Harding, Loevner Management
Global Equity Investing

1994 Second Quarter Report

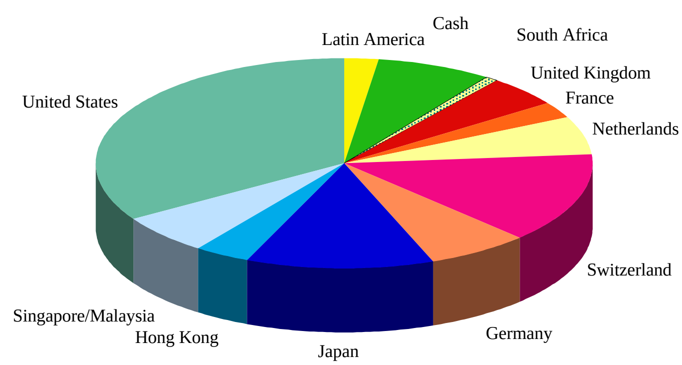
The following material is excerpted from the 1994 second quarter report on a global portfolio managed by Harding, Loevner Management ("HLM"). The portfolio is invested worldwide in common stocks and convertible securities with the objective of preserving and increasing its capital value in US dollar terms.

Portfolio Overview

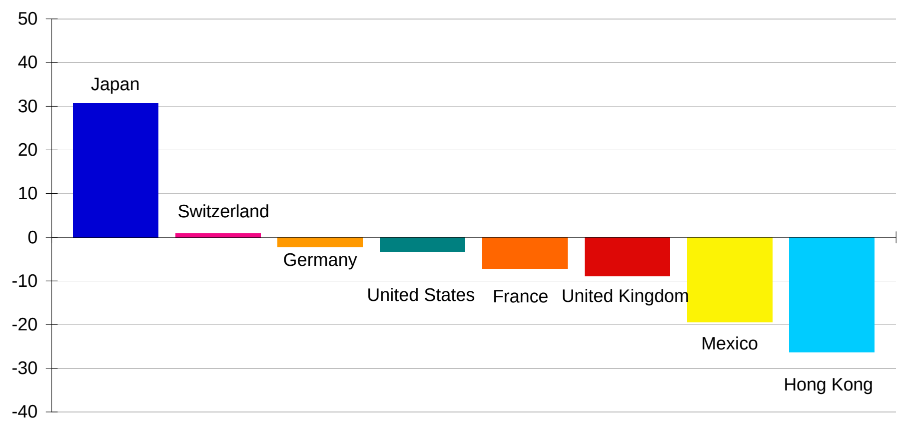
At June 30, 1994, the portfolio:

- held investments in 45 companies in 12 countries, including 17 US companies;
- was broadly diversified in terms of geographic and industry distribution;
- consisted of 93% stocks and warrants, the balance in cash; and
- had an annual yield, before expenses, of 2.4%.

Portfolio Allocation by Country as of June 30, 1994



1994 Year to Date Performance of Major Markets



Performance

	1994 YTD	1993	1992	1991	1990	Since Inception (11/30/89) Cumulative	Annual
	Total Returns %						
HLM Global Equity	**-0.9**	**24.2**	**9.1**	**31.6**	**3.6**	**89.4**	**15.0**
Comparative Benchmarks:							
FT World Index	4.6	22.6	-5.1	19.7	-17.1	24.5	4.9
MSCI World Index	3.9	23.1	-4.7	18.7	-16.4	25.0	5.0
S & P 500	-3.5	10.0	7.7	30.4	-3.1	48.0	8.9
Global Fund Index (Lipper)	-2.7	32.7	-3.2	18.7	-11.2	37.0	7.1

Note: This performance data refers to HLM's Global Equity Composite, a dollar-weighted average of *all* global equity accounts managed by HLM. Performance of the composite is reported before management fees. These fees reduce returns to investors by approximately 1.0% per annum.

The portfolio rose in value by 2.1% in the quarter. The FT World Index also rose, by 3.5%. These two short sentences do not do justice to the tumultuous conditions in global financial markets in the second quarter. Bond markets throughout the world have continued to plummet, short-term interest rates have, at best, stopped falling, commodity prices have soared and the US dollar has been under almost continuous pressure. Despite such a background, equity indices were remarkably stable—in dollar terms, at least. Europe fell by 1.4%, but the Pacific markets outside Japan rose by 1.5%. In the US, the broad market index rose by 0.3%, but an index of smaller, OTC stocks lost 5.0% of its value. The Japanese market was a notable exception to the general, uninspiring trend, rising by 7.6% in Yen and 11.9% in dollars. Japan's performance was sufficiently strong to produce a rise of 3.5% in the World Index, of which Japan counts for nearly one third.

Portfolio Review and Outlook

Amongst this turmoil, and despite an exposure to Japan well below that of the World Index, the value of the portfolio held up well in the quarter. There were several contributing factors:

- Notwithstanding its broad diversification by geography and by industry, the portfolio's holdings are uniformly high in quality. Very few of the companies in the portfolio have disappointed in terms of their underlying earnings growth.
- The portfolio's investments are concentrated in three sectors that performed well: capital goods, energy and US financial companies.
- Investments in Europe are concentrated in Germany and Switzerland— strong currency countries where stock price falls were substantially mitigated in dollar terms by currency appreciation.

Recent market turmoil reflects continued “fallout” from the reversal in interest rate trends initiated by the US Federal Reserve in the first quarter. Investors are still adjusting their portfolios in light of higher nominal (and real) interest rates, a process that is neither instantaneous nor necessarily smooth. In particular, the de-leveraging of speculative positions, in which long term assets are sold to reduce excessive short-term borrowings, is invariably disorderly.

HLM remains optimistic about the outlook for stock prices of the portfolio’s companies, because it foresees an environment of stable interest rates, low inflation, and rising corporate earnings. Bond yields have already risen significantly. The rapid rate of the rise reflects the unwinding of speculative excess, but the levels to which yields have now risen reflect higher levels of credit demand stemming from the incipient economic recoveries in Western Europe and Japan. Rising production in these markets and resulting productivity gains will enable globally competitive companies to grow their earnings.

Higher bond yields reflect higher real rates of interest; they do not imply higher levels of inflation. Global competition, free-ish trade, surplus manufacturing capacity and labour, industrialization of the developing world and increasingly effective use of computer technology continue to combine to reduce production costs and inhibit price rises. Against this background of stable interest rates and low inflation, stocks of growing companies, such as those held in the portfolio, are reasonably priced.

Demographics also continue to play a role positive for financial assets. The bulging “baby boom” cohorts throughout the developed world are entering the most productive years of their careers, and are just now beginning to save in earnest for their retirement. Their appetite for long-term financial assets will grow strongly until their vanguard reaches retirement age, 15 to 20 years from today.

The portfolio is heavily weighted towards the capital goods sector. Companies such as **Brown Boveri**, **Dover**, **AMP**, **Mitsubishi Heavy Industries**, **Canon Sales** and **Krones** will all benefit from higher levels of investment required in the 1990's. High levels of investment will continue to be required to enable corporations in both developed and developing countries to succeed in a competitive global marketplace, to provide infrastructure for continued growth in developing economies in Asia and Latin America, and to enable Eastern Europe to re-equip its industrial base. This virtuous circle of rising investment, rising productivity and lower prices means that, though real interest rates may remain high, earnings for the best companies— those able to respond on a global basis to increased competition and an expanded marketplace— will grow.

Another area of emphasis is on financial companies, the best of which, such as **JP Morgan**, **First Fidelity** and **Exel**, are found in the US. HLM believes that, in an era of low inflation, high demand for capital and high real interest rates, well-managed financial companies will provide returns to shareholders well in excess of those implied by their current modest, single digit price earnings ratios.

Second Quarter Portfolio Activity

HLM bought three stocks in the quarter, added to three others, and sold three. The new holdings are:

- **Canon Sales**, the independent marketing arm of Canon which holds exclusive rights to Japanese domestic sales of Canon products and is also the primary Japanese distributor for Apple Computer. Despite their fearsome reputation in manufacturing, Japanese companies are dramatically underinvested in office technology. Their need to restore shareholder returns in the face of a strong Yen, greater foreign competition and a sluggish domestic economy will drive Japanese companies to improve white collar productivity through investment in computers and peripheral equipment. As exclusive distributor for Canon's powerful line of printers and scanners as well as for Apple computers, whose facility in Japanese kanji characters has led to strong market acceptance, Canon Sales is well placed to benefit from this secular trend.

- **Panamerican Beverages,** with operations in Mexico, Columbia and Brazil, is the largest soft drink bottler in Latin America and the largest Coca-Cola bottler outside the United States. Future growth will result from rising demand for premium Coca-cola products from the increasingly affluent Latin American middle class, and from the introduction of new downmarket products based on PB's own brands. With Coca Cola's encouragement, PB will also use its financial strength to acquire smaller distributors unable to make the necessary investments in new plant and packaging equipment.

- **Liblife Strategic Investments (Libsil)** is an investment holding company comprising four of South Africa's finest companies: South African Breweries, Standard Bank, Gold Fields, and Premier Foods Group. The consumer, industrial, and finance sectors in South Africa have been particularly stifled by the long period of apartheid, economic sanctions, and severe recession. Libsil provides diversified exposure to three non-mining companies that we found, through company research visits, to be among the best in South Africa, and offers better liquidity than the shares of the underlying companies themselves which, though larger, are closely held.

HLM added to holdings in electronic connector maker **AMP**, UK diversified company **Trafalgar House** and bottling equipment maker **Krones**. The latter was by way of a rights offering to shareholders at a discount to market price.

HLM sold three stocks. One was on price grounds, where shares in **Kimberly Clark de Mexico** had significantly outperformed a weak Mexican market and doubled inside a year, leaving them expensive against the local market and, more importantly, relative to expected growth. Kimberly remains a fine company, however, and a candidate for reinvestment at lower prices. The other two, agro-industrial giant **Archer Daniels** and tire retreader **Bandag**, were sold because their earnings had not responded as expected to improvement in general business conditions in the US.