Global Core Equity Investing

1993 First Quarter Report

The following material is excerpted from the 1993 first quarter report on a global portfolio managed by Harding, Loevner, McNally & Co.. The portfolio is invested worldwide in common stocks and convertible securities with the objective of preserving and increasing its capital value in US dollar terms.

Description

The global core equity portfolio invests worldwide in common stocks and convertible securities with the objective of preserving and increasing investors' capital in US dollar terms.

Portfolio Overview

At March 31, 1993, the portfolio:

- held investments in 42 companies, including 21 US companies;
- was broadly diversified in terms of geographic distribution;
- consisted of 95% common stocks, the balance in cash and convertible bonds; and
- had an annual yield of 2.4%.

Performance

	1993	1992	1991	1990	Since Inception (12/89)	
	1st quarter				Cumulative	Compound
	Total Returns %					
Global Core Equity Portfolio	**4.8**	**11.3**	**28.5**	**6.4**	**65.1**	**16.2**
Comparative Benchmarks:						
FT World Index	9.1	-5.1	19.7	-17.1	6.0	1.8
S & P 500	4.3	7.7	30.4	-3.1	45.3	11.9
Global Fund Index (Lipper)	6.7	-3.2	18.7	n / a	n / a	n / a

Note: Performance of the global core equity portfolio is reported before management fees. These fees reduce returns to investors by approximately 1.0% per annum.

The global core equity portfolio's first quarter returns reflected buoyant conditions in global stock markets. For the first time in a number of years, the US market performed less well than the indices for the rest of the world.

The global core equity portfolio's holdings are in companies of very high financial quality. At a time of widespread gloom about corporate profitability, it is worth noting that two-thirds of the companies in the portfolio were able to raise their dividends in the last year.

Global Review and Stock Market Outlook

The US market has outperformed the rest of the world for three calendar years in succession. In the first quarter of 1993, it did not, by a substantial margin. The S&P 500 Index rose by 4.3%, while the FT Index of stocks outside the US rose by 12.3%, in dollars. There were several reasons for this reversal of fortunes:

- The Bundesbank, Europe's most important central bank, has now acknowledged that recession poses a greater threat than inflation, and has lowered interest rates accordingly.

  Lower interest rates have stimulated demand for European stocks, but there is little sign as yet of economic improvement. Declining interest rates should continue to provide a healthy backdrop for most European equity markets in coming quarters.

  The exception is in the UK, where the economy appears to be making the first steps towards recovery; inflationary pressures are re-emerging quickly, hastened by last Autumn's currency devaluation.

  The global core equity portfolio has over 35% of its assets invested in Continental Europe. Holdings are concentrated in hard currency countries, such as Germany, Switzerland and France, where interest rates have further to fall.

- US stocks are already expensive, supported mainly by low yields on alternative investments.

  Current prices are sustainable so long as the the Fed is still on the side of relaxation and corporate earnings are rising. The latter assumption, however, is vulnerable. One group after another—drugs, tobaccos, foods—have disappointed over-optimistic investors with their earnings outlooks: more sacred cows of the '80s remain to be slaughtered on negative earnings shocks.

  In this environment stock selection is of paramount importance.

  The global core equity portfolio's US companies generally have superior financial strength, have strong management, and demonstrated records of ability to prosper in this difficult environment.

- The Japanese market offers an unattractive combination of low growth and high valuations. The Japanese Government, however, pressured domestic investment institutions into supporting stock prices. That pressure, plus firmer indications as to the extent of economic stimulus, reversed the long bear market in Japanese equities.

  Stock prices are underpinned at lower levels by Government liquidity.

  Massive fiscal stimulus will eventually assist economic recovery.

  HLM has not added to the portfolio's two holdings in this expensive market.

- Corporate earnings in Asia outside Japan are growing strongly and stock markets are now beginning to respond.

The Hong Kong market has recovered sharply, but the rift between the British and Chinese governments will likely persist; the market will remain a bumpy one. Stock prices in Hong Kong are supported by an extraordinary enthusiasm for “China related” investments. That enthusiasm is becoming a speculative frenzy.

The portfolio’s holdings are in conservatively managed companies where earnings growth is not dependent on hopes for China business.

The Thai market has fallen sharply in response to scandal, while the conservative virtues of highly regulated Singapore are now beginning to be recognised!

The global core equity portfolio has added to holdings in Singapore this quarter. Holdings in Thailand were sold before the market’s decline.

First Quarter Portfolio Activity

Stocks sold in the quarter were:

- **Bangkok Bank,** which has been a remarkably successful investment which was bought at a time when the valuation was under pressure from a series of equity issues and poor banking margins. That has changed, earnings have grown and the share has become the market leader. It now appears over-valued.
- **Siam Fund** was held as a well-run, diversified portfolio of stocks in the Thai market, with the added attraction of being bought at a discount to its assets but being able to be sold at asset value when it converted in early 1993 to being an open-ended fund. All that came to pass and HLM took a substantial gain in the shares.
- HLM sold part of the holding in **Hong Kong Gas**. The shares have performed well in response to good earnings growth, and the position had increased to more than 5% of the portfolio.
- **Bayer** has performed well in difficult market conditions, but profits from the company’s bulk chemical business continue to disappoint. It remains a misunderstood company, but at this stage of the market cycle, the worth of its more stable pharmaceutical business is unlikely to be recognised.
- **Put options** over **Swiss Francs** and **Deutschemarks**, to hedge the portfolio’s European currency exposure were sold. Holdings are now unhedged.

Stocks newly bought were:

- **Hochtief**, a financially strong construction company, with a leading industry position, that should enjoy many years of robust earnings and dividend growth from the rebuilding of Eastern Germany. The majority of its shares are held by other German industrial companies.

- **Jurong Shipyard**, one of Singapore’s leading ship repair companies. It is the best positioned to benefit from an expected upturn in shipping rates and from the next newbuilding cycle. In contrast to its competitors, it has not diversified aggressively, but has instead prepared for a significant increase in capacity. It has an excellent balance sheet and a very high return on shareholders’ funds.
- **Banc One** is a large regional bank holding company with banks in the midwest, Texas, and Arizona. The bank is a leading processor of debit/credit card transactions. Banc One is a remarkable financial institution with an uninterrupted record of growth in earnings and dividends.
- **Burlington Resources** was organized in 1988 to hold all the oil and gas assets of Burlington Northern and subsequently spun off to shareholders. It is a growing company that has improved its asset base, earnings, and dividends every year in a very difficult period of depressed gas prices. BR is extremely well positioned to benefit from the higher natural gas demand that is likely to arise from the desire for a clean-burning fuel in a growing economy.
- **East Asiatic (Malaysia)** is a subsidiary of EAC of Denmark. As an agent for many leading consumer product companies, it will benefit from the upsurge in middle class spending in Malaysia. HLM expects to add to the small initial position.

HLM also added to natural gas related holdings through buying more shares in **Royal Dutch Petroleum,** the world’s largest holder of gas reserves.

The net effect of the transactions is to leave the portfolio fairly fully invested, with a higher level of investment in energy (11%), through the two holdings mentioned above, but a lower level of investment in South East Asia. HLM still regards South East Asia as an attractive region and will either increase existing holdings or add more companies.