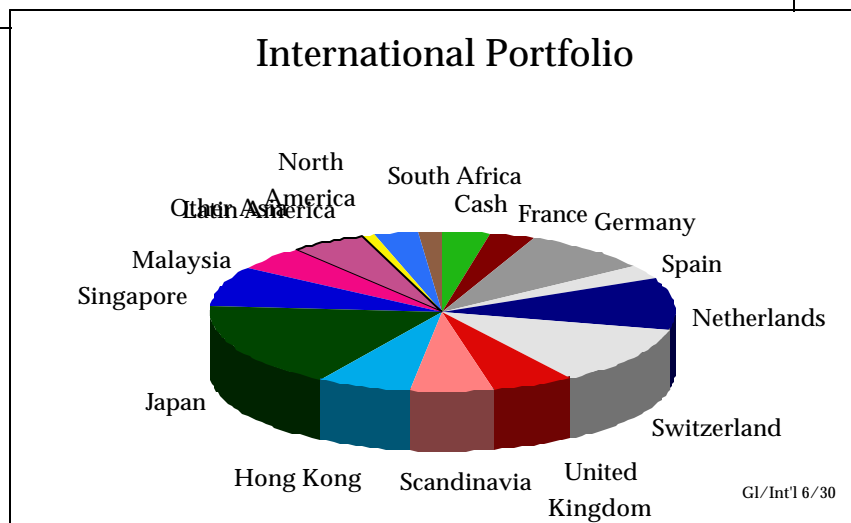
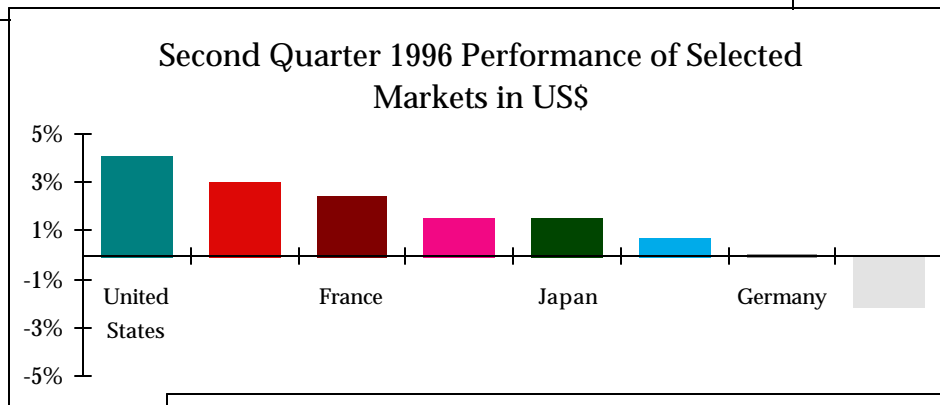
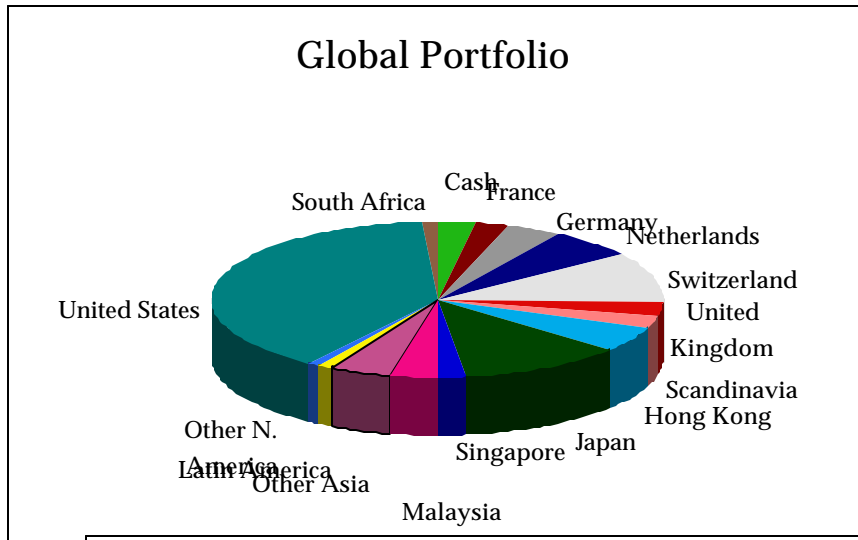


Harding, Loevner Management

Global and International Equity Investing

1996 Second Quarter Report

The following material is excerpted from reports to equity clients of Hardi Management.



Overview of Equity Portfolios

Harding, Loevner Management offers clients a choice of equity programs: *global equity*, which includes US-based companies, and *international equity*, which excludes US-based companies. Within each equity program, carefully selected companies are combined in portfolios that are broadly diversified by industry and by geography. The following table provides a 'snapshot' at June 30, 1996, of two representative portfolios:

Portfolio Characteristics	HLM Global Portfolio	HLM International Portfolio
Number of companies	47	46
Number of countries	17	19
current yield	2.0%	2.0%
Geographic Allocation (%)		
US	39	--
Europe	28	48
Japan	12	18
South East Asia	15	25
Other	3	6
Cash (US\$)	<u>3</u>	<u>3</u>
	100	100

Performance

Both global and international portfolios made additional gains in the second quarter, adding to the strong returns of the first three months of 1996. Global portfolios returned 3.5% in the second quarter of 1996, better than passive indexes, but slightly below active indices; the FT World Index rose by 2.9%, and the Lipper Global Index rose by 3.8%. International portfolios returned 5.3%, versus 2.0% for the FT World ex-US Index and 3.9% for the Lipper International Index.

	1996 YTD	Compound Annual Returns (%) for periods ending 6/30/96			
		<u>1 year</u>	<u>3 years</u>	<u>5 years</u>	<u>Inception</u>
HLM Global Equity Portfolio	11.3	16.5	15.6	16.1	15.1
FT World Index	7.0	18.4	12.9	12.1	7.6
S & P 500 Index	10.0	26.0	17.2	15.7	13.9
Global Fund Index (Lipper)	9.7	17.1	13.8	12.9	9.8
HLM International Equity Portfolio	12.8	19.4	18.7	19.2	13.6
FT World ex-US Index	5.0	14.0	10.4	9.8	4.2
MSCI World ex-US Index	4.9	13.7	10.8	10.2	4.7
MSCI EAFE Index	4.7	13.6	10.8	10.3	4.4
International Fund Index (Lipper)	8.5	16.4	12.9	11.2	7.7

Note: The HLM performance data refer to its global and international equity composites, which are dollar-weighted averages of *all* HLM-managed global and international equity accounts, respectively. Inception date for global composite, 11/30/89; international composite, 9/30/89. HLM composite performance is presented before management and custody fees. See attached composite performance summaries for details.

The US market once again outperformed most of the larger international market indices. Global indices were dragged down by modest returns from the two largest markets outside the US — Japan, and the UK, and by depreciation of most major currencies against the dollar. Several of the non-US stocks in the portfolios, however, actually benefited from the rising US dollar: **Honda Motor, Canon, Surveillance,** and **Unitor** all fit this description, since they have very large dollar revenues, and US dollar strength boosted their earnings as reported in local currencies.

The gains in the portfolios have also been made in the face of consistently rising yields in the US bond market — in earlier periods a deterrent for international equities. The US market appears expensive by traditional valuation benchmarks, and has discounted the continuation of the favorable conditions of low inflation, generally low interest rates, and high corporate profitability. Increasingly, there are worrying signs of speculative excess, and anecdotal evidence of the maturity of the extended bull market in US stocks.

There are few significantly undervalued sectors in the US market, and stocks of companies that are clearly global leaders are very expensive set against our global valuation standards. An obvious example is Coca Cola, a company that embodies global leadership and sustained growth, but whose shares trade at a lofty trailing price earnings ratio of 40, and a dividend yield of just 1.0% — too expensive, in our view.

Review and Outlook

The US companies in the global portfolios reflect our concerns; they are well diversified by industry, of high financial quality, balanced between cyclical and non-cyclical businesses, and, typically, capable of sustaining growth through business investments outside the United States. Our emphasis on these characteristics serves to reduce the risk of the portfolios in a risky market. The most visible consequence to the global portfolios of the overvaluation of the US stock market is that US companies now constitute only about 40% of their total assets.

Whenever we describe our process of investing, we repeatedly emphasise our strong preference for companies whose managements have a track record of treating outside shareholders properly, whose financial strength is outstanding, and who are globally competitive. Over time we have found that these are the attributes of industrial excellence, and companies who exhibit them tend to be the leaders of their industry. These qualities underlie a single concept that the market has labeled 'creating shareholder value'. Many US companies exhibit these qualities, and have done so for a long time; such qualities have been hard to find among foreign based companies. This year, however, there has been a remarkable change: non-US company managements are adopting these precepts with considerable enthusiasm.

Some commentators have focused on the gathering pace of corporate restructuring in Europe, brought on by slow economic growth, by the advent of deregulation, and by increased global competition, all of which have put enormous pressure on corporate profits and, in turn, company managements. Others have highlighted the past decade of underperformance for European equity markets relative to US stocks. They lay the blame on managements for failing to earn the true cost of their capital, and assert that the managerial cultural tide has turned, such that managements are now turning their attention to shareholders' returns, and away from discredited goals of market share, diversification, or self-aggrandizement. Still other observers see long-term demographic and economic forces at work. They are looking ahead at the inexorable fiscal crisis that will engulf Europe and Japan in the next few decades, as large proportions of their populations are transformed from productive workers and taxpayers to pensioners. They argue that one way to counteract the crisis is through the creation of a much more vibrant environment for equity investment, so that private savings can be increased, and channeled to more productive enterprises.

Whichever of these three explanations is correct, the fact is this: a small but growing number of non-US companies are taking specific actions to make their stock prices rise, both in the short and the long term. These actions, which have become commonplace among US companies in recent years, range from cost cutting and layoffs, to more transparent accounting, to generous dividend increases, to target rates of return

for new investments, to an emphasis on corporate focus, to divestment of non-core businesses, to management share options, to share repurchases. It is no coincidence that a significant number of those pioneers (for, outside the US, that is what they are) are companies in the portfolios. Our own explanation is that the best managements have watched the comparative advantage that their US-based global competitors have garnered from putting shareholders' interests first, and have responded as excellent managers should: by adopting a best practice when they see it. Companies who view themselves in a global context are the first to recognise the benefits of these practices. The companies who most quickly can adopt these strategies are those with the best balance sheets, and the strongest free cash flows. It is important to remember that, at the most fundamental level, shareholder value is created when a company makes investments that return more than its cost of capital; the comparative advantage gained by putting shareholders first is the ability to raise capital more cheaply than otherwise, due to a higher share price.

Permit us a litany, if you will, of some of the actions taken by some of the companies in the portfolios during the first half of 1996:

- **Investor** launched the largest ever initial public offering of a Swedish company in order to realize the value of its holding in Scania, the world's most profitable truck manufacturer. This move also served to make the valuation of its underlying assets more transparent, since now virtually all of Investor's holdings are publicly traded. The important goal from Investor's point of view is to reduce the discount at which its shares trade relative to its underlying assets, because such a financial discount is an industrial handicap in the global capital marketplace.
- **Wolters Kluwer** historically would have made a call on shareholders through a dilutive rights offering to raise additional equity to finance its \$2 billion acquisition of Commerce Clearing House in the US. By using debt instead of equity financing, Wolters was able both to lower its average cost of capital, and to preserve growth in earnings, without dilution to existing shareholders. This was an excellent use of a pristine balance sheet, given the predictable nature of combined company's future earnings, and the acquisition's role in transforming European leadership into global leadership in the professional specialty publishing industry.
- **Deutsche Bank** asked its shareholders to approve one of the first management share option plans ever in Germany. It also adopted International Accounting Standards, making its financial statements more transparent for shareholders, and enabling them better to compare Deutsche with its global competitors, such as JP Morgan. It has also undertaken to reduce its stakes in unrelated companies such as Allianz and Daimler-Benz, as it sharpens its focus to compete with other global banks. It has set an ambitious target for return on equity, which, if it is achieved, can dramatically increase the earnings and the share price.
- **Surveillance** has overcome for the second time the high tax disincentives in Switzerland against share repurchases, and has bought back over 4% of its shares. This returns to shareholders some of the excess cash which has accumulated from the highly profitable inspection services. In previous years — under different management — excess cash was either hoarded, at low Swiss Franc interest rates, or was spent on dubious acquisitions that were meant to diversify the company's lines of business away from its core competence of inspection services. Both were poor uses of capital. The chairwoman's latest move demonstrates her commitment to make the value of the shares more accurately reflect the value of the business franchise.
- In Hong Kong, **Hutchison Whampoa** has bought back stock, and Mr. Li Ka-Shing, the controlling shareholder, has increased his personal holdings. This is at a time when Hutchison has moved to realise the value of some of its investments through the flotations of Orange and Asia Sat.

Finally, we can't help contrasting these companies and their management policies with well-publicised equity offerings here and abroad: Japan Tobacco, a company in a protected industry with 87% market share

and profitability that can only decline as deregulation progresses and global competitors arrive; INA, a government controlled insurance company in Italy, whose financial statements are incomprehensible; Deutsche Telecom, the German monopoly telephone operator, whose technology is out of date on most fronts, and whose demands for investor capital will be very large as they try to retain market share against new competitors with new technologies and faster reflexes; we hardly know where to begin in the US, where IPOs of risky companies with unproven products are recommended via America Online, and actual earnings invariably disappoint. We are, as you might infer, sensibly avoiding the first three, and appalled at the last.

Transactions

There were few transactions this quarter; our companies are generally performing well.

For both international and global portfolios, we bought:

- **Atlantis Japan Growth Fund**, an investment company whose shares are listed on the London Stock Exchange. The investment objective of the company is to achieve long-term growth through investment in listed securities in Japan. The management of Atlantis have been known to us for many years, and access to their acknowledged expertise in smaller companies allows us to raise the portfolios' exposure to an attractive asset class where local knowledge can add considerably to returns.

For global portfolios only, we bought:

- **Investor**, the holding company of the Wallenberg family in Sweden which owns stakes in a number of blue chip global companies. We had owned this company's convertible bonds, but they became less attractive when the company declared a special dividend to common stockholders to distribute proceeds from their sale of Scania, including a small number of warrants on Scania stock. We sold the bonds to buy the shares.

For international portfolios only, we bought:

- **Far East Levingston**, one of the main subsidiaries of Keppel Corporation, another portfolio holding in Singapore, is a builder of mobile offshore oil drilling and production platforms and other specialised ships. With the decade-long slump in rig building now over, this healthy survivor is well placed to benefit from the revival of demand for new units, which is already evident and which is being spurred by new oil provinces and new technologies.

We also added to holdings in **Deutsche Bank**, which has put itself squarely amongst the leaders in delivering shareholder value, but whose shares have not performed particularly well so far this year.

HARDING, LOEVNER MANAGEMENT
Global Equity Performance Summary 6/30/96

	Calendar Year Returns						
	1996						
	6 Mos	1995	1994	1993	1992	1991	1990
HLM Global Equity Composite	11.3	19.0	-0.1	24.2	9.1	31.6	3.6
<i>Financial Times World Index</i>	7.0	19.6	5.9	22.6	-5.1	19.6	-17.0
<i>Morgan Stanley Capital International World Index</i>	7.3	21.3	5.6	23.1	-4.7	18.7	-16.4
<i>S&P 500</i>	10.0	37.5	1.3	10.1	7.7	30.2	-3.1
<i>Lipper Global Fund Index</i>	9.7	14.0	-2.2	32.8	0.1	20.3	-9.1

	Average Annual Returns for periods ending 6/30/96			
	Since			
	1 year	3 years	5 years	Inception*
HLM Global Equity Composite	16.5	15.6	16.1	15.1
<i>Financial Times World Index</i>	18.4	12.9	12.1	7.6
<i>Morgan Stanley Capital International World Index</i>	19.0	13.6	12.5	8.0
<i>S&P 500</i>	26.0	17.2	15.7	13.9
<i>Lipper Global Fund Index</i>	17.1	13.8	12.9	9.8

* Inception date: 11/30/89

Notes:

1. Returns shown are time-weighted total returns, and include reinvestment of dividends.
2. Returns from all cash reserve and equivalents, bonds and/or convertible securities used in place of equities are included in performance calculations.
3. Composite calculations have been weighted by account size.
4. Figures include all global equity accounts under discretionary management from their inception dates, including accounts no longer in existence.
5. No alterations of composites as presented here have occurred due to changes in personnel or other reasons at any time.
6. No selective periods of performance have been utilized.
7. Results are presented after brokerage commissions but before management and custodial fees. Management fees are described in our Form ADV Part II. Inclusion of standard management fees would reduce annual returns for global composite by approximately 1%.
8. Lipper Index performance is after fees and expenses.

Account summary information:

1. Number of accounts included in composite: 1989: 1; 1990: 4; 1991: 7; 1992: 14; 1993: 17; 1994: 17; 1995: 13; 1996: 12.
2. Total market value at year-end of accounts included in composite ('000): 1989: \$1,564; 1990: \$15,311; 1991: \$36,637; 1992: \$64,513; 1993: \$93,197; 1994: \$112,683; 1995: \$147,062; 1996 O2: \$191,132.

HARDING, LOEVNER MANAGEMENT
International (Non-US) Equity Performance Summary 6/30/96

	Calendar Year Returns						
	1996 6 mos	1995	1994	1993	1992	1991	1990
HLM International (non-US) Equity Composite	12.8	13.2	2.5	46.3	9.9	21.9	-12.9
<i>Financial Times World ex.-US Index</i>	5.0	10.4	8.4	32.1	-13.1	13.3	-23.1
<i>Morgan Stanley Capital International World Ex-US Index</i>	4.9	11.8	7.6	32.6	-11.9	12.4	-22.8
<i>Lipper International Fund Index</i>	8.5	9.3	-0.9	39.2	-4.3	13.2	-12.4
<i>MSCI EAFE Index</i>	4.7	11.6	8.1	32.9	-11.9	12.5	-23.2

	Average Annual Returns for periods ending 6/30/96			
	1 year	3 years	5 years	Since Inception*
HLM International (non-US) Equity Composite	19.4	18.7	19.2	13.6
<i>Financial Times World ex.-US Index</i>	14.0	10.4	9.8	4.2
<i>Morgan Stanley Capital International World Ex-US Index</i>	13.7	10.8	10.2	4.7
<i>Lipper International Fund Index</i>	16.4	12.9	11.2	7.7
<i>MSCI EAFE Index</i>	13.6	10.8	10.3	4.4

* Inception date: 9/30/89

Notes:

- Returns shown are time-weighted total returns, and include reinvestment of dividends.
- Returns from all cash reserve and equivalents, bonds and/or convertible securities used in place of equities are included in performance calculations.
- Composite calculations have been weighted by account size.
- Figures include all international equity accounts under discretionary management from their inception dates, including accounts no longer in existence.
- No alterations of composites as presented here have occurred due to changes in personnel or other reasons at any time.
- No selective periods of performance have been utilized.
- Results are presented after brokerage commissions but before management and custodial fees. Management fees are described in our Form ADV Part II. Inclusion of standard management fees would reduce annual returns for international composite by approximately 1%.
- Lipper Index performance is after fees and expenses.

Account summary information:

- Number of accounts included in composite: 1989: 1; 1990: 2; 1991: 3; 1992: 4; 1993: 5; 1994: 14; 1995: 26; 1996: 32.
- Total market value at year-end of accounts included in composite ('000): 1989: \$10,899; 1990: \$10,599; 1991: \$6,770; 1992: \$12,061; 1993: \$23,003; 1994: \$110,370; 1995: \$347,107; 1996 Q2 \$551,061