.

OID: Tell us about your role at Templeton.

Mark Holowesko: I have many roles at Templeton as do most people who work for Sir John: For example, I'm a director of Templeton, Galbraith & Hansberger which is the parent company for all of our companies worldwide. Although I'm not a member, I sit in on all of the meetings of our Executive Committee which is comprised of Sir John, John Galbraith, Tom Hansburger, John Templeton, Jr. and Martin Flannagan.

OID: Don't feel bad. I crashed your breakfasts for several years myself.

Holowesko: We have three directors of research — John Templeton being Chairman of the Research Group, and Tom Hansberger as Global Research Coordinator. I'm Director of Global Equity Research. Mark Mobius is Director of Emerging Markets Research. And Sam Forester is the Director of Fixed-Income Research. Finally, I'm a portfolio manager and an analyst.

OID: Sounds like a full plate. What does it mean?

Holowesko: As a portfolio manager, I'm involved in day-to-day management of mutual funds from Nassau. As an analyst, I sort of free lance. Most of the other analysts, aside from the other directors of research, have specific research responsibilities. I go and develop ideas wherever I see best.

THE INVESTMENT PROCESS AT TEMPLETON:
FIRST & FOREMOST, THE BARGAIN LIST.

OID: Sounds like fun.

Holowesko: It is. Everyone in the group spends about 60% of their time on the research side. Everything we do revolves around stock picking. The most important

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TEMPLETON GROWTH FUND'S
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thing we're all doing is helping to construct the bargain list.

We really don't have a portfolio management process similar to other groups. The role of a portfolio manager at Templeton is to make sure that his or her accounts reflect the bargain list as much as possible given the constraints on the account.

OID: Focusing on one of your hats for a moment, what does it mean being Director of Global Equity Research?

Holowesko: My job as director of research is to take an incredibly talented, ambitious and energetic group of people in various offices around the world and try to organize them in such a way that we maintain the Templeton tradition and also maintain a certain amount of integrity and excellence in our bargain list.

Part of my job is to make sure that people are allowed to shine within the system, but at the same time the system works under the Templeton approach.

OID: The Templeton approach?

Holowesko: The Templeton approach is almost a way of life. John Templeton instills certain values into the people who work around him. It's no surprise to those in-house that we have a lot of people who are doing good jobs and achieving good results in their own portfolios. A lot of that has to do with the fact that the Templeton approach is a very learnable approach.

I try to instill patience, hard work, discipline, independence, a value orientation, a long-term perspective and try to maintain them within the group.

It's important to us that whether you come to a Templeton office in London, Canada or Nassau that you get a Templeton product. So part of my job is to try to make sure that we have consistency of product around the world.

OID: Sort of like McDonald's.

Holowesko: That's right. Also, my job is to organize the research. When I first came on board at Templeton, we used to cover the world by country. Today, we primarily cover the world by industry. We've organized the research effort so that we have analysts around the world that cover certain industries globally.

We still maintain country coverage because there are certain companies that don't fit neatly into one industry. Also, there are certain companies and industries that it doesn't make sense to compare globally. But our primary emphasis is on global industry research.

For example, we have one analyst who covers banks and another who covers airlines globally. A lot of research sources out there aren't set up that way. That makes our job harder.

But that's also a good thing because it also leads to a lot of inefficiencies. You have firms with an analyst in the U.S. covering U.S. airlines and an analyst in the U.K. covering U.K. airlines both working for the same company. They may have differences of opinion on the same industry.

OID: Like the proverb of the three blind men trying to describe an elephant. Obviously, TV analysts in South Korea and the U.S. would get a very different picture.

Holowesko: It requires more work. But at the same time, I think it gives us an advantage.

Unfortunately, I think the industry's beginning to move in our direction. I noticed that Morgan Stanley came out in '91 and said they were moving to industry coverage globally — which is something we've been doing for about five years now. So you're slowly seeing that approach being forced on the industry.

OID: As the world gets smaller....

Holowesko: We have three meetings a week on Tuesdays, Thursdays and Fridays by telephone and we review every industry and country around the world every six months formally.

Six months may seem like a long time. But when you consider our five-year average holding period and that we're talking about stocks all the time anyway, we're very comfortable with six months.

What happens is that a report is prepared and goes out to all our offices world-wide every Tuesday. Those offices that can, hook up via telephone conference. For example, last Tuesday we reviewed the telecommunications industry, Indonesia and Spain. Reports are written by various analysts internally on those countries or industries.

The reports really emphasize the companies. If it's a country report, it's probably only one page long. If it's an industry, it's a little bit more in depth — with the bulk of the reports being information specific to the companies.

OID: And on the other two days?

Holowesko: On Thursdays, we discuss new buy ideas that anyone may have, new sell ideas and news that might impact our holdings.

OID: And on Fridays?

Holowesko: Then every Friday, we take accounts by manager, send them to the offices world-wide, show the breakdown of the assets, the transactions in the account and the performance.

And it's a free-for-all — a peer review. If two banks were on the bargain list, someone will ask why we bought one versus another. Or if the bargain list is 20% Europe and we're at 35%, someone will ask why. People in our group have some independence. But by having peer review, we also get some conformity and some great dialogue. We learn a lot from each other in the process.

OID: It sounds like it would be very helpful — especially for someone who invests globally.

Holowesko: It's fun. One of the problems that I've seen other firms have is that people are always looking at new ideas — and they forget about the things that they already own. What these reviews do is force us to look at our current holdings as well as new ideas.

One of the nice things about it, too, is that we rotate responsibilities. At Templeton you only wind up covering an industry or country for about two years — even less if it's a smaller industry or country. That's because every analyst at Templeton is a portfolio manager. And we want to make sure that everyone gets a global perspective.

For example, we just hired the number one ranked telecommunications and engineering analyst for Europe. But he's not covering telecommunications and engineering

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for us — because in our group he's going to be a portfolio manager who has got to know about other areas of the world as well. But it's great when we're doing the telecommunications review that we have the guy who was the number one telecommunications analyst in Europe sitting there.

PLUS I WEAR TWO OTHER HATS:
PORTFOLIO MANAGER & ANALYST.

OID: Tell us about your role as portfolio manager and analyst.

Holowesko: As an analyst I spend 50%-60% of my time just pouring through research, traveling, visiting companies and trying to develop ideas.

Also, twice a month I put out what's informally called "Buys, Sells and Other Comments". Depending on travel, it's sometimes more frequent, sometimes less...

OID: Inexcusable.

Holowesko: It's my picks from the bargain list and also the research work that I've done since the last "Buys, Sells and Other Comments". The other comments aren't really top down analysis. They're industry analysis or interesting things that are developing that I think everyone should be aware of that I might present to try and get feedback on.

OID: For example?

Holowesko: One example is real estate prices in Japan. Another example is the impact of the Russian decline on the global oil markets since the Soviet Union is such a large producer and user of oil.

And then I have very brief comments on specific stocks I like.

OID: If you're going around freelancing, can't you pretty much do the research wherever you smell bargains?

Holowesko: That's mostly the case. But every once in awhile, it's good to sit down and work through the dynamics of an industry. It's a very time consuming thing. And it's also very helpful from time to time to sit down and go through the entire dynamics of a country.

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OID: Exactly what I always say. Very helpful...

Holowesko: In the past when I was freelancing, I was doing it stock by stock. Now when I'm finding a lot of ideas in one particular area, I start reviewing the whole area.

OID: Sounds like fun. How do you interact with Sir John?

Holowesko: Part of my role is to assist Sir John in the day-to-day management of most of the mutual funds in Nassau. I spent last Friday meeting with him most of the day. I'm 31 years old. And yet I was exhausted keeping up with the mental pace he maintained.

OID: Despite the fact he's approaching middle age, as he likes to say, at age 79.

Holowesko: That's right.

OID: Do the funds have anything in common — besides the fact that you're working on them?

Holowesko: They're all global funds. I'm really helping run international money — in other words, non-U.S. money — global money and small cap money.

OID: I gather that "non-U.S." means outside the U.S. and that "global" means including the U.S.?

Holowesko: That's exactly right.

OID: Could you run us through the portfolio managers for each of those funds?

Holowesko: Sir John, Tom Hansburger and I are the portfolio managers for many of the funds in Nassau.

Having said that, we need someone out there pulling the trigger on a day-to-day basis. Different people do it for different funds. But once again, the portfolio manager's job at Templeton is to make sure that the accounts as much as possible reflect the bargain list.

There's no mystery at all why the Global Mutual Fund Scoreboard in the *Wall Street Journal* in the global category includes most every Templeton Fund that qualifies for the category and that they're among the top 15 funds industry-wide in the category.

Those are run by different people but all those people use the same bargain list. You don't have as much of an individual portfolio manager's signature on a fund as you would have elsewhere because we're not making traditional portfolio management decisions. We're not making asset allocation or timing decisions. We're not raising cash or lowering it.

And we have three portfolio managers assigned to every account. You need backups and you need people to be there. We all spend about three months a year traveling. And when you're traveling, you need someone there for corporate actions and to follow up on trades. But because of our approach, the most important people are the research analysts, not the portfolio managers.

OID: Because they're the ones who come up with the good ideas?

Holowesko: That's right — that go on the bargain list. When you're a stockpicker, once you have a list of the cheapest stocks in the world, portfolio management is relatively easy.

OID: Of course, doesn't your discretion as gatekeepers

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have a lot to do with the quality of that list?

Holowesko: Although we are the gatekeepers, these ideas are coming from our research staff around the world.

OID: What percentage of the names that are proposed by the analysts for the bargain list do you approve?

Holowesko: Probably around 80%.

OID: That high?

Holowesko: Our analysts are good.

THE GREATEST THREAT TODAY
TO THE WORLD FINANCIAL SYSTEM:

OID: Could you run us through the most important developments that you're seeing worldwide?

Holowesko: Recently in New York, Sir John observed how one of the biggest threats to the financial system is the overvaluation of the Japanese real estate market. He observed how it has a value of ¥16 trillion. I'd use closer to ¥14 trillion — depending on what you included and how you valued it.

OID: Picky, picky, picky. Of course, a trillion here, a trillion there....

Holowesko: The Japanese stock market declined about 46% before recovering somewhat. If the Japanese real estate market followed the same pattern and declined by the same amount, it would drop to roughly ¥7 trillion before recovering to ¥8 trillion.

That evaporation of value would be the equivalent of the disappearance in value of about 70% of all the stocks in the world. And it would be *more* than all the stocks in the world if it went down 46% and stayed there.

That's a huge amount of money.

OID: By almost any measure.

Holowesko: It's mostly impacting the Japanese — which is a bit different than a similar collapse in real estate prices in the U.S. In the case of a collapse in U.S. prices, there would be a lot of Europeans, Asians and Americans caught up in it. But the Japanese market is mostly controlled and dominated by the Japanese.

OID: How likely is such a collapse?

Holowesko: We're already seeing some signs of it. A securitization of a piece of property in downtown Japan gives the impression that Japanese real estate has already declined 30%.

OID: Just what Tiger's Julian Robertson is saying.

Holowesko: And buyers of Tokyo office buildings now expect to earn a minimum yield of 4% on their investment.

OID: How onerous.

Holowesko: That's much lower than Americans require — but it implies a decline of at least 30% in value.

So we believe that a deterioration in the Japanese real estate market is occurring. It's not getting a lot of press. And there aren't a lot of transactions around.

OID: Fascinating.

Holowesko: What's also fascinating to us is that Japanese business failures are at record levels.

OID: Especially for a country as leveraged as Japan.

Holowesko: Exactly.

OID: As Sir John has mentioned, real estate serves as a very big chunk of the assets of Japanese banks. The loss of liquidity to Japanese business could be incredible and could make what we're experiencing in terms of credit contraction seem mild by comparison.

And it could be worse still since Japanese investors seem to be almost exclusively trend followers rather than value investors.

Holowesko: That's correct. But every negative has a positive side. Look at the real estate market in the U.S. Much of it is in terrible shape.

But that's a positive for the country as a whole. The Japanese don't have excess real estate capacity which is one of the reasons real estate prices are so high. Many places in Europe don't have excess real estate capacity.

In the U.S., despite the fact that it's a negative for the banking system and a negative for real estate developers, the excess capacity is a wonderful asset for U.S. businesses.

It's a wonderful asset to enable economic expansion down the road. By comparison, in certain places in Europe and in parts of Japan, real estate is a problem and economic expansion is being inhibited.

ANOTHER CONCERN:
GLOBAL LIQUIDITY.

OID: Are there any other important developments worldwide that offer special opportunities or otherwise impact your investment perspective?

Holowesko: Most of the important developments are industry-related. One that isn't — at least in one way — is the level of liquidity on a global basis. That's a concern.

Many people concentrate on changes in M-2 or M-1. But if you look at M-4, this is the first time since the 1930s that an acceleration in money growth was not visible after five discount rate cuts.

OID: Sounds ominous. But for those of our subscribers fortunate enough not to be economists, what exactly does M-4 mean?

Holowesko: It's the broadest measure of liquidity in the system. I don't think people should worry about M-1, M-2, M-3 or M-4. From my standpoint, those measures are an old-fashioned way of measuring liquidity.

For example, most measures of liquidity don't take into consideration the fact that U.S. companies can borrow from abroad. Liquidity measures should take our global trading partners into consideration. I think most people don't concentrate enough on global levels of liquidity.

So global liquidity is what matters. And global liquidity is low. So it's a concern.

OID: We're more concerned with liquidity locally, but we know what you mean.

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Does the fact that there's this tremendous demand for capital in so many different places — infrastructure and the like — with the spread of democracy and capitalism imply higher interest rates?

Holowesko: The U.S. fought one of the most expensive wars in world history with interest rates never reaching as high as 5%. They were able to control them. Interest rates are controllable to a certain extent by governments.

OID: So it's not really supply and demand as much as it's government policy.

Holowesko: It's much more supply and demand in terms of equity prices than it is in terms of interest rates.

However, to a certain extent, equity has to be raised by countries and companies around the world. In order to do that, they'll have to make it attractive.

Last year, for example, emerging stock markets around the world provided $22 billion in fresh money for companies. That's a huge amount of money. And I think capital markets are going to be a more important source of money in most of these countries than debt markets.

OID: Does the fact that there has been and there's going to be a burgeoning supply of new issues have any negative implications, since they have to be attractive?

Holowesko: There has been an increase in the volume of new issues in the U.S. market. Just to give you an idea, during the second quarter of '91, net equity issuance rose to a record amount of $12 billion.

OID: But isn't that a negative — supply, demand and so forth?

Holowesko: Not really. Although we've had a huge amount of equity issuance over the last 12 or 18 months, it's important to put it in perspective. Between '83 and '84, we had what Sir John talked about for many years — the shrinkage of stocks outstanding. For example, there were about $70 billion in equities retired in '84. And in '85, there was about $65 billion retired.

In total, between '83 and '90, $553 billion worth of equity just disappeared to leverage buyouts and companies buying in shares.

OID: Don't look at me.

Holowesko: That was the equivalent, I believe, of about 1/5th of the equity issuance outstanding before '83.

OID: A pretty amazing statistic all right.

Holowesko: So despite the fact that we've had a record amount of equity issuance during the second quarter of '91, the $12 billion raised is dwarfed by the $553 billion

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that disappeared during the final two-thirds of the 1980s. We're not yet anywhere near replacing what disappeared.

OID: Fascinating.

Holowesko: In '90 alone, about $53 billion in equity disappeared.

OID: And my portfolio only accounted for a tiny portion of that.

Holowesko: So we still don't have the equity issuance that should be in the system.

A SHORTAGE OF CAPITAL
WILL CREATE WINNERS & LOSERS....

OID: Roger Engemann observes that in the long run, earnings drive stock prices; but in the short run, demand for money seems to drive them.

Holowesko: I'd agree with that.

OID: In that case, couldn't all of these wonderful developments towards free markets and democracy worldwide therefore lead to lower valuations at the same time standards of living are improving greatly?

Holowesko: There is a greater demand for capital worldwide for a variety of reasons. And it's not only because of these countries that need the capital to develop and grow their economic base.

There's also a huge amount of debt that needs to be rescheduled. The '80s was the decade of leverage. The '90s will be the decade of *de*-leveraging. An awful lot of capital will be required for that.

Demand for capital will also come from many industries that have not made heavy levels of capital investment in the recent past that will have to do so in the near future.

Transportation is a classic example — both for airlines and shipping. In the '70s, ships were being built at an incredible pace. As a result of overbuilding, massive bankruptcies followed.

Therefore, there was very little shipbuilding all through the '80s. But we're getting to the stage now where we have an extremely old fleet that needs to be replaced during the 1990s. There are developments like that within industries that require massive amounts of capital as well.

But that's good and bad.

OID: Depending on whether you're a shipbuilder or not, no doubt.

Holowesko: There are negatives from the standpoint that there are people out there who need capital and aren't going to get it.

But there are positives to it as well. Let me give you two examples pertaining to the oil and airline industries. The deterioration in the Soviet Union is a terrible thing. It has to occur. Any time you go from a Socialist or Communist system to a democratic system, there has to be a period of pain that you have to go through. It'll probably take much longer in Russia than in some of the countries where Communism was imposed on them. Those countries will probably be more willing to change — and suffer to incur that change.

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OID: Unlike New York, for example.

Holowesko: Although the Soviet Union's breakdown has mostly negative connotations for many industries, the opening up of Eastern Europe carries huge positives with it. Certain countries in Europe will benefit substantially. For example, we anticipate that northern European countries' GNP will grow 1/2% to 1% more per year just because of the opening up of Eastern Europe.

Most of the benefits will be in infrastructure. Orders are coming through already for infrastructure for many parts of Eastern Europe. And they're benefiting Western European countries tremendously.

And just think about the oil market. One of the wonderful opportunities is the oil situation. During the Gulf War, many people were concerned about it. But if you asked ten people to name the largest producer of oil in the world, only one might get it right.

Russia isn't the largest exporter, but they produce the largest amount. The second largest producer is the U.S.

OID: Also little known.

Holowesko: Although Russia exports roughly 2 million barrels a day, they produce about 10-1/2 million barrels a day. The U.S. by comparison produces about 8-1/2 million barrels a day.

People didn't pay much attention to the Soviet Union until the coup. And Soviet production is declining very dramatically. It hasn't impacted exports so far because they need hard cash. They need the liquidity. But it's getting to the point where it's going to start to affect their exports. Even official estimates show Soviet production declining by about 15% a year.

OID: That much?

Holowesko: It's very dramatic. And not only is it declining, but the methods they're using to get the oil out are actually damaging the fields and some of the oil that remains in the ground. They're using terrible methods in their desire to maintain production and export oil.

To give you an idea of the size of their production, Kuwait "only" produces 1-1/2 to 2 million barrels a day at full production. So you can see the potential impact of the Soviet Union's economy disintegrating. The amount that it exports is similar to Kuwaiti exports.

And not only is Soviet oil production dropping, but so is production in the U.S. So the largest two producers of oil in the world are having declines in production.

Therefore, the Soviet Union probably won't get the capital they need. That will be a negative for oil production. And that will cause higher oil price increases.

OID: With all of the inherent negative implications for the stock market.

BUT CAPITAL SCARCITY
WILL BENEFIT SOME.

Holowesko: There are companies that will benefit from higher oil prices and, indirectly, from the shortage of capital or will do well even with higher oil prices.

The refining business in Europe is a wonderful business because there's very little new refining capacity coming onstream in Europe. It's actually shrinking — a lot of old capacity is being shut down. And there's not a lot of new refining capacity coming on globally either despite the fact that oil prices may trend higher because of what's happening in the Soviet Union.

And the consumption of refined products in Europe is much lower than it is in the U.S. or Japan. For example, unleaded gasoline usage in Europe is much lower than it is here. So there are a lot of wonderful dynamics going on in the refining business there.

ANOTHER BENEFICIARY:
SINGAPORE AIRLINES.

Holowesko: Another example of a shortage of capital being a positive for some people is the airline business. If you looked at a graph of the orders outstanding on the books of major airlines around the world and the financial sums required relative to the amount of cash flow that these airlines are generating, you'd see a huge gap.

OID: We can certainly relate there.

Holowesko: An amazing amount of money will be required to finance expansion of fleets on a global basis. And not everyone's going to get it.

OID: That's an opportunity? I didn't realize that there were any publicly traded bankruptcy attorneys.

Holowesko: The financially stronger airlines will get the capital. They're in the process of gaining market share. We made major investments in transportation stocks — primarily airline stocks — at the beginning of 1991.

We did that not because any of them would make much money in 1991. Some won't even make much money in 1992. But longer term, you have an industry that's in consolidation, that was temporarily impacted by the spike in oil prices and by the fact that U.S. bankruptcy courts don't allow companies to go bankrupt quickly.

By allowing companies like Eastern and Pan Am to operate when they should shut down creates an environment where companies compete just to get money in the door at any price — whether it makes economic sense or not.

What's the result? You have airlines keeping prices lower than normal because they should be in bankruptcy. And you have amazing demand for capital in a consolidating industry.

It's a wonderful opportunity for the financially strongest airlines in the world to expand. They're the ones who are going to get the capital that's needed. Not only will they get the capital they need, but they'll gain routes and market share.

OID: For example?

Holowesko: Singapore Airlines is an incredible airline. They're so financially strong that they can write checks for the airplanes that they need.

OID: How novel.

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Holowesko: Also, most airline companies write their airplanes off over about 12 years. Singapore Airlines does it over 5 years.

Other good examples right now are American Airlines and British Airlines. Again, we don't really anticipate that these companies will make a lot of money this year or generate a lot of cash flow. All they're doing is gaining more market share. And they will get the financing when they need it.

OID: A classic case of losing money on each passenger, but making it up in volume.

Holowesko: Industries not being able to get money can be a big plus for certain players in those industries.

OID: Could you run us through Singapore Air's fundamentals?

Holowesko: They cover their dividend 11 times.

OID: That's coverage.

Holowesko: And their cash balances are almost $2 billion Singapore. Their current ratio is 170%. Their cash flow covers their debt almost 12 times. Interest is covered 44 times. It has a net cash position after all debt.

OID: So they're very strong financially. What about returns?

Holowesko: Singapore Air's return on equity is 25%.

OID: And is that normal for them?

Holowesko: That's normal in a normal operating environment.

OID: Versus a normalized return for the entire U.S. airline industry of about zero.

Holowesko: That's right — at best. Incidentally, the cash balance that I gave you may be down at year end because of their decision to pay cash for three airplanes instead of making the typical leasing arrangement.

OID: Despite the state of the industry.

Holowesko: That's right. One of the biggest problems in the airline industry is that there is a lot of capacity that does need to come on board. And there are going to be relatively few sources of financing for that capacity.

When people look at airlines, they don't tend to look at their off-balance sheet debt and leasing agreements that have been signed by these companies. When you do, debt to equity levels for many of these companies almost double. So it's going to be very difficult for many of them to find the financing to get the capacity additions.

OID: But not for Singapore Air. If only they weren't in the airline business. But isn't that industry near a cyclical low?

Holowesko: You have a number of things going on. There's the slowdown in the industry that's caused by the recession.

But the U.S. has a bit of blame to bear for the situation of the airline industry. In America, you have this wonderful thing called Chapter 11. And I think it is a wonderful thing. It's terrible to watch a company go bankrupt. But bankruptcies mean the system's working. If you don't allow companies to go bankrupt when they should, you're creating a false business environment.

OID: Akin to people not being able to die no matter how sick or pain-ridden they might be.

Holowesko: Pan American announced that they were going into Chapter 11 at the beginning of '91, but it wasn't until the end of '91 that they actually closed their doors. Too many airlines after announcing Chapter 11 have been allowed to operate when they weren't really viable operating enterprises and should really have been shut down.

So not only did we have a normal economic cyclical decline, but we also had too many operators being allowed to operate when they should have been closed.

OID: I believe Charlie Munger and Warren Buffett said the same thing at last year's Berkshire meeting.

Holowesko: The result is that they dragged down service and rates — because they were willing to fill seats at almost any cost. So not only will there be a cyclical rebound when the economy recovers, but as the sick operators get out of the system and rates get up to an economic level, the upturn may even be larger than most people anticipate.

And it could be even better still because there's been a consolidation of routes, not to mention the fact that some major airlines have captured new routes at relatively attractive prices because they were being sold off by airlines in bankruptcy.

OID: A strong case for a lousy industry.

Holowesko: I can't say whether or not we're at a cyclical low, but I can say that the extent of the bounce from the low is probably going to surprise a lot of people.

OID: It sounds like virtually the only negative that they aren't facing right now is high oil prices.

Holowesko: And financing. But credit availability is going to be a little more scarce in the '90s than it was in the '80s.

OID: What can you tell us about Singapore Airlines' earnings?

Holowesko: It earned about $1.85 in 1990. We estimate that despite the high oil prices in the beginning of 1991, it may earn about $1.60 in 1991.

OID: And your estimate of earning power for 1992?

Holowesko: Roughly $1.80. They pay a dividend of roughly 2-1/2¢. And that's on a stock price of roughly $18 — again in Singapore dollars. So there isn't much of a dividend yield.

OID: On the other hand, you have a company somehow earning a 25% return on equity at only about 10 times normalized earnings.

Holowesko: That's right. And it's in the fastest growth region in the world in terms of airline traffic — the Asia/Pacific area.

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OID: How do they manage such high returns in such a brutal business?

Holowesko: It's an extremely well run company. But they've also benefited from incredible government support. The government ownership is very high for one thing. The government is also very willing to loan them money at a very good rate. And the government has not really enacted legislation that would hurt them from a labor standpoint. There's very little interference at a government level with their labor agreements which are very good.

Singapore is a very small country. So in order for them to survive in the region, they've had to be able to compete without relying on their home market. There are few airlines that can do that. Most of the major airlines rely in a huge way on their domination of the domestic business — for example, British Airlines on their domination of Heathrow.

But Singapore Airlines had to be able to go out and provide the best service. And they do. They're constantly winning awards for offering the best service to passengers.

OID: And the reason they had to do that is because it's a small market.

Holowesko: That's right. They have to compete aggressively. And they do.

OID: And if you were guestimating earnings growth going forward?

Holowesko: I would expect sales growth going forward of about 14%. They've just announced their intention to increase their routes to the West Coast of the U.S. That should be a big plus for them.

When we look out five years down the road, we're showing earnings of about $3.00 per share compared to roughly $1.80 in 1990 and $1.70 in 1991.

HISTORICALLY LOW PRICES & LIMITED CAPACITY EQUAL BARGAIN-PRICED ALUMINUM STOCKS....

OID: Are there any other areas with more than their share of bargains today?

Holowesko: The aluminum industry is very interesting today. Aluminum prices are at all-time lows in real terms. The reasons why are that certain countries like the Soviet Union are dumping aluminum to raise hard cash and we're in a recession.

Inventory levels are abnormally low and aluminum plants are operating at abnormally high levels of operating capacity for this stage in the economic cycle. At this stage, aluminum plants are generally operating at 75%-80% of capacity. But today, they're operating over the 95% level.

And yet prices are at all time lows in real terms.

OID: That's pretty wild all right.

Holowesko: It shows you the dramatic implications of what's going on in the Soviet Union. Few realize how they dominate many industries. Even when they're the marginal producer in an industry, they can have a big impact. Although they're not a dominant producer in the aluminum business, they're having a dramatic impact on prices because of dumping.

So you can see that what goes on in the Soviet Union does have implications for the rest of the world. We should worry about them and be concerned about what's going on over there from an economic standpoint.

The whole aluminum business is very attractive. And there's very little new capacity coming onstream longer term.

OID: Are you still buying aluminum stocks today?

Holowesko: Yes, we are. Aluminum is still an area that we're concentrating on.

OID: Might we trouble you to get specific?

Holowesko: The two aluminum stocks we would continue to add to are ALCOA and Pechiney.

Pechiney is based in France. There are actually two classes of Pechiney. There's Pechiney, International and a Pechiney, CIP. The Pechiney, CIP is the one that we would be a buyer of today.

OID: And what's the difference between the Pechiney, International and the Pechiney, CIP shares?

Holowesko: Pechiney, International is basically the holding company that includes Pechiney, CIP. So the International shares are a much more cyclical play than CIP which has more of the packaging division in it.

What's interesting about Pechiney, CIP is that it's being priced as if it were a pure commodity aluminum producer when it's not. It's more of a value-added packaging company. And the packaging operation is not being priced properly in our view.

OID: Why is a packaging operation so hot?

Holowesko: Most of its packaging operation exposure is in Europe. And whereas the U.S. packaging market is relatively mature, the European packaging market has a lot of growth ahead of it. Despite similar populations, there are about 100 billion cans consumed annually in the U.S. vs. only about 1/5th of that in Europe. Growth in the European market may therefore be twice that in the U.S.

OID: Interesting.

Holowesko: And Pechiney's subsidary — Howmet — is the world leader in turbine blades for jet engines.

OID: And you think that industry is about to take off?

Holowesko: The sky's the limit. But the real play in Pechiney is its packaging operations.

OID: Could you run us through the fundamentals?

Holowesko: Pechiney is currently 279 French francs. It has a gross dividend of 22-1/2 French francs. Our estimate of normalized earnings five years out is 57 French francs per share.

So looking out five years and deducting for dividends during that period, we believe that we're buying Pechiney at less than 3 times earnings — actually more like 2.8 times. We'll adjust a price for the five years' worth of dividends over that time frame to take into consideration the

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difference between a company that's paying dividends and one's that not.

OID: Sounds cheap all right. But tell us about their earnings history.

Holowesko: The earnings for fiscal 1991 were roughly 18 French francs a year. But in the years before that, they were 44 and 54 French francs per share, respectively.

OID: Sounds like they're either cyclical or growing in reverse.

Holowesko: It is cyclical. But the cyclicality is declining because their packaging operations have become a larger and larger portion of their business over the last three or four years.

We estimate that next year, earnings will increase to 34 French francs. Their fiscal 1991 earnings had a lot to do with the elimination of some special one-time charges and with the continuing reduction in debt.

They've also incurred debt to make some acquisitions — including Howmet. But they'll be paying off that debt with cash flow.

OID: How do you assess Pechiney's earnings growth rate on a normalized basis?

Holowesko: We estimate that they'll have about 10% growth in sales on a normalized basis.

OID: So it's mostly a cyclical recovery.

Holowesko: To a certain extent. But I believe that our estimates are very conservative.

OID: What could turn Pechiney into a mistake?

Holowesko: Our only problem with Pechiney is its high debt levels. To give you an idea, long-term debt to operating cash flow is only about 1.8 times. Net debt to equity is about 150%.

But the debt will continue to be payed down. And that will continue to add impetus to the turnaround in earnings.

OID: What about ALCOA?

Holowesko: It's much more of a cyclical play than Pechiney. Again, prices are at an all-time low for aluminum ingots. And yet capacity usage is at pretty high levels for a recession.

OID: That is fascinating. But tell us about ALCOA's fundamentals.

Holowesko: ALCOA is at \$64 or \$65. And what's interesting is that they recently had a dividend cut. Yet even deducting for a cut dividend — it was cut from about \$3 to \$1.78 — we estimate that we're buying ALCOA at slightly over 5 times our estimate of normalized earnings five years out which is \$10.63.

In this case, we have a sales growth estimate of 6% over the next five years. So most of the earnings growth we anticipate will be in margin improvement. To give you an idea, two years ago the company earned \$10.67 — which is more than our estimate of earnings five years out.

OID: That certainly sounds very conservative.

Holowesko: We do tend to be conservative on the numbers.

EVERY DOG HAS ITS DAY
— EVEN CAPITAL INTENSIVE CYCLICALS.

OID: Any other interesting areas?

Holowesko: Right now, because of the recession and because many companies aren't showing earnings, most of the stocks that are making our bargain list are doing it on a future earnings basis.

And most of the industries with fun dynamics evolving are heavily capital intensive industries. But many of the events that are unfolding will take some time to unfold.

Our list is being dominated by cyclicals because during a recession, most people aren't willing to pay for the earnings of cyclical stocks. People aren't willing to look beyond the recession and pay for future earnings.

OID: Where investors seem to assume that we'll never come out of the recession.

Holowesko: Right. Plus it's worth noting that the U.S. has experienced the greatest period of outperformance of consumer stocks vs. capital goods stocks in U.S. history.

OID: Robert Noel points out that those stocks enjoyed a double boost from cheaper raw materials and higher premiums being paid for brand names — and that the party may be over.

Holowesko: I agree. The outperformance began almost right at the beginning of the 1980s. And it's been the most dramatic period of outperformance in U.S. history.

By comparison, during the 1970s, capital goods stocks actually outperformed consumer goods stocks. To a certain extent that makes sense when you look at investment flows. During the 1970s, investment flows into capital goods were actually greater than they were into consumer goods. And their stock performance showed it. By comparison, during the 1980s, investment flows into the consumer side outpaced those into the capital goods side.

OID: Interesting.

Holowesko: We're still trying to get information on future flows of capital goods versus consumer goods because our bargain list today shows more capital goods stocks than consumer goods stocks. I don't have enough numbers from a top-down standpoint to support it. But from a bottoms-up standpoint, the majority of things we're looking at are on the capital goods side. So from a bottoms-up standpoint, it looks like this trend will be reversed.

OID: Did the capital goods stocks outperform not only in terms of stock performance during the '70s, but also in terms of returns on equity?

Holowesko: They did. It was a very definite pattern in the 1970s. During the 1960s, it wasn't a definite pattern. There was a period when capital goods stocks outperformed and then they underperformed. And it was the same thing with the '50s. But there's been a very clear trend during the '70s and the '80s.

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A PHARMACEUTICAL GEM
IN COMMODITY CYCLICAL'S CLOTHING....

OID: Are there any other bargains you can tell us about?

Holowesko: I have to mention chemicals.

OID: If you must.

Holowesko: Germany-based BASF is cheap. Its market value as a percentage of sales is only about 30%. To give you an idea of just how cheap BASF is, many observers are pounding the table about U.S.-based Dow Chemical saying it's a great cyclical buy. But Dow Chemical's market value to sales is about 110%.

OID: Or nearly four times that of BASF.

Holowesko: That's right. And market value to operating cash flow for Dow Chemical is about 6 times. For BASF, by comparison, it's only about 2-1/2 times.

There's no net gearing — which is highly unusual for a company of its size.

OID: Gearing being another word for debt.

Holowesko: That's correct. Also 24% of BASF's sales are dollar-related. So it's something of a dollar play.

Finally, BASF's dividend yield compares very favorably to that of the 10-year DM bond for the domestic German investor. The 10-year bond currently yields about 9-1/2%. A domestic German investor's yield on BASF is about 8%.

OID: Sounds attractive.

Holowesko: Also, BASF's total market value is less than what the group has spent in capital investments over the past three years. It's the only major chemical company with a net cash position. Yet it sells at the lowest multiple of operating cash flow of all the major chemical companies.

OID: And doesn't it have a reputation for being relatively well managed?

Holowesko: Yes. One of the problems with BASF is that it has a small pharmaceutical division that's really too small to compete on a global basis. Most of the other major chemical companies have much larger pharmaceutical

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divisions. The result is that many people are recommending Bayer using the argument that Bayer is being priced like a commodity chemical company when in fact 30%-40% of its business is pharmaceuticals — which deserves a much higher multiple, and it does.

BASF's much more of a commodity chemical company. Its pharmaceutical division is really too small to bear the burdens necessary to compete effectively. So that's the downside to the stock.

OID: What about earnings?

Holowesko: We estimate that BASF will earn about 45 Deutsche marks per share on a normalized basis five years out. And the current price is roughly 220. But again, we adjust it for dividends. And BASF is paying a dividend of about DM13 per share. Subtracting out the DM65 for the five years of dividends, BASF is selling for about 3-1/2 times our estimate of earnings five years out.

OID: Sounds cheap.

Holowesko: Very cheap. BASF is definitely a buy in our opinion.

THERE'S LIKELY TO BE A SHIPPING SHORTAGE
AND STOLT WILL BE A BENEFICIARY.

OID: Where else are you finding bargains?

Holowesko: I mentioned shipping earlier. Credit was easily available in the shipping business during the 1970s. So a lot of people built ships for speculative reasons.

Rates went higher and higher and higher just like they used to in the real estate business. And it got to the point where there were too many ships being built. So we entered the 1980s with massive bankruptcies. We had hardly any ship building at all in the 1980's because of excess capacity during the '80s. So all of these ship builders went out of business and rates tumbled.

Today, we're operating in an environment where 80% of the shipping fleet is going to be 20 years older or more in the next two years. And the useful life of a ship is only about 20 years.

OID: Very interesting.

Holowesko: And we don't have enough ship builders out there today to meet the demand that's likely to come on for new ships over the next 5 to 10 years.

It's a fascinating business. Today's shipping rates don't justify new ship building. If you're a banker and a shipper comes to you and says that he wants to build a new ship, you say, "Show me how you're going to get a rate of return on the ship sufficient to pay off your debt."

Ship building costs are so high because there are only a few players out there and shipping rates are so low that it doesn't justify new ship building. Something's got to give and it's most likely going to be rates.

Then there's another piece to the puzzle — which is possible pending U.S. legislation requiring double hulls for vessels because of the Valdez disaster and all of these other potential and actual disasters that have occurred in U.S. waters.

OID: More expensive than breathalyzers, but more

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reliable too.

Holowesko: Stolt Tankers is just a great play on this situation. Stolt is a parcel tanker. A parcel tanker is a ship that's able to carry more than one liquid cargo in it. So a parcel tanker by nature is double hulled because it has more than one compartment. If there's legislation that comes out that requires double hulls, it really doesn't have much of an impact on parcel tankers because they're already double hulled.

OID: So far, so good.

Holowesko: And Stolt has got a relatively young fleet and has very good routes. The type of liquids that it transports is also at very competitive rates.

The shipping business is a fascinating business that's unfolding before our very eyes. And it also, by the way, is a business that needs capital. These guys need money to build new ships. It's going to be interesting to see who gets the money because rates don't justify ship building costs right now.

OID: And yet these guys seem to be earning decent returns on their capital right now.

Holowesko: They are. But it's a bit misleading because although they're earning a decent return on capital, it doesn't take into consideration the replacement cost of their vessels.

OID: In other words, their ships have been depreciated way down.

Holowesko: Not only that, but to a certain extent their returns temporarily spiked up during the Gulf War. Many of these tankers were floating storage vehicles during the war.

OID: Are there any other fundamentals that attracted you to Stolt?

Holowesko: Yes, quite a few things. But basically at around $20, it's selling for about 4 times cash flow. We've tried to look at the company, at the financing costs it would incur with its vessels and the relative age of its fleet. We think that we're buying Stolt at less than 4-1/2 times what it will earn during the next cycle. I don't believe that it will be a great performer over the next 6-12 months, but longer term, it's attractive.

OID: At what point in the cycle?

Holowesko: That's one of the things I should explain. People know that we're value investors at Templeton. And they believe that means that we're buying stocks with low P/E ratios and low price-to-book multiples.

OID: And you're not?

Holowesko: We look at many things. We look at a stock and its underlying company on a breakup basis.

We look at companies in a turnaround phase. The classic example was Philips in the Netherlands a year ago. They had a massive restructuring taking place.

We also look at stocks based on what we think they can grow their assets or their earnings to on a normalized basis during the next cycle. We don't predict when recessions are going to end. We just figure that we'll have both a recession and an expansion over the next five years. So we estimate each company's average normalized earnings power and asset growth during an entire cycle.

We think that we're buying Stolt at 4-1/2 times normalized earnings over the next five years.

OID: Do you believe that some companies are worth a much lower multiple of earnings or assets than others?

Holowesko: In general, if we're buying something on an earnings basis, we're buying it at less than 4-1/2 times future earnings after adjusting it for dividends.

OID: And for your asset-oriented investments?

Holowesko: In the case of an asset situation, we tend to buy stocks at less than half of what we think their assets are going to be over the next business cycle. If we think a company will sell at its asset value over the next cycle, we're going to look for 15% appreciation per year.

OID: Or 14%, but who's counting.

TODAY'S BARGAIN LIST: SMALLER COMPANIES STILL DOMINATE.

OID: If you can't find stocks meeting your criteria, your bargain list shrinks?

Holowesko: That's correct.

OID: How many names tend to be on it?

Holowesko: The longest it's ever been during my eight years at Templeton was during the fourth quarter of last year — which is kind of interesting. Back then it was about 250 names. Today, I'd say it's about 180 names.

OID: That large? I'm surprised.

Holowesko: We are looking at markets world-wide.

OID: What's the lowest number of names you've ever had on your bargain list?

Holowesko: The lowest it's ever been since I've been with the group has been roughly 100 names.

OID: But you've never found less than 100?

Holowesko: Don't forget that we're looking at stocks from an earnings, asset, turnaround and breakup basis. Sometimes we aren't finding very many growth stocks and the asset plays are abundant. Other times, restructuring stocks are rising and the other categories are shrinking.

OID: Do you require the stocks you buy to have any minimum capitalization?

Holowesko: No — because we run small-cap funds. We have four accounts here in Nassau that are limited to investing in smaller companies world-wide. And we define smaller companies in general as having a market cap of $500 million or less.

But also because of our long-term approach, we're willing to buy smaller stocks than the average manager might be willing to buy because we're willing to build

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positions in them very slowly. Even in larger funds like Templeton World Fund or Templeton Growth Fund, we have securities with a market cap below $100 million. In fact, smaller U.S. company stocks still dominate our list.

OID: Even after the recent runup?

Holowesko: The percentage is lower than it was at the beginning of the year. However, the number of European and Asian smaller stocks are growing and beginning to dominate our bargain list more than before. It almost seems as if the European and Asian markets are a year behind those in the U.S.

OID: That would certainly give you something to look forward to.

Holowesko: Just in the Hong Kong market alone, there are probably 10 names on our bargain list that have a market cap of $500 million or less — plus an additional 10 names or so with market caps above $500 million.

FRANCHISE, YOU SAY.
HERE'S A POTENTIALLY HUGE ONE....

Holowesko: Asia offers some wonderful cheap and growing securities. Actually, Hong Kong offers most of them due to the perception of the problem caused by the introduction of China into the Hong Kong market in 1997.

OID: That's putting it nicely, isn't it? Isn't it possible that the entire work force may have to wear red?

Holowesko: Most people don't realize that when Hong Kong reverts to Chinese rule in 1997, much of the current legislation, rules and systems will be maintained for 50 years after 1997 under the current agreement.

OID: I didn't realize that.

Holowesko: Hong Kong has the right to maintain their own legislation system. They can actually develop international treaties on their own. There's a whole list of things that they can continue to do despite the fact that they're under the Chinese flag.

And when you understand Hong Kong's importance to China, you begin to understand the threat is not so much that China takes over Hong Kong, but that Hong Kong takes over China. And that represents a huge opportunity.

Let me give you an example.

OID: Twist my arm.

Holowesko: There's a company called Sime Darby Hong Kong. Sime Darby is actually a Malaysian company. But Sime Darby Hong Kong is the Hong Kong subsidiary.

Sime Darby Hong Kong has two main businesses. The first is an automotive distributorship. They sell primarily higher priced European autos in Hong Kong.

But the real interesting part about Sime Darby Hong Kong is that it also has the Caterpillar franchise — not only for Hong Kong, but for most of China.

OID: Fascinating. And, of course, when you say that they have the franchise, you mean that they receive a royalty on all sales. It's not like they have to spend money on R&D, plant and equipment and so forth.

Holowesko: That's right.

OID: Could you run us through the fundamentals?

Holowesko: Sure. Sime Darby's current stock price is HK$7-1/2. Its current P/E is only 10 times and it's got net cash on its balance sheet of about HK$400 million. It's also yielding 8-1/2%. And because the currency is pegged to the dollar, there's almost no currency risk in that 8-1/2% yield.

Also, its market cap is only HK$2.8 billion. To convert that into U.S. dollars, you simply divide by 7.87. So we're talking about a company with a market cap of less than $400 million.

OID: More like $360 million.

Holowesko: Now that's incredible when you think about it — that a company as small as Sime Darby Hong Kong has the Caterpillar franchise for a large part of China.

OID: You're starting to get me excited.

Holowesko: It's just a super company that's likely to enjoy tremendous growth.

In the case of Sime Darby Hong Kong, we think that we're paying less than 4 times normalized 5-year earnings. Plus instead of earning 4% on T-Bills, we're getting 8-1/2% while we wait for the franchise for China to bear fruit.

OID: It really sounds terrific. And I'll bet you're not even including the upside of the mainland Chinese connection in your numbers.

Holowesko: Not much.

OID: And these aren't exactly what you'd call salad days for Hong Kong — since many are worrying more about gaining citizenship elsewhere than buying luxury cars or building new facilities.

Holowesko: That's right. The depressed luxury car business is one of the reasons why the stock has recently been under a bit of pressure.

But they have the luxury car market tied up for certain lines in Hong Kong. And believe it or not, they make a tremendous amount of money shipping cars over the line to China. We're talking about BMWs, Alpha Romeos and the like. And people in China are paying huge amounts of money for them.

OID: How rapidly do you expect Sime Darby Hong Kong to increase its earnings over the next five years?

Holowesko: Over the past 5 years, sales and earnings have compounded at 19% and 23.9% per year, respectively. We're expecting them to compound sales and earnings at 17% and 23% per year, respectively.

OID: It sounds like it may be very well managed.

Holowesko: It is. The Sime Darby Group dominates many industries and businesses in Asia. Sime Darby Asia is the parent company. And one reason why the yield is so high is that the parent company in Malaysia needs money.

OID: Who doesn't?

Holowesko: So there's a good incentive to keep that yield high.

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OID: Incredible. You're paying a P/E multiple of 10 and getting a dividend yield of 8-1/2% for a company that's compounded earnings at over 20% per year. And you get the franchise for over a billion people who may be about to move up the standard of living curve at no extra charge. What a kicker.

Holowesko: We think so.

WE CAN LIVE WITH 30% GROWTH
AT 8 TIMES 1991 EARNINGS.

OID: That one's a very tough act to follow. But are there any more like that you could tell us about?

Holowesko: Another super little company is called C.P. Pokphand — pronounced "Pok Pan". Like Sime Darby Hong Kong, it's listed on the Hong Kong exchange.

It has two businesses. First, they're the largest manufacturer of motorcycles in China. Second, they're one of the largest producers of chickens in China.

OID: What synergy.

Holowesko: Believe it or not, there couldn't be two better businesses to be in than producing chickens and manufacturing motorcycles in China.

OID: We're all ears.

Holowesko: The current usage of motorcycles is just booming. And annual per capita chicken consumption in China is about what I consume on a weekend. I don't remember the exact number, but it's something like 1.4 kilograms per year — 1/50th of what it is in the U.S.

It's the largest country in the world population-wise. Their per capita consumption is so low that it's almost certain to grow tremendously. The potential future consumption of chicken in China is huge.

OID: Sounds like a safe bet — especially long term. Too bad there's no such thing as a chicken franchise.

Holowesko: And we believe that we're buying this company at 2.3 times the 5-year out adjusted earnings. This company has a market cap of U.S.$170 million.

For that, we're getting the largest producer of chickens and one of the largest producers of motorcycles in China.

OID: Sounds pretty wild all right. Could you tell us a little bit about the current fundamentals?

Holowesko: C.P. Pokphand's current stock price is H.K.$1.35. That's approximately 8 times 1991 earnings. There's no dividend currently being paid. But at 8 times this year's earnings and less than 2-1/2 times our estimate 5 years out, we can live with it.

OID: That implies super fast earnings growth.

Holowesko: C.P. Pokphand's earnings have grown by over 25% per year historically. Between 1989 and 1990, their profits were up 31%. And between 1990 and 1991, we estimate that profits will be up 35%.

OID: That's fast growth all right.

Holowesko: And that's what we're expecting it to be for the next 5 years.

OID: What do you expect it to be?

Holowesko: It's so hard to gauge because of the possibility of government interference. But their return on equity is around 23% and their historical growth rate has been over 30% per year. And I see absolutely no reason why it should slow down.

OID: Why, then, is it so cheap?

Holowesko: There are the obvious fears about 1997. And they have had some problems getting facilities in certain areas.

Also, they used to manufacture their motorcycles under the Honda label. They've moved away from that which temporarily slowed down some of their sales. But they seem to have gotten over most of the problems associated with that.

When I look at their financials, the market potential open to them and the fact that most of their problems are behind them, I can't help but get excited about it.

OID: The 30%+ that you mention is earnings growth. How rapidly have sales been growing?

Holowesko: Sales growth has exceeded that. They've paid some above normal financing charges to accommodate their rapid growth.

OID: It's hard to think of the motorcycle and/or chicken business being either high growth or high return on equity.

Holowesko: C.P. Pokphand and Sime Darby Hong Kong are the two companies that I would be excited about.

OID: It's easy to see why. And it's interesting to imagine that when you go to another culture, there's a whole new cast of characters of exceptional businessmen who are their equivalent of Sam Walton, Leslie Wexner, etc.

Holowesko: That's right. That's one of the things that is so fascinating about China. The Chinese are the most capitalistic communists there are in this world.

OID: Is that like being the tallest pygmy?

Holowesko: They're entrepreneurs by heart. If you ever go to Hong Kong, you immediately realize that it's just an amazing place. It's capitalism gone wild.

It is just wonderful to watch the level of energy these people have. They work at jobs during the day and have businesses they operate by night. It's just fascinating. The Chinese have always been merchants historically. They know how to run businesses.

The opening up of China is going to be one of the greatest periods of economic growth that we're going to witness for a long time. It's going to be an absolutely wonderful period watching that market open up.

Right now, people are starting a lot of funds to invest in Eastern Europe and the Soviet Union — directly and indirectly. The next big wave, I bet, will be funds that invest in China.

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TEMPLETON GROWTH FUND'S
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(cont'd from preceding page)

OID: I hope you're right.

Incidentally, I hate to generalize, but the success of Chinese immigrants in the U.S. is striking. And I'm told that it's not just in the U.S.

Holowesko: We have an office in Hong Kong. And these analysts work incredibly hard.

They're bright, well educated, hard working people. It's no wonder that the U.S. is losing market share to many companies in Asia.

THE LEADING ENGLISH LANGUAGE MAGAZINE
AT 50% OF SALES & 9 TIMES TRAILING EARNINGS.

OID: Are there other situations out there like those two little Hong Kong gems?

Holowesko: South China Morning Post is another classic example. It produces English language publications. Here's a company that owns the leading English language magazine in Hong Kong. It has 50% of the classified ads and 17% of total display advertising. About 80% of their revenues come from advertising — about 60% of that from a huge classified advertising section.

South China Morning Post's ultimate parent is News Corp. — which has huge cash needs. Meanwhile South China Morning Post is debt free. But because of News Corp.'s need for funds, South China Morning Post's dividend is safe.

When we bought the stock at HK$2.70, the yield was 11%. That's a yield on a debt free balance sheet on a fairly good business in Hong Kong pegged to the dollar.

OID: Not bad.

Holowesko: Now earnings growth won't be dramatic. It'll just be GDP growth plus inflation — which may be something in the 8%-9% level. But the company just made an acquisition and is going into the Chinese language area. So our earnings estimates may be a little low.

OID: What sort of earnings growth have they historically had?

Holowesko: It's historically been 4%-5% over GDP.

OID: But GDP in Hong Kong, of course, has been growing very rapidly.

Holowesko: That's right. GDP growth has averaged about 6% per year in recent times.

And although the stock price has gone up from $2.70 where we bought it up to a little over $3 now, it's still yielding over 8-1/2% on a debt-free balance sheet. And it's a very solid business. So rather than owning Treasury Bills yielding 4%, I'd rather own stocks like South China Morning Post in Hong Kong.

OID: Makes sense to us.

Holowesko: The P/E is currently about 9 times. It's selling at about 50% of sales.

OID: Which is very cheap for that type of business.

Holowesko: Yes, it is. And it has a net cash position representing about 20% of its market cap. Its market cap is about $4 billion Hong Kong.

OID: Or only about $500 million in equity capitalization before deducting for its cash.

Holowesko: That's right. We estimate they'll earn about 32¢ per share this year. And we're only estimating an increase to 45¢ in five years. So when we deduct its 28¢ dividend from its $3.00 stock price for the next five years, we get $1.60 — which is only 3-1/2 times our estimate of earnings five years out.

OID: And it's not exactly a lousy business either. But how well managed are they?

Holowesko: They're extremely well managed. That's why they're debt free.

OID: I beg your pardon.

CAFE DE CORAL: 20% EARNINGS GROWTH
& A 6% YIELD TIED TO THE U.S. DOLLAR.

OID: Any others?

Holowesko: We also like Cafe de Coral which is the most popular fast food operator in Hong Kong. They're growing their revenues at 25% a year and their earnings at a little less than that — about 20%.

And yet its stock is only at a little less than 9 times what we estimate it will earn this year. So it's a relatively depressed P/E multiple.

The yield is about 6% — with the Hong Kong dollar pegged to the U.S. dollar.

OID: Wow.

Holowesko: So again, rather than owning Treasury Bills and getting 4%, you can own Cafe de Coral, get a yield of 6% and buy a 20% per year growth operation.

OID: Sounds great. And Cafe de Coral's current stock price?

Holowesko: It's roughly HK$2.30.

OID: And your estimate of earnings per share?

Holowesko: Roughly 24¢.

OID: Why is Cafe de Coral so cheap? Is it because of the fear of what happens in 1997?

Holowesko: It's partly due to this fear. All of the Hong Kong stocks are cheap because of that fear. And I think most of it is based on misunderstanding. There's just no reason why you should be able to go to Hong Kong and buy stocks growing at 20% per year yielding 6% at dirt cheap prices.

OID: But I'm sure glad you can.
Thanks for sharing them with us, Mr. Holowesko.

—OID

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We're also pleased to bring you the following excerpts from Templeton Funds' latest annual meeting in New York and from the breakfast meeting immediately preceding it. In addition to Templeton, we've included portions of remarks from Tom Hansberger — president of Templeton, Galbraith and Hansberger.

As always, Templeton intersperses the principles that he views as being most important for successful investing, practices which make individuals, businesses and nations prosperous and happy and views on economies and markets worldwide. We hope that you find it as valuable as we do:

SUCCESSFUL INVESTING
IS MOSTLY COMMON SENSE.

Templeton's Laws of investing in free markets:

Templeton: I've been helping investors for 51 years. In that time, I've watched those people who've been successful and those who haven't been successful investing. And I've tried to learn the common sense principles that work.

I've come up with four laws of successful investing in free markets. These are not universal laws like Moses gave us, but laws that are universal for all assets in free markets. And this is the first time that I've taken the opportunity to share with you what I believe are the most basic concepts that will make investing successful.

You're no doubt familiar with Parkinson's laws, Peter's laws and so forth. Here are four of Templeton's laws that are universal, but only for investing in free markets:

Fourth Law: Investing by concensus assures mediocrity.

Templeton: I'm going to start with the fourth law and work up to the first one. The fourth law is, "If you buy the same securities as other people, you'll have the same results as other people."

I assure you that's correct. It's common sense — and it's true, but people go around asking, "What did you buy? What do you recommend?" And they buy the same thing. The result is they don't produce a superior performance.

Superior investment performance is possible only if you invest differently from the crowd. If ten doctors tell you to take a certain medicine, you'd be wise to take that medicine. Or if ten civil engineers tell you to build a bridge a certain way, then you should build the bridge that way.

But when selecting securities, concensus is dangerous. If ten security analysts tell you independently to buy a certain asset, stay away from it. The popularity will already be reflected in a high price.

Third Law: All assets are risky — especially cash.

Templeton: The third law is, "All assets are risky." I assure you again that there's no doubt about it. Millions of people — perhaps even the majority of people — don't stop to realize that.

You may have heard someone say, "We're going to play it safe." They mean that they'll hold only cash. But actually, cash is continually losing its purchasing power in virtually every nation. For example, if you had sold a grocery store in Argentina in 1933, you would probably need more than 100 million times as much Argentine money to buy back that same store today. The store represented reasonable security, but the money did not.

Income producing assets maintain their value in the long run better than cash, gold or collectibles or any other asset. In every nation, the purchasing power fluctuates widely and rapidly for every asset including cash, stocks, bonds and real estate.

However, a close approach to safety is wide diversification — that is, to diversify among types of assets in many nations including stocks in more than three dozen corporations in more than a dozen nations. That is the closest you can come to safety with your assets.

Just think of some of the nations that went through hell and revolutions and communism. If their citizens had been diversified in a dozen nations instead of having all of their assets in one nation, they would not have suffered so much....

It seems to me that one of the great mistakes that investors are making right now is their desire to own fixed income assets, cash, money market funds, certificates of deposit and bond funds. We agree that the bull market in bonds is likely to continue for awhile, but all the evidence is that you will produce far better results by investing in equities — in shares — than you will by investing in cash. And yet, today the public has more cash than it has ever had in history. The average family has less than half as much in common stocks in relation to its assets than it has at other times in the past.

But people are fooling themselves today to think that they play safe by holding cash assets.

Second Law: Buy into pessimism and sell into optimism.

Templeton: The Second Law is, "Buy at the point of maximum pessimism. And sell at the point of maximum optimism."

Again that seems so simple — like so much common sense. But not only does the public not do that, but very few investment professionals do that ... because it goes against human nature.

It's only human nature to be afraid to buy when you're hearing many stories of failure. It's also human nature to cast caution to the winds when you are surrounded by multitudes of boastful stories about easy profits.

However, simple common sense tells you that the lowest price for any actively traded asset can occur *only* when the maximum number of owners are pessimistic. It *has* to be that way. It can be no other. If even a few owners recover their optimism, the price will already have risen.

In other words, the bull market begins when least expected. Markets go up in anticipation of good news. The beginning of such anticipation, and not the good news itself, is the beginning of a bull market. If you wait to see the light at the end of the tunnel, just remember that other big investors can see it, too.

This law applies not only to the time of maximum pessimism of a particular asset, but also to the question of which assets you're wise to select. When investors are enthusiastic about the outlook for a nation, rarely can

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bargains be found in securities in that nation. It is more fruitful to search for bargains in those nations where investors have been most pessimistic for years. And the same laws apply to selecting those industries where the best bargains can be found.

Excessive optimism is also contagious. Great fortunes have been lost by buying at the point of maximum optimism whereas a cool head with common sense would have been selling.

All serious investors should read the 1841 book by Charles Mackay called, *Extraordinary Popular Delusions and the Madness of Crowds*.... We recently republished it with an introduction by me because it is a real guidebook to avoiding the mistakes of investing in marketable assets.

First Law: Wealth accumulation brings blessings to all.

Templeton: Finally, there's The First Law: "The thrifty will eventually own the spendthrifts."

This law applies not only to real estate developers, but also to nations and to families and persons. For example, the person who saves money to buy a house can pay a major part of the cost from the interest and the gains during those savings years. On the other hand, simple arithmetic will show that the person who purchases a house with a 90% mortgage loan for 30 years will in fact pay more than twice the purchase price of the house in interest.

In other words, a spendthrift is paying interest to the thrifty. This law becomes more apparent over longer periods. For example, it may interest you that if the Indians who sold Manhattan to the Dutch had invested the proceeds at 8%, then the compounding would have produced enough cash today to buy back all of the real estate on Manhattan Island and have billions left over.

[Editor's note: A favorite example. Buffett used it in his Buffett Partnership letter — as did Peter Lynch in his more recent classic *One Up On Wall Street*.]

Often those who buy stocks with borrowed money are later wiped out — forced to sell at just the wrong time. Also, businesses seeking to grow faster than their accumulated savings often borrow too heavily and are later forced into bankruptcy.

Now there are over 20,000 members of the Association of Investment Management and Research. And there are over 23,000 candidates for Chartered Financial Analyst

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certification. But few security analysts ever become wealthy because only a few of the wise security analysts are ever thrifty. Analysts can be well paid to make others wealthy. But saving and investing your own savings is the better road to superior wealth.

This law of thrift can be illustrated by studying the history of nations also. Where the people of a nation are most thrifty, that nation becomes prosperous and powerful. Where the people are spendthrifts, that nation declines into poverty.

Seventy years ago, Americans were famous for their thrift. And the Europeans were writing stories about the danger of America owning the assets of Europe. Now, in relation to the size of its gross national product, Americans save only a tiny fraction as much as the Japanese, Germans, Chinese or others. The U.S. Congress should study the multitudes of ways to encourage thrift now used by many other nations.

Wealth accumulation brings blessings — not only to those who accumulate the wealth, but also to the nation and to the world....

How Templeton decided on his style: common sense....

Templeton: I'd like to think it was common sense. Common sense is not common....

We were one of the first 51 years ago to adopt that method. It's now widespread. Hundreds of our competitors try to do the same thing — called value investing — searching for bargains. But when we began, most of the other security analysts were studying corporations and issuing reports saying this company has good products, good management and a good outlook, so buy the shares....

So half a century ago, we adopted value investing — which is appraising the value or future earning power of thousands of corporations. That makes it much simpler. That way, you can have any clerk compare the market prices compared to your value estimates and buy the best value that day. So global value investing has been one of the great methods that we pioneered. And it's contributed to our investment results.

But it's no longer exclusive with us. So we're now experimenting with eight other methods of investing. And that's necessary. No one method of investing will always produce the best results. When it becomes too popular, it's already reflected in market prices. So if we're going to produce better results for you than other managers, we must continually improve our methods and use methods that are as unknown today as value investing was half a century ago.

We're not going to tell you what our new research is doing because the way for us to make money for you is to develop new ways of selecting investments and then hope that others don't catch up with us for a generation....

PESSIMISM & RECESSIONS OFFER OPPORTUNITY.
BE PREPARED PSYCHOLOGICALLY & FINANCIALLY.

Don't wait til you see a turn in the cycle. Then it's too late.

Templeton: I don't know when the downturn will pass. I never have known. If I were that smart, I'd be a lot richer.... I've always tried to anticipate business and market cycles, but our performance has not been consistent

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in that.

And we've searched everywhere for organizations of people who can consistently make those predictions. But we have yet to find any person or organization who has been right more than 60% of the time. So we do not use it as a major part of our investment policy for you.

But I do know that ... there will be a bounce back. We know, for example, that every bear market is followed by a bull market. We know that every recession is followed by prosperity. I do know that business will reach the highest level in history and that the market will reach levels never seen before. I just don't know *when*.

And we believe that the prosperity of America is going to come into the best era in its entire history.... So we do know that if you're a true long-term investor, now is the time to own shares. You don't wait until you can see the turn in the business cycle. The best economists in the world have studied for fifty years how to predict business cycles. And there are twelve leading indicators. The most advanced and reliable of those indicators is the stock market itself.

So if you wait until business cycles improve to buy shares, you'll have missed most of the rise already.... If you're going to get in at the bottom of the market, you have to get in before other people can see any improvement coming along....

Recessions aren't bad for stocks. Quite the contrary....

Hansberger: Many people assume that share prices generally decline during a recession. However, in actuality, in the second half of seven of the last eight recessions, share prices went up, not down. And since 1948, the average bull market began about 4.4 months and gained 17% prior to the end of any recession.

Contrary to popular belief, you ain't seen nothin' yet....

Hansberger: Since 1948, bull markets have lasted about 28 months with an increase averaging about 78%....

A bumper sticker that I saw in Fort Lauderdale last weekend typifies the attitude of most of the American public right now. The bumper sticker said, "I sure do feel better now that I've given up hope."

I think that's kind of true about what most of us are going through.... But there have always been difficult times. I'm sure that the decade of the '90s will be full of challenges as well as opportunities....

Be prepared financially & psychologically for bear markets.

Templeton: We try to prepare our clients.... We keep telling them that there's going to be a bear market. We don't know exactly when it will be, but we know that there will be at least two bear markets every twelve years.

So be prepared. And be prepared in two ways: First, be prepared financially. If you don't have too much debt, you won't get sold out at the wrong time.

But more importantly, don't get frightened out at the wrong time. For every person who's forced out, many more people are frightened out. People get frightened after a year or two of bear markets and sell out of excessive pessimism. I think people should buy mutual funds to hold for *at least* one market cycle....

So prepare yourself to know that there are going to be business recessions and bear markets. And they are not to be worried about. And they shouldn't be frightening to you.

They're opportunities. The time to get rich is by buying when share prices are low. You can buy shares for a small fraction of what that corporation is worth....

We welcome these wide fluctuations. Wide fluctuations may disturb some people. But for us, they increase the possibility that we can produce superior investment results....

There's still lots of pessimisn. That's a good sign for stocks.

Templeton: Just about the middle.... I said publicly that in all my 51 years of investment counsel that I could not remember a time when the big investors were more pessimistic than they were in October of 1990....

We've now passed that point. And people aren't as pessimistic as they were.... But we still have a lot of pessimists. It's not hard to see it — whether it's in the newspapers, on television or just talking with professionals — that a lot of people are fearful.

That means you're relatively safe. Bear markets do not start in periods of fear. They start in periods of optimism. And I don't think that any of you would characterize today as a period of excess optimism. There are still a high proportion of people who are still fighting this market — who are bears.

In business, the number of people who are predicting better business next year is the lowest it's been in 19 years. There's pessimism abroad. And in the midst of pessimism is the time to buy....

IF YOU WANT TO WORRY, WORRY ABOUT INFLATION — NOT DEFLATION OR DEPRESSION.

Another Depression? I don't think you'll even see deflation.

Templeton: I lived through the Depression of 1932. But in my opinion, the chance of that happening again is almost zero. Conditions are just not the same as they were then....

At that time, the major difference was that people didn't think it was the duty of the government to interfere. The government was to set the laws and the pattern and let the business cycles run their course. Now we've changed our minds. The politicians and we voters rush to Washington if there's even a hint of possible deflation. And any economist can tell you a dozen ways to reflate if you don't mind the disadvantages of inflation. And that's what's happened.

So I would stick my neck out and predict that never in your lifetime will you see even one year of deflation. Never will you be able to say that it costs less to live today than it did a year earlier.

If you want to worry, worry about inflation — not deflation.

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Templeton: That means you don't need to prepare your investments for deflation. What you need to prepare for is more inflation. You prepare for inflation because the government is not going to balance the budget. That's become fairly obvious. Not only America, but almost no nation on earth has a balanced budget. The politics are just such that it's not politically popular to work on a balanced budget or have any deflation....

We have experts studying what is likely for the future in inflation and other economic questions. Our present estimate for inflation in America is about 5-1/2% per year.

There may be some good years in which inflation will be 1% or less for temporary, short, favorable periods. There will be other bad years in America where inflation will be likely to get back to what it was ten or fifteen years ago when it got up as high as 18%-19% in one year. But the average over many cycles may be about 5-1/2% a year....

Another thing — people worry that American government debt is the largest in history. In fact, it's almost as large as the debt of all other nations on earth. And that is a terrible thing.

But what is the result? People can go bankrupt. Corporations can go bankrupt. But nations do not go bankrupt....

It's almost unknown for any nation to pay off its debts. Instead they reduce the burden of their debt by inflation. If inflation reduces the purchasing power of their money by 50%, then the burden of carrying their debt is also reduced by 50%. That's been the pattern of most nations generation after generation. And it's almost certainly going to be the pattern for most major nations in the world in the future — more inflation, not a depression.

We have plenty of problems to worry about. But don't worry about a deflation. Worry about how to protect your assets from inflation....

PEOPLE WILL LEARN TO IGNORE THE MEDIA,
WHY NOT TRY PRIVATIZATION IN THE U.S. & MORE.

People will learn to ignore the pessimism in our media.

Templeton: It's very interesting to me that that spread of communications has increased the misery of people. It's fascinating, in fact.... There's something in human nature that makes you welcome catastrophe, that

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makes you excited about terrible events. If you're trying to sell newspapers, put on the front page the most awful thing you can imagine and people will buy that paper. Or if you're trying to get people to turn to your television program, do the same thing....

Because we have free communications here, if you're going to succeed in communications, you have to cater to the human weakness of desiring horrible things. And now that communications are so much greater than it was when I became an investment counselor. At that time, there was no television. There was no program about investments on earth at that time. Now we're just flooded with communications.

As a result, we're flooded with bad news. And this bad news is making people depressed at a time when prosperity is at its greatest ever. We should be so optimistic. We have more blessings than at any time in history. We become pessimistic because we turn on those things that are bearish — that are pessimistic.

And I notice it particularly in reading the newspapers. The newspapers will interpret almost anything in bearish terms. If you read carefully through a paper and see how many horrible things there are compared to favorable ones, you'll see that horrible things outnumber favorable things 3 or 4 to one. They have to do that. In a free market, that's the way to sell newspapers....

This is the first time in world history that we've had so much facility at sharing whatever happens all over the world. Catastrophes, murders and so forth that happened 50 years ago in Asia were not heard of. Now they're on the front page of your newspaper.

And this has a depressing effect. I believe, though, that it will wear off. I believe that there's only a certain amount of bad news that we can take. As we get used to it, we will gradually learn to overlook it — just as the people in the communist nations began to overlook what was in their newspapers. It had been wrong for so long that they just ignored it. And I believe that we'll learn to ignore the pessimism in our media.

I do not know *when* there will be a bounce back in sentiment. I do know that there *will* be, however....

If privatization is good for Mexico & Russia, why not for us?

Templeton: Those nations progress most rapidly that have the lowest tax burdens. If you study nations and their rate of growth, almost without exception those that have the lowest taxation have the most rapid growth.

It's not easy. Efficiency in government is one way to do it. One way that's proving very popular all over the world is privatization — where government sells the government corporations to the public where they will be more efficiently managed. So the government doesn't need the taxes anymore to support what become private corporations.

Privatization which hasn't spread rapidly in America, but should, could be one of the best ways to do that....

SOME PERSPECTIVES ON REAL ESTATE
IN THE U.S. & JAPAN.

Real estate markets are very local & its cycles are very long.

Templeton: I don't know when real estate will hit

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bottom either. We work very hard — we work days, nights and weekends. But we don't know much. We feel that in a year's time, if two thirds of our decisions were profitable then we rejoice. The difficulty of our work is so great that at least one third of what we decide to do turns out to be unprofitable. And that includes trying to predict the cycle in real estate.

So I can only make general comments about it. One is that real estate is different from stocks because it's so local. You can have a real estate boom in one area and a depression in another at the same time. You can have a boom in farmland and a depression in city land....

There have always been cycles in real estate prices in every nation. But, in general, they're longer cycles. The average length of a cycle in the stock market in most major nations is about six years. The average length of a real estate cycle is eighteen years.

Now that doesn't mean that every cycle is that long, but it does mean that the down cycle in real estate prices in most areas of America probably has not reached its bottom yet. The S&Ls have turned over their bad selections of real estate to the government. The government is trying to sell them. That has a depressing influence on prices. Now the government is going to auction them off. That will depress prices further.

Some areas have already passed the low point. I think Dallas and possibly Houston, for example. But in most areas of America, I think real estate prices still will have years ahead where you can buy better bargains than you can today.

Now having said all that, we do not think it will be like it was during the Great Depression. It's always been my policy not to go into debt. So when I was a young man having finished Yale and having come back and gotten a job on Wall Street, I saved my money and kept looking for a home until I found one for a quarter of what it cost to build. It was a three bedroom and three bath house only ten miles from Manhattan. And I bought the whole thing for $5,000.

Now that was at the bottom of a real estate depression that had gone on since 1929. It had gone on for 11 years. I don't think that's going to happen again — mainly because of what I've said already about inflation. At that time, there was no inflation. Now there's continual inflation.

For example, if you study the average prices of homes in America, the average price of new houses this year is the highest in all of history. The cost of new homes has not declined — it's been going up — not in every area, but in the nation as a whole. So the real estate problems, which are very large, are not presently in homes and probably won't be.

The value of a new home depends more on what it costs to produce. The cost of producing a home is not going down. So I don't think home prices are likely to go down.

The greatest financial problem on earth....

Templeton: What is the greatest financial problem on earth today? It's the Japanese real estate market....

The Japanese real estate is appraised by official government figures every year and now works out to $16 trillion in land prices in Japan — $16 trillion.

How great is $16 trillion? That means that land in Japan which is smaller than the state of Montana has a market valuation greater than all 50 American states. Also, $16 trillion is twice as great as the market value today of all stocks on earth. So if they should have a 48% decline in real estate prices like they did in share prices, the world would be $8 trillion poorer in terms of theoretical value. That's more than all the stocks on earth today.

So from a financial or investment standpoint, the thing you want to keep your eye on today and in the near future is what is happening to prices of Japanese real estate. I didn't think they'd go as high as they are now. They've sort of stabilized. And in some areas — such as Tokyo and Osaka — land values have gone down moderately already.

But it is the single most dominating factor on market valuations in the world today — the most exciting thing. If you really want to worry financially, look at Japanese real estate prices....

WE'RE ENTERING A GLORIOUS PERIOD.
OPPORTUNITIES WORLDWIDE ARE TRULY AWESOME.

We're entering a glorious period that will be nearly ideal....

Templeton: I'm excited about that.... I believe that the U.S. and Europe both are coming into the most glorious period in world history.

I know that's an extreme statement. And I don't like extreme statements. But let me just explain quickly. Throughout most of my life, for 40 years, you and I and almost everybody worldwide had two enormous worries — two things that were putting a wet blanket on everything.

One was the danger of nuclear war. Remember how people feared nuclear war? Now, in just three years, that danger has shrunk to almost nothing.

The other great worry was that the communists might accomplish what for 70 years they said they were going to do — and that is to dominate the world. It had always been said that communism was the wave of the future.

And they did capture nation after nation — never by voting, but they captured nations. And up until 3 years ago, no nation captured had ever again become free.

They not only captured nations, but they captured minds. They captured the minds of some of the most intelligent people on earth — college professors, Christian ministers and journalists. And if that process had gone on much longer, they might have accomplished what they said 71 years ago — that communism would dominate the earth.

Now that fear seems to be gone entirely. Communism rotted out at the core — almost as though in answer to prayer. There wasn't even very much bloodshed required to free the world from that terrible disease called communism.

We should be overwhelmingly grateful for those two great things that occurred. When the history books are written, they will show the last three years as one of the great turning points in history — when the world became suddenly free of those burdens and, therefore, more prosperous and more happy.

...You'll have greater communications, greater travel, greater investing across international boundaries, more

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TEMPLETON GROWTH FUND'S
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international commerce, more rapidly rising standard of living, more brotherhood, more spread of religion and much, much more.

We're coming into a period of peace that's almost unknown if you read back through the history books. We're coming into a period that's almost ideal in many ways — especially for investors.... I think the next 10 years will be the happiest period — and the most progressive and rapidly increasing prosperity for both Europe and America.

We believe Europe will grow about 1% per year faster than we had been thinking. We had been estimating that the standard of living in Europe would grow by about 2% per year on average. Now because of the factors we just talked about, we think it will now be about 3% per year.... So in Europe, we do think that the standard of living is likely to double in only twenty-four years.

And progress will be even greater still in Latin America.

Templeton: But in Latin America, its speed is likely be even greater — mainly because there's more room to grow. They're starting from such a low point that the Latin American nations have a much greater scope of progress.

Also, the Latin American nations have now turned away from their former mistakes. For the first time in world history, every Latin American nation in both Central and South America has an elected government. That's an enormous change.

And most of the governments in Latin America have changed over from state control to free enterprise. They're privatizing those corporations that were previously owned by the government that were losing vast amounts of money and costing the government so much. They're doing many things even more rapidly than even we in the developed world are doing. So that Latin America is likely to enjoy a standard of living so great that it may double their standard of living in only fifteen years.

China entering a period of extraordinary economic progress.

Templeton: I can't leave this question without observing that Red China has a program to double its standard of living in only nine years. And I believe that they will accomplish it.

I don't think China will have democracy. China's never

(continued in next column)

had democracy. But you don't have to have democracy to have increasing prosperity. Hong Kong has never had democracy. Yet their standard of living is twenty times as high as it was fifty years ago. Taiwan hasn't had a democracy. And yet its standard of living is even higher than it is in Hong Kong.

So I believe mainland China is entering a period of extraodinarily rapid increases in their standard of living — even moreso than Latin America. And the same thing is true probably to a lesser extent in India and other places....

America: the land of entrepreneurship & emerging growth....

Templeton: At the moment, it's popular to say that America has too many problems and that we should invest in Europe. And we have a lot of money invested in Europe.

But if you go to Europe and look back, America looks better.... No nation on earth has ever formed 2,000 new corporations every business day except America. Three quarters of all masters of business administration are in America alone. No nation on earth ever tripled the number of employed people as America has done over the past 55 years. Just in the last 30 years, America's created 30 million additional new jobs — a million new jobs every year. America is the land of opportunity. No other nation has 90 professors of entrepreneurship.

So wherever you look, America is the land of entrepreneurship, of emerging growth companies and growth stocks. The freedom and entrepreneurship is going to make America even better than Europe over the next 10 years, although Europe itself should enjoy the greatest increase in prosperity that they've ever had.

Worldwide opportunities for future growth are awesome.

Hansberger: For the past 30 years, we have been known as global investors. Yet we've had to expand our investment universe dramatically to accomodate the new developing markets which are expanding almost on a monthly basis....

It truly is a very exciting period. We've gone from about 10 countries in 10 years to where we're now investing in 40 countries. I have no idea where we'll be in the next 10 years, but it could well be another double.

And I think it could be a truly exciting time for us to look for opportunities — not only in the emerging markets, but in the more developed markets which are furnishing a lot of the goods and services for these markets.

The opportunites for future growth are truly awesome....

The southern hemisphere offers incredible potential.

Hansberger: The southern hemisphere has the least powerful economies. The north — led by the United States, Japan, Germany, the United Kingdom, Italy, France and a somewhat questionable Russia — certainly are the dominant economic factors....

And this is a global population in balance. You can see where the major population centers and the major markets of the world are. Truly, the markets of the future will be where the people are. Mexico, Brazil, Indonesia,

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China and India certainly stand out.

These demographics are certainly important to the future of global investing. The potential of the southern hemisphere is incredible.

The next most dramatic emerging market — Pakistan.

Hansberger: I got a call last night from Dr. Mobius — who runs The Emerging Markets Group — from Karachi, Pakistan of all places which he firmly believes will be *the* next most dramatic market in his sphere of emerging markets.

He's also doing a lot of work in places where we wouldn't really think about looking for publicly owned companies — such as Sri Lanka, Bangladesh and many of the other South American countries that are expanding rapidly.

While emerging markets are important to our investment effort, just as Japan was important in 1970 when Sir John went into it while it was an emerging market, many of the other markets that we are invested in through our typical global funds were emerging markets during the last 10-20 years that have emerged. And that's what we're looking for in the future.

Our effort is still concentrated in the major markets in the world.... And ... we're finding value in many areas of the world. It is well diversified although we are somewhat over-weighted in the U.S. marketplace....

Dow 6,000 — or more — by the year 2000.

Templeton: The odds are better than even that you will see 6,000 by the end of the year 2,000.... And I consider that modest.

It's normal for the earning power of corporations to rise because they don't pay out all that they earn. But more important is inflation. We don't think that inflation is over. Until nations learn to balance their budgets, we're almost sure to have more and more inflation.

So we're estimating that the combination of inflation and retained earnings will cause corporations' profits to rise at an average rate of 9-1/2% per year. That's enough to double their earnings every 8 years. And if earnings double, you'd expect dividends and share prices to double also.

But I think it's quite possible that share prices might do even better than that because we are developing a shortage of shares. Up until 1984, there had hardly ever been a major nation where there had been a shrinkage in the number of shares. Underwriters were always bringing out so many new shares that there were more shares than the year before.

But in that year, hundreds of corporations were buying in their own stock, making acquisitions, leveraged buyouts and so forth. And that resulted in a net shrinkage of all American shares of over $70 billion. About the same shrinkage occurred in 1985, 1986, 1987 and 1990. And in 1988 and 1989, it was even larger. So over 1/5 of American stocks simply ceased to exist.

Cash held by Americans is the greatest in all of history....

Templeton: And yet the amount of cash held by all Americans is the greatest it's ever been in all of history. So share prices in the future might sell higher in relation to earnings and dividends than has been normal in past American history.

Take an extreme example which I do *not* think will occur in America. When there was a shortage of shares in Japan, P/E ratios went up from an average of 4 times earnings to 75 times earnings.

Now we weren't smart enough to know that was going to happen. So we began to sell out our Japanese stocks when they got up to 23 times earnings. But they went on up to 75 times earnings. Again, I don't think that can happen in America. But it does illustrate the fact that a shortage of shares can result in a higher price in relation to earnings than has been customary before....

BANKING & INSURANCE STOCKS,
SMALL GROWTH STOCKS & MORE.

A good opportunity to own banking and insurance stocks....

Templeton: It's an opportunity. You make money for your investors when shares are on the bargain counter and they're depressed in price. And there are many shares in the banking industry that are greatly depressed in price. The industry's problems have been so well publicized for so many years that even the strongest banks have share prices that are much lower in relation to earnings and dividends than other shares.

So if you pick the really well managed, strong banks, it's a good opportunity to own a lot of bank stocks....

For different reasons, we think the same thing is true in the insurance industry. The fire and casualty insurance industry has gone through a normal cycle of competition so that premiums are lower than usual. That has gone in cycles every five or six years. At some time, there will be an upward phase in that cycle. And the fire and casualty stocks will make a lot of money.

The life insurance stocks have been depressed for different reasons. So there are wonderful bargains in some of the finest life insurance companies. So I think in the long run, it will be a benefit for you.

Will small caps continue to outperform? Probably....

Templeton: Nobody knows. There are fashions in investing. Different things become highly popular and unpopular. And these young, growing companies with small capitalizations reached a maximum point of optimism in July 1983. Now that's a long time ago. And they hadn't become popular again through October 1990 — which was the low point relative to the market.

Since then, we've had a favorable period for small stocks. But that follows a seven year unfavorable period. So it's not likely we've yet seen small stocks reach their peak. They're probably still going to outperform the general market.

We say that especially because we can still find dozens of wonderful bargains among the young, rapidly growing companies. We don't have to pay any more for a young, rapidly growing stock than we do for a non-growth stock....

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