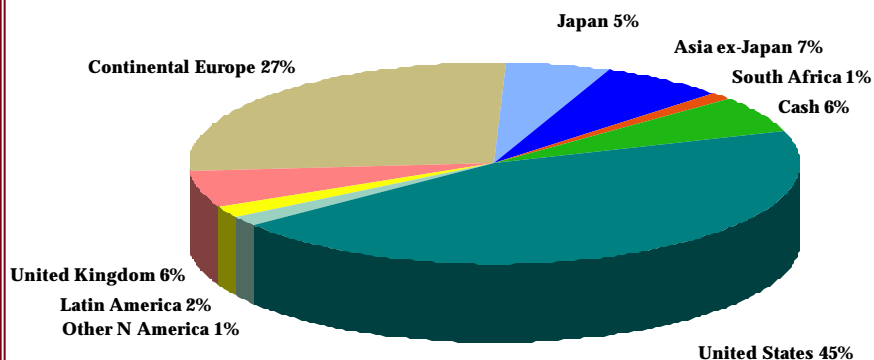


# HARDING, LOEVNER MANAGEMENT, L. P.

## GLOBAL AND INTERNATIONAL INVESTING

### 1997 Year End Report

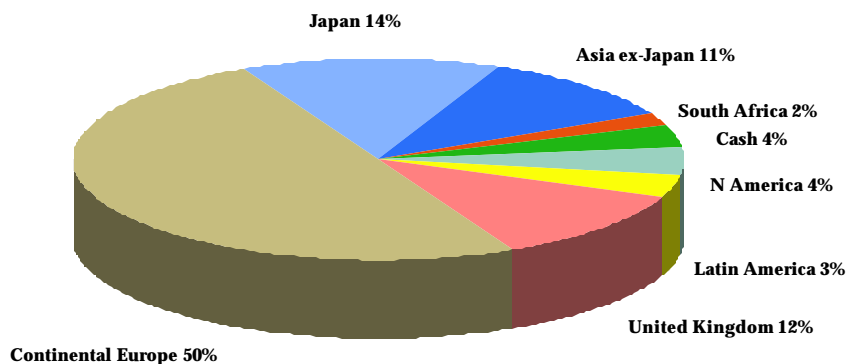
#### GLOBAL EQUITY PORTFOLIO



The *Global Equity Portfolio* seeks long-term capital appreciation through investments in equity securities of companies based both inside and outside the US.

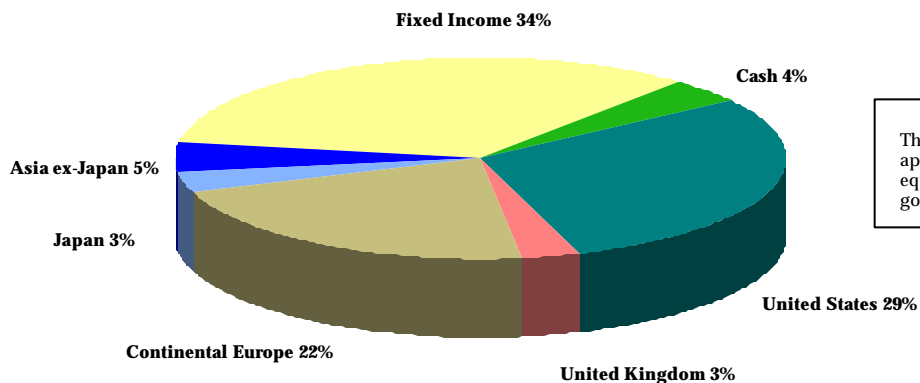
#### INTERNATIONAL EQUITY PORTFOLIO

The *International Equity Portfolio* seeks long-term capital appreciation through investments in equity securities of companies based outside the US, including large & small companies in mature markets and established companies in emerging markets.



#### MULTI-ASSET GLOBAL PORTFOLIO

The *Multi-Asset Global Portfolio* seeks long-term capital appreciation and current income through investments in equity and fixed income securities of companies and government bodies throughout the world.



The charts above provide a 'snapshot' of the portfolios at December 31, 1997. See inside for details of performance.

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### **HARDING, LOEVNER MANAGEMENT, L.P.**

Harding, Loevner Management, L.P. (“HLM”) is a registered investment advisor providing global investment management to private and institutional clients since 1989. Based in Somerville, New Jersey, the firm is independent and employee owned. It manages in excess of \$1.5 billion in assets for private investors and institutions.

#### **Investment Approach**

HLM’s seeks to achieve consistent absolute returns while limiting the potential for substantial loss. HLM’s investment approach is *bottom up*. It focuses on companies and their securities, restricting its attention to companies that it knows well and whose businesses it understands. It seeks to identify companies with superior long-term growth prospects, and to select from among them those whose shares appear to offer attractive absolute returns. HLM’s investment criteria include both growth and value considerations. HLM favors companies with strong balance sheets, sustainable internal growth, superior financial returns, capable and forthright management, and enduring competitive advantages.

To determine *when* to invest in a company meeting its criteria, HLM uses valuation tests, including domestic market and cross-border comparisons. HLM invests with the view to being a long-term shareholder, but divests if a company’s business performance, management actions or changes in the external environment

reveal a flaw in the underlying investment thesis, or if its shares become substantially overvalued.

Country and sector portfolio weightings reflect the results of stock selection, rather than the results of any country or sector allocation process.

However, HLM’s outlook for various industries and national economies is important in individual company evaluation. Weightings are adjusted, if necessary, to ensure that portfolios remain well diversified, but no consideration is given to index weightings. HLM hedges foreign currency exposure only on those infrequent occasions when diversification is inadequate or when it has a strong negative view on the prospects for a particular currency. Portfolio turnover is low – about 30-35% annually.

#### **Investment Programs**

HLM offers three related investment programs. Each is available on a separately-managed account basis or through mutual funds.

*Global Equity* is a conservative program intended to form the core of an investor’s equity portfolio, comprising common stocks and convertible securities of high-quality, growing companies, both US and non-US.

*International Equity* is a focused program for investors seeking long-term capital appreciation through investment in growing companies outside of the US, including large and small companies in

mature markets as well as established companies in emerging markets.

*Multi-Asset Global* is a balanced program in which global equity, fixed income and cash

equivalent securities are combined to meet the investor's particular requirements for income, growth, stability, and liquidity.

## GLOBAL EQUITY PORTFOLIO

### Performance

The portfolio fell 3.3% in the fourth quarter, in line with both active and passive indices, as the financial tumult in Asian markets weighed on stocks around the world. The FT World Index fell 2.9%, and the Lipper Global Fund Index dropped 5.0%.

For the year as a whole, the portfolio returned 11.0%, trailing both the active and passive indices: the FT World Index gained 15.4% on the year, while the Lipper Global Fund Index was up 14.0%. From a performance perspective, 1997 was a year in which geographic allocations mattered more than individual stock selection. US and European investments were helpful; Asian investments were harmful. As 78% of our investments is domiciled in the US and Europe, the portfolio benefited from positive investor sentiment in these regions. With the year-long reduction of our Asian exposure — now down to 12% — we limited the damage to the portfolio from the market collapses across that region.

### Review and Outlook

Past letters this year have dedicated much space to our concerns about the longevity of the US bull market. The portfolio reflects our caution. 49% of its assets are invested in US stocks, but in 1997 the portfolio would have benefited from a larger US allocation. Our US stocks remain those of global leaders that we see as having sustainable competitive advantages that will enable them to grow across business cycles. But it is not enough for a company to be an industry leader; we look for stocks that can deliver superior returns. The prices found in today's US stock market temper our enthusiasm even for 'great companies.' The concerns we expressed last quarter continue: many of the stocks driving the bull market are at risk from earnings disappointments, be they from wage pressures, strength of the dollar, or the slowing of efficiency gains from restructuring efforts. We see the market punishing stocks that fail to meet aggressive earnings targets in *any* quarter for *any* reason. In the US, companies that

can keep up with the market's exacting requirements will soon be many fewer.

**Schlumberger, Colgate-Palmolive, Dover, Wrigley, and Fannie Mae** justify our faith by continuing to focus on product innovation, and by fanatic attention to costs. They continue both *to manage* and *to meet* analysts' expectations. Each of their shares has delivered returns of over 40% this year. On the other hand, stocks of companies that did not satisfy quarter-to-quarter requirements were hit hard. The shares of **Airgas**, the largest independent gas distributor in the US, dropped 17% in the fourth quarter as margins on newly-acquired businesses proved not (*yet*) up to management's targets or the market's expectations. An unexpectedly weak quarter of paging sales in China caused **Motorola** shares to fall 20% in the quarter. **Boeing** lost 10% of its value in the quarter when it announced business was *too* good and that bottlenecks in the supply chain would cause costs to rise. We are also reminded of stocks we sold earlier in the year, including **AMP** and **Union Pacific**. Both are good companies with growing businesses, but each has suffered since we sold it, due to an inability to meet declared quarterly earnings targets. While earnings momentum can be an indicator of long-term success, we invest in companies not with insight into their next quarter's performance, but rather because of their ability to maintain a trend of growth throughout business cycles. We don't see many companies out there that meet this criterion and are attractively valued.

Even the benign macro-environment of low inflation and low nominal interest rates — which we can see practically institutionalized in the US by consumer expectations as well as by the added weight of the currency devaluations of many of the US's trading partners — holds in it the seeds of more trouble for individual corporate earnings, and reinforces our conservative bent. The shock waves of the Asian financial collapse have only just begun to be felt on our shores. The flood of cheap imports we can expect from the devaluation of Asian currencies will benefit the American consumer in the short run, of course, but will exacerbate the already cutthroat pricing

environment in which so many American companies operate. Companies with the ability to raise prices and the financial strength to maintain profitable growth will continue to command premium prices. The beneficiaries of such a business climate are difficult to find and are indeed even more difficult to replace.

Two companies that are taking advantage of the low interest rates and the continued growth in the US economy, **Fannie Mae** and **Allied Capital** (both up over 50% on the year), are the only domestic financial stocks in the portfolio. It is how they go about their business that continues to attract us to them. Fannie Mae, the government-sponsored mortgage financing company, has unequaled databases, computer systems, credit processes, and access to banks across the country. The company is expanding into such new markets as low-income housing, and such new products as second mortgages and home equity loans. Allied Capital, the small business finance company, has consolidated into a single operating entity to reduce its administrative and funding costs even while it broadens its debt and equity finance portfolio. Including Bermuda-based reinsurer **Partner Re**, the portfolio has 10% of its assets in North American financial companies, but owns not a single US bank. Banking is a sector we view with particular caution, seeing lingering overcapacity, deteriorating credit quality, and increasing incidence of financial accidents.

Our European holdings share many of the same traits as their American counterparts, although we see them as beneficiaries of operating in the early stages of the business cycle. Restructuring, cost cutting and attention to returns are driving such European holdings as **Deutsche Bank**, **Nestlé**, and **Rentokil** towards the US paradigm, and the returns of much of the balance of our European portfolio reflects these positive trends. However, our core belief that companies with a global reach will provide better returns than companies with a purely local brief was put to the test this year. Particularly in Europe, 1997 was a year in which companies that pursue growth in emerging markets were punished for their efforts. Those multinational companies with significant operations or customers in the Asian markets were penalized

as much as some of their Asian-based competitors. South East Asia accounts for 10% of the revenues of **ABB**, the global leader in electricity generation and distribution equipment; its stock dropped 15% in the fourth quarter on worries over future infrastructure projects. The shares in **Bayer**, the German chemical company, dropped 7% in the quarter, mostly on diminished expectations from its loudly-touted Asian strategy. **Surveillance**, the Swiss global inspection concern with a significant exposure to the trade flows of Asia, lost 17% for the year. The Anglo/Australian mining company **Rio Tinto** fell 26% over the fourth quarter, as commodity prices fell in conjunction with concerns that slowing global demand for industrial metals.

The negative returns for the quarter came primarily from our Asian holdings. As we have outlined in previous letters, we actively reduced our Asian exposure during the year as individual companies that disappointed us were sold. Many of our complaints with these companies whose stock we sold illustrate the troubles that plagued the economies of the region, particularly the failure to generate returns to minority investors. Sometimes we would have been better off exiting earlier, but our style of approaching investment decisions one by one keeps us, we believe, not only from making precipitate buying decisions, but also from headlong selling. By year-end our holdings in Asia totaled 12% (including 5% in Japan), down from the 26% level where we began the year. The stocks we continue to own range from globally-competitive exporters like Hong Kong's **Johnson Electric** (whose shares returned 6% in dollar terms in the fourth quarter and gained a remarkable 25% on the year), and Japan's **Canon** (down 14% in dollars in the quarter, but still up 19% on the year), to one we should have sold, Thailand's **Siam Cement**, which in dollars is down 53% in the quarter and 75% on the year. As the leading industrial company in the country, it will be the guide to the Thai recovery.

We continue to monitor the events in Asia closely — five of us traveled to the region in the fourth quarter — but we feel it is too soon to tell if the rewards to the early returning investor outweigh

the risks of economies that have yet to solve many of their endemic problems. We will add to our Asian holdings as we find ‘belt and suspenders’ companies with compelling valuations that rank high on our fundamental criteria, or see diminished risk in the region, the latter to include a clear resolution of China’s response to the competitive devaluations of her neighbors.

And so, notwithstanding the ‘what-else-could-go-wrong?’ year in Asia, we think that the case for investing internationally remains strong. The globalization of money and capital markets has not brought a uniformity of risk and returns to the globe; instead, the circumstances of and expectations for individual companies — and the regions and countries in which they operate — continue to be the primary drivers of stock prices. The differences between individual markets in 1997 could not be more stark: in dollar terms, the Mexican market shot up 50%, the US rose 33%, Germany was up 24%, the UK was up 21%, Japan dropped 25%, and the Pacific region ex-Japan was off 34%. These results tell us not only that relative prices have changed, but also that the world’s stock markets still do not move in unison. In a global portfolio approach lies the opportunity for risk reduction through diversification, and for buying stocks of good companies when they are cheapest.

The portfolio, which is a collection of companies reflecting our biases and beliefs, rather than a mirror of an index or investment ‘style,’ ends 1997 positioned with an eye towards thriving in the anticipated harsh business climate. In particular, we continue to believe that ‘global’ and ‘growth’ are synonymous. The companies we own are ones that will, we believe: (1) continue to grow profits in a straightforward and predictable way, (2) use their financial strength to compete fiercely, and (3) generate enhanced returns to shareholders by adopting increasingly shareholder-focused management principles.

### Activity

The markets’ turbulence gave us the opportunity to undertake several transactions during the fourth quarter. The result was to reduce our Japanese

exposure, increase the US weight, grow the proportion of select emerging markets exposure, and emphasize companies where we see defensible and predictable earnings.

We purchased **Pfizer**, the US pharmaceutical company, which has the best product profile and broadest product line in the industry. 1998 and 1999 will see significant new product launches, including Viagra (for male erectile dysfunction), and Trovan (the first of a new class of antibiotics), which give us confidence in rapid earnings growth over the next five years.

We purchased **Wellman Inc.**, a specialty chemical manufacturer focused on polyester fibers and PET for plastic bottles. As shares trade at less than book value, we see Wellman as an undervalued stock. In the midst of a major capital expenditure program (funded entirely by internal cash flow) and at the bottom of the petrochemical cycle, Wellman has remained profitable. The company is poised for sharply accelerated earnings when the cycle turns.

We purchased **Kimberly-Clark de Mexico**, the Mexican subsidiary of the US-based Kimberly-Clark Corporation. The company is one of the prime beneficiaries of the recovery of the consumer segment of the Mexican economy, with operating leverage increased by the acquisition of a large competitor. It will use its strong cash flow to continue buying back its shares.

The turmoil of October gave us the opportunity to add to positions in companies where we felt the market was exacting too great a penalty for missing aggressive earnings targets. In the US, we added to **Allied Capital, Baxter, Boeing** and **Motorola**. We added to the Dutch publisher **Wolters Kluwer** after the announcement of its merger with rival Reed Elsevier caused its shares to falter. We think the combined company will generate double-digit earnings gains for the foreseeable future. In Asia, we added to positions in the companies that we feel are among the best in the region. Japan’s **Mitsubishi Corporation** is positioned to benefit from changes in the Japanese economy — when they come. We are encouraged by the company’s shift in focus from growth to

profitability, and see Mitsubishi as the bellwether for reform in Japan. **Hutchison Whampoa**, the Hong Kong conglomerate with interests in port facilities, telecommunications and property, continues to be, in our view, the best way to invest in growth in China. **Siam Cement**, whose shares suffered a 75% decline in dollars in 1997, will need to cut costs and grow exports to renew investors' faith. We believe the company will succeed.

We swapped shares in the Argentinean brewer **Quilmes**, switching from the non-voting US-listed shares to the voting Luxembourg shares, which are owned by the company's controlling family and trade at a lower price.

We purchased **US Treasury Notes** during the quarter, funded by the proceeds from sales of equities.

We sold long-time holding **Honda**, its stock having reached the lofty price target we had set for it. Notwithstanding the company's exemplary management and production capability, Honda remains a cyclical auto company; we believe such shares should be sold when their stars are shining brightest.

We also sold **Mitsubishi Heavy Industries**, whose prospects have turned bleak with the collapse of Asian capital equipment needs and the precipitous drop in infrastructure expenditures by the Japanese government. Management seems unwilling to confront the fact that the company must undertake a radical restructuring, starting with its high labor costs.

We cut back our holding in **Schlumberger**. Having appreciated over 60% in 1997 (after a gain of 44% in 1996), the holding had risen to an inordinately large proportion of the portfolio.

## INTERNATIONAL EQUITY PORTFOLIO

### Performance

The value of the portfolio fell 9.3% in the fourth quarter, with most of the loss coming in October. Over the three-month period, the passive benchmark, the FT World ex-US Index, fell by 8.6%, while the Lipper Index of large international mutual funds was down 7.6%. It was a terrible quarter for investors, especially in Asian markets, where the FT Pacific Basin Index fell by 22.2% in dollars. The financial crisis in South East Asia spread north, to Korea, and led to grave concern in the West that the combination of economic growth and low inflation that its stock markets have so enjoyed in the 1990's would be replaced by recession and outright deflation. The crisis also threatened to engulf other emerging markets, in Eastern Europe and in Latin America. The result has been an increase in the returns demanded by investors from debt and equity instruments of all issuers in developing markets.

For the year as a whole, the portfolio was down by 3.7%, behind both the passive benchmark (up 0.8%) and the Lipper Index (up 7.3%). In short, we had a poor year because our portfolio had too much exposure to Asia. This exposure was direct — we owned Asian companies — and indirect — we owned companies doing business in Asia. During the year we cut *direct* exposure sharply, by selling a number of holdings, in Hong Kong, Singapore, and Malaysia. The fact that the South East Asian companies we retained — superior by our usual criteria of growth prospects, financial strength, management quality and strength of business franchise — declined less than their respective markets provides no comfort in light of the absolute losses sustained.

We owned too many Asian companies, even after the sales; we also owned too many European multi-national companies with extensive Asian business, but did not sell any. Finally, our policy of not hedging foreign exchange exposure was costly in a year in which the US dollar rose sharply, not just against the crisis-hit currencies in Asia, but also against harder, European currencies.

### Annual Review

We seek to build diversified portfolios of reasonably-priced stocks in companies that can demonstrate sustainable growth in earnings and dividends over long periods of time. Specifically, we prize four fundamental attributes in a company:

**Growth** — we believe that wealth is created by the compounding of return over economic cycles, not by timing financial markets.

**Financial strength** — to enable a company to finance internally its growth opportunities, irrespective of the capital market environment.

**Strong management** — to identify and take advantage of opportunities, while defending existing business.

**Global competitiveness** — short hand for our view that the business environment is increasingly competitive, product prices are constantly under pressure, and high returns are the subject of competitive threats.

Companies with these fundamental attributes have provided good returns in the past. Why then did our portfolio companies fail to provide good returns in 1997? Were we mistaken about their attributes, or did our philosophy let us down? We were clearly mistaken about one key attribute — growth — of a number of companies, specifically those operating in the Asian countries subsequently engulfed in crisis. Their earnings, at least in the near term, will be much lower than we had expected. With respect to the other attributes, we think our judgements were broadly correct — or at least as correct as in other, more successful, years.

So, should we conclude that our philosophy let us down? With respect to this single year, the answer is, 'yes'. In 1997, *growth* and, possibly, *strong management*, were rewarded by stock markets, but *financial strength*, and *global competitiveness* were not. Financial strength was irrelevant, because capital, generally cheap and plentiful, made no distinction between weak and strong companies, though it did — in the final quarter of the year — distinguish between weak

and strong countries. Habitually under-achieving companies, including many newly-privatized, had no difficulty attracting investment on managements' flimsiest promises of future good behavior. Neither was global competitiveness rewarded last year; perversely, it was often punished. Many companies that operate on a global basis were well exposed to former growth markets turned frightening places, and fell from investors' favor.

We think that the value of these four fundamental attributes will be recognized again, in time. As spreading bankruptcies re-sensitize investors to differences in credit risk and capital access among companies, high financial quality will be valued once more; and, to fulfill their mission of creating shareholder value, companies cannot grow profits through margin improvement alone, and must seek profit growth through top line growth, most readily available in the faster-growing regions of the globe.

In Asia, we made sales during the year, but, with hindsight, not enough. The companies we retained are clearly the best in their industries, representing the cream of Asian industrial and financial companies. Our view that they would serve the portfolio well might have been correct had we experienced the slowdown from breakneck rates of economic growth that we expected, and not the meltdown in financial markets that actually occurred. In some cases, the companies we sold violated our quality criteria through being profligate with their capital. For example, **Singapore Press** refused to raise its dividend, preferring instead to speculate in property with the massive free cash from its publishing business. Sometimes the high stock prices of companies we sold could not be justified by their growth rates — as in the case of **Sime Darby**, the Malaysian regional conglomerate. It was clear to us at the time that some companies were becoming careless of the need to generate returns to the providers of capital. We sold holdings in those companies. What was not clear to us until after the event was that this was a generalized regional problem, and one that would lead to financial catastrophe.

During the year, we added to holdings in Japanese companies. This was a mistake. In other markets, such as Switzerland, or Germany, we profited by foreseeing the pressures for change in business culture that led to changes in business practices that are good for shareholders, such as better managerial incentives and the adoption of strict financial targets. In Japan, we saw the same pressures for change, and invested in companies in the forefront of change, but have been disappointed by the lack of real progress, and consequent poor investment returns. The pace of change has been slower than in Europe. The Japanese financial crisis in the fourth quarter has intensified the pressure, to the point where real change may shortly occur.

We sold a number of the Asian companies but did not sell the European and Japanese companies whose stock prices suffered as a result of their exposure to Asia. **Surveillance**, the Swiss inspection service company which bought back nearly 10% of its stock in the fourth quarter, still saw its stock price fall 16.7% in a market up by 44.7%; **Bayer**, the German chemical company, whose management has explicitly described its plans for growth in Asia, fell by 8.7%, despite a rise of 22.5% in the German stock market as a whole.

We were attracted to these companies because they fulfilled our fundamental criteria as outlined. We admire companies with the products and vision to seek opportunities in developing markets, at a time when the prospects for growth at home are less attractive. Stock prices of such European companies operating worldwide were punished for that last year, despite good local stock market returns.

### Outlook and Action

In the weakness in October we added to exposure to growth stocks, such as **Wolters Kluwer** and **Luxottica**, the Italian eyeglass manufacturer and retailer; to developing economies, by buying more **Kimberly-Clark**, the Mexican consumer products company, and **Hutchison Whampoa**, Hong Kong's leading conglomerate; and to European restructuring, by adding a holding in **Allianz**, the

German insurance giant, which epitomizes financial strength and is at the heart of the changes in corporate culture in Germany, and continental Europe.

Our core beliefs about Asia and its prospects are intact. These are that high levels of education, an entrepreneurial and flexible work ethic, and a high savings rate are sufficient to ensure that, in the long term, economic growth rates will be higher than those of other economies. By this we mean, not just of other *developed* economies, but of other *developing* economies as well. Unusually, among the various emerging market crises that have rocked financial markets periodically in the last twenty years, this crisis in Asia is not the result of excessive consumption and profligate Governments. Rather it is about too much capital, profligate companies and too much investment! In a world where capital will be less freely available, domestic availability will be a key advantage.

Corporate profligacy came about, not just because providers of capital were careless about ensuring appropriate returns, but also because governments, through fixed exchange rates, underwrote foreign exchange risks, obscuring companies' real cost of capital in local currency. The collapse of regional currencies has two important effects. First, of course, the collapse makes the economies remarkably competitive — **Siam Cement** told us in November that they had just shipped their first steel to the United Kingdom, home of one of the world's most efficient steel industries! Lower costs, and, now, huge excess capacity, have encouraged bond markets in the West, which see that cheap manufactured goods from the East will keep overall consumer price increases modest. The restoration of Asian competitiveness, however brutal the means, has provided the final piece of evidence for the proponents of 'Ice' — the theory that erosion of pricing power and heightened levels of global competition will increasingly act together to erode corporate profitability. Second, the collapse in Asian currencies provides a measurable and realistic cost of capital for Asian companies — and the cost of debt is considerably higher than it was when borrowings in US Dollars financed investments in Baht, Rupiah, or Ringgits. The cost of equity has also risen, as investors are

now demanding more return from the companies to which they entrust their capital.

We expect that Asia's governments will play a smaller role in capital allocation than in the past. Policy makers in South Korea, Japan, and Malaysia are beginning to realize that the decision-making nexus of bureaucracy, business, politics and corruption is discredited and broken. The environment will increasingly be open and competitive, one in which the best companies prosper and the bad ones decline, or fail.

We own the best, and will actively be seeking more such companies in countries that have shown they are willing to make changes. We are confident that companies such as **DBS Bank** in Singapore, **Hutchison Whampoa** and **Johnson Electric** in Hong Kong, and **Siam Cement** in Thailand will be the companies that have the financial strength, products, and management to take advantage of the new environment. Countries are beginning to change, even if the embrace of that change is not yet whole hearted. The Thais have allowed 56 — out of a total of 58 — finance companies to go bankrupt, and foreigners to own pieces of their financial system. In Japan, the government is turning away from excessive fiscal prudence. The Singaporeans, whose regulatory environment has saved them from the disasters seen elsewhere in the region, are beginning to talk both of 'regulation with a lighter touch', and of ways to make their corporate sector more competitive. It was encouraging to meet, in November, an official from government-controlled DBS Bank who relished the opportunity for his company to 'show all' about its balance sheet and earnings once its competitors were also forced to do so.

We will also be looking at high-quality companies in Western markets whose share prices have suffered solely because of their Asian exposure. We still believe that, in the long run, companies must seek opportunity globally if they are to maintain rates of revenue growth. Finally, we will seek opportunities that arose from the sharp price declines in other emerging markets, as a result of the Asian crisis.

In our European holdings, we expect modest potential portfolio changes, but not wholesale ones. We own companies that are global and at the forefront of the changing business culture. The road to European Monetary Union may not be entirely smooth, but at the end of it lies a more open, less regulated and more competitive marketplace. As in Asia, the best companies, which are those willing to embrace change, will prosper under these circumstances.

## Conclusion

It has been a bad year for international investing, especially relative to the US market, and a worse one for the stocks we favour. We believe the case for investing internationally is, however, even stronger than it was before. Not only have relative prices changed, as the US stock market has continued its remarkable bull run, but the events of 1997 proved that the world's economies, and hence stock markets, still do not move in harmonious synchronicity that some have predicted. Therein lies the opportunity for portfolio diversification, and to buy stocks of good companies at good prices.

The portfolio is positioned today so that it comprises companies that:

can generate stable and predictable rates of growth — **Wolters Kluwer, Rentokil, Nestle, Novartis**;

are large industry leaders — **Daimler Benz, Canon, Michelin, Royal Dutch, Rio Tinto**;

have great financial strength — **Allianz, DBS Bank, Deutsche Bank, Tokio Marine & Fire**;

have rare pricing power (**Luxottica**), a highly defensible franchise (**Railtrack**), or a commitment to generating strong shareholder returns from commonplace businesses (**Johnson Electric**).

## Activity

We sold shares in two companies, bought four and added to another four. New holdings were:

**Allianz**, the largest German insurance company, and one of the largest in the world. Allianz offers exposure to a broad range of German industry through its investment portfolio, which is increasingly actively managed to achieve higher returns for Allianz's own shareholders. In its insurance business, Allianz will endeavor to maintain its leading position in an ever more competitive domestic environment, whilst taking the fight overseas, looking to improve international margins and improve its distribution capability, while enhancing the returns on its investments. Allianz is at the center of the movement in Germany to refocus on shareholder value, and will emerge in an enhanced position in the global insurance industry;

**Glaxo Wellcome**, the British pharmaceutical giant. Glaxo has the best new product/patent vulnerability profile in the pharmaceutical industry. Glaxo should have 12 to 15 products introduced between 1996 and 2000, each with potential peak annual sales of over \$500 million. We have a high degree of confidence in annual earnings growth of 13-14% from 1998 to 2002. Double-digit sales growth should start in the second half of 1998 and continue through 2001, and operating margins will grow to 37-38% by 2000;

**Kimberly-Clark de Mexico**, the Mexican subsidiary of the US-based Kimberly-Clark Corporation. It is a high-quality consumer company with a demonstrated ability to capitalize on the growth opportunities in Mexico. The company's four most important business product categories are disposable diapers, bathroom tissue, notebooks, and coated-free sheet paper for business writing and printing papers. Kimberly-Clark is the market leader in every product category in which it competes. Kimberly will continue to capitalize on its superior manufacturing technology, strong financial position, superior expense control procedures, dominant market shares, and the strength and growth of its major distributors;

**Luxottica**, the world's largest and lowest cost producer of high quality eyeglass and sunglass frames. The firm controls all aspects of product design, manufacture and distribution. Luxottica

also owns US-based LensCrafters, the largest optical retail chain in the world. Demand for high-quality eyewear is expected to grow by 10% per annum driven by changing demographic and life style trends (aging population, use of computers, increasing fashion element in eyewear) coupled with increased demand from emerging economies. Luxottica's earnings should grow significantly faster than the industry as the company leverages its vertically integrated structure to increase global market share at the expense of less efficient competitors.

We added to holdings in Hong Kong conglomerate **Hutchison Whampoa**; in Japan, to water treatment company **Kurita**, and conglomerate **Mitsubishi Corporation**; and to Dutch publishing company **Wolters Kluwer**. We also completed a portion of a swap of **Rio Tinto** for its affiliate **Rio Tinto Ltd. (Australia)** whose underlying assets are essentially the same.

We sold:

**Honda Motor**, whose share price rise reflects its emergence as Japan's number two automobile company, but not the increased risks to growth in its Asian motor cycle business; and

**Norsk Hydro**, whose share price rose as the company has successfully implemented its cost-cutting campaign, and no longer reflected the cyclical risks to its commodity chemical businesses.

## MULTI-ASSET GLOBAL PORTFOLIO

### Performance

The portfolio fell 0.6% in the fourth quarter, ahead of the constructed benchmark (60% FT World Index and 40% Salomon World Government Bond Index) which fell 1.6%, and the Lipper Global Flexible Fund Index, which fell 2.4%. For the year as a whole, the portfolio rose 13.2%, ahead of the constructed passive index, up 9.4%, and in line with the same Lipper index, which rose 12.1%.

Bonds in the portfolio rose 1.6% in the quarter, and rose 8.8% for the year as a whole, good returns compared with the 0.2% annual return of the Salomon World Government Bond Index, 9.7% for the more familiar Lehman Aggregate (US) Bond Index, and the 3.4% return of the Lipper Global Income Fund Index.

Equities in the portfolio fell 2.0% in the quarter, but returned 15.3% for the year as a whole, just behind the FT World Equity Index, which returned 15.4%, and ahead of the Lipper Global Equity Fund Index, which rose 14.0%. US stocks in the portfolio returned 37.9% for the year, ahead even of the pacesetter S&P 500 index return of 33.3%

### Review

The year has been characterized by some of the most unusually divergent market performance in recent memory, in spite of positive economic growth and moderate inflation in almost every country. The US economy continues to lead the industrialized countries with strong growth, while developing countries grew even faster. Inflation has been tamed almost everywhere, falling to around two percent in the US and most of Europe. Even Brazil managed to achieve an annual inflation in single digits last year. Securities prices and exchange rates are a different story; they had nowhere near such uniformity. The US dollar rose against almost every currency in the world this year, against some by huge proportions. The Yen fell by 8%, the Deutschmark by 14%, but the British Pound by only 4%; the Thai Baht declined by 30% and the Mexican Peso by a mere 3%. The S&P 500 index rose by 33%, the German market

by 23%, but the Japanese stock market fell by 26%; the Brazilian market rose by 45%, but the Malaysian market fell by 72% (all measured in dollars). US bonds returned 9.7%, and Latin American Brady bonds 15%, but the strength of the dollar meant that a portfolio of AAA government bonds outside the US, if not hedged against currency risk, *lost* 3.5% in the year.

The divergence was not randomly spread, but was in fact regional: Asian markets performed horribly. Thailand's stock market index fell by 79% in dollar terms, Malaysia's by 72%, Singapore's by 46%, Hong Kong's by 27%, Japan's by 26%, and even isolated Australia's market fell by 6%. The 'Asian miracle' came unglued, at least in its manifestation of fixed or managed exchange rates, which encouraged the accumulation of foreign currency debt to fund the rapid expansion of the region's capital stock. Beginning in Thailand, stock markets and currencies collapsed across the region, as market participants struggled to preserve their capital in markets where reflexive buying in all price corrections had for years been rewarded. Japan's situation, as the developed market 'sponsor' to the region, was more complex, as its economy is still struggling to recover from the asset deflation and consequent banking crisis that is the legacy of its 1980's bubble. The net result, however, was similar, if more muted: a weaker currency, and lower stock prices. The difference was that Japan's abundant stock of savings fled to the highest credit quality securities, the safe havens of government bonds and cash, creating the lowest interest rates in the world. Other Asian economies, normally quite robust, adopted high, investment-crushing domestic interest rates in order to entice capital back into their economies.

The dampening of inflation everywhere provided a very positive backdrop for long-term interest rates, and resulted in rising prices of long-dated government bonds and a collapse in the price of gold. The turmoil in Asia, with its ripple effects around the rest of the developing world, meant that credit spreads began to widen for the first time since 1994. As a consequence, all bonds did not follow the lead of the government bellwethers. Emerging market debt, while turning in very good performance for the year overall, performed

poorly in the fourth quarter, declining 12% in the month of October. Our preference for US dollar-denominated debt, and for AAA credit quality, meant that our fixed income holdings benefited from the two strongest forces at work in global bond markets: the rising dollar and the flight to quality. The non-US fixed income holdings returned 15.7% for the year, due to their unusual skew towards emerging market debt.

Still, we sold our holding in **South African 12% Gilts** in December, judging them to have held up extremely well in the emerging debt market carnage of October, while being vulnerable to the risk of further currency declines among countries who need to fund balance of payments deficits. As a result, recalling our third quarter sale of **Argentine Brady bonds**, the portfolio currently has no emerging market debt exposure. We expect that the coming months will provide attractive opportunities in that sector.

## Outlook

It is only a few years ago that we were writing about another regional currency crisis (in Europe), another group of emerging markets that had collapsed due to policy mismanagement (in Latin America), and about the banking crisis in Japan. Since that period, '93-'94, markets have performed extremely well, as European Monetary Union got back on track and interest rates did indeed converge, as the US economy, using the tools of NAFTA, dragged Mexico and the rest of Latin America back to growth and as Japanese banks managed to muddle through, with the connivance of their regulators. Are we presently poised for a replay, with a different cast of characters? We think not. First, unlike Latin nations, the developing Asian nations currently in turmoil don't have a wealthy and vibrant neighbor like the US to spur their economies. Their former patron Japan, and newly-wealthy neighbor China, are both driven by their own growth imperatives, and will compete fiercely against them in world markets for manufactured goods. Second, there is no overarching political will that can contemplate making the economic sacrifices required to stabilize currencies for the 'greater good.' Third, Japan's banking crisis seems to be coming to a

head, having failed to recover under the 'Greenspan Cure', a combination of time and a steep yield curve, because the low overall level of interest rates in Japan has rendered half of that therapy—a wide spread between deposit rates and lending rates—virtually impossible to achieve.

Consequently, we are concerned that Asian markets will not recover as quickly as Latin markets did after the Fed tightening in 1994 sent developing markets reeling, capped by the Mexican devaluation. On the contrary, we are concerned about the potential economic effects on developed countries from the Asian crisis, such as a further intensification of price competition in manufactured goods, as Asia's debt deflation is exported to the West, and the consequent effects on corporate profit growth and inflation in industrialized countries. The rise of volatility and divergence in world markets generally has come at a time when there has been very little risk priced into markets; credit spreads had been extremely tight in debt markets, and equity valuations very high. Our response has been gradually to move the portfolio in a conservative direction over the course of the year. The percentage of assets devoted to equities has been reduced, and now stands at 62%, with bonds at 34% and cash at 4%. Furthermore, the allocations to more risky markets has fallen, both through action—we made specific sales—and from purposeful inaction—we have refrained from adding to investments that have fallen markedly. Investments in all of Asia, including Japan, now represent less than a tenth of the portfolio. We regard bonds as offering competitive long-term returns to equities at current levels and valuations. We do not envision a shift back towards equities until a higher return premium incorporated in stock valuations entices us to accept the higher risks involved.

If one potential outcome of the debt deflation in Asia is still lower inflation in the West, then secure investment income will be at a premium, especially for foundations with defined spending fractions. We have made a noticeable change within the fixed income holdings over the year by adding more fixed-rate, long-dated bonds. In this quarter we added two new bonds that have very long maturities. **USWest**, the baby Bell telephone

operator, had issued a curiously structured bond, with a 40 year maturity, but granting the investor the right to put the bonds back to the company in 2004. We look at this security inside out: as a note maturing in six years, but with an option to keep it for forty years. This option is highly valuable insurance against a deflationary scenario, wherein fixed coupon returns would be one of the few reliable sources of investment income. We sold our shares in USWest to fund the purchase of these bonds. We also bought another unique security in the **UK 4% Consols** (undated). These government bonds, with a current yield of 6.6%, actually never mature. They are the product of a consolidation (hence the name ‘consols’) of War Loans that the British Government had issued during the Great (First World) War. We are big fans of Mr. Edward (‘Steady Eddie’) George, Governor of the Bank of England. We have applauded his early moves to raise interest rates to head off any resurgence in inflation as the UK economy continues to recover strongly from its slump of the early 90’s. These two additions, along with further purchases of **ten year US Treasuries**, has appreciably extended the average maturity of the fixed income holdings.

The Asian turmoil has done nothing to encourage us as far as equity market valuations are concerned—especially US valuations. Although lower interest rates support higher stock prices, the potential risks for corporate earnings growth are large. Asian manufacturers desperate to meet their debt payments will be competing on price with producers in domestic markets, and in third markets where both compete as exporters. The devaluations in the region will have three effects: Asian exports will carry huge price advantages; US, European, and Japanese companies whose growth lay in producing the capital investment goods that was propelling these economies’ growth will no longer be favored suppliers; and the high interest rates that have accompanied the devaluations will cause much slower economic growth, slowing the expansion of multinational consumer product companies’ sales in these countries, an expansion that is anticipated by these companies’ valuations. With US companies at the forefront of this global expansion, it is unlikely that

they—whose valuations have been stretched still further by this year’s stock price performance—will escape these effects. The US companies in the portfolio returned 37.9% for the year. Because of their positive relative performance, US companies still make up just under a third of the total portfolio.

We continue to prune the equity holdings in an attempt to keep only those companies most able to deliver the demanding earnings growth implied by the stock prices. We sold both **Honda Motors** (with a large gain) and **Mitsubishi Heavy Industries** (at a large loss) in the fourth quarter. Not only are they both exposed to Japan’s economy, which continues to disappoint, but both are also heavily involved in the economies of developing Asia, where Honda is the largest seller of motorcycles, and MHI is a large supplier of power generation and other capital equipment. We sold several US companies earlier in the year—such as **AMP, Cummins Engine**, and **EDS**—which did not deliver the earnings growth that we expected. Mid year, we sold **HSBC** and **Sime Darby** because their prices did not reflect the growing risks of doing business in the Asian region, and **Keppel** because its management was unable to hide its apparent disdain for the needs of shareholders. By and large, the proceeds from these sales went to purchase additional bonds.

### Activity

We sold three companies in the quarter, and reduced holdings in another. We bought only one new company, and added to five existing companies. Significant bond transactions have already been discussed.

We sold:

**Honda Motors**, which has reached the temporary end of a highly successful series of innovative model introductions that allowed it to prosper in the dormant Japanese consumer economy and in international auto markets as well. Its very profitable motorcycle business is heavily skewed to South East Asian demand, and its share price did not, in our view, reflect the heightened risks to its profits;

**Mitsubishi Heavy Industries**, whose power generation business, while highly competitive, will be impacted by the fiscal and monetary pressures facing its customers, often government agencies or regulated monopolies in Japan and the rest of Asia, as well as by the currency advantages of some of its competitors. Other of its businesses, shipbuilding and heavy equipment, face an equally difficult future. Its aerospace and defense businesses are just not large enough to carry the valuation of the company; and

**US West Communications**, the regional Bell Telephone operator, whose shares had appreciated from the low 30's to the low 40's, and which we used to fund the purchase of the **US West 6.95% (putable) Debentures, due 2037**.

We also reduced holdings in **Schlumberger**, for price reasons.

We bought:

**Wolters Kluwer**, which, after its proposed merger with Reed-Elsevier, will be the world's largest publisher of professional tax, legal, scientific, and medical journals. The 'need to know' content of these publications, combined with the company's early determination to deliver them both in print and electronically to suit their customers' desires, make this a franchise with highly visible and predictable earnings growth. Strong cash flow generation allows the company to acquire niche publishers, augmenting that growth. This is a premier European growth company, deserving of its premium valuation, which we were able to buy at an attractive price in the October market decline.

We also added to existing holdings of **Allied Capital, Boeing, Mitsubishi Corporation** (the Japanese trading company), **Motorola**, and **Siam Cement**.

## GLOBAL EQUITY HOLDINGS

as of December 31, 1997

Company	Country	Weight	Description
Allied Capital	US	4.4%	Financial institution making equity linked loans to small businesses
Fannie Mae	US	4.3%	Government-sponsored agency that buys & repackages mortgages
Schlumberger	US	4.1%	Premier supplier of technical services & equipment to the petroleum industry
Royal Dutch ADR	NETH	4.0%	Premier oil company operating worldwide
Dover	US	3.9%	Diversified capital goods manufacturer
Thermo Electron	US	3.3%	World leader in environmental monitoring, analysis instruments & biomedical products
Deutsche Bank	GER	3.0%	One of Europe's premier universal banks
Investor	SWE	2.9%	Holding company for Wallenberg family interests in Swedish industrial concerns
Hutchison Whampoa	HK	2.9%	Conglomerate involved in container terminals, housing, energy, telecoms, & retailing
Surveillance	SWITZ	2.8%	Worldwide provider of trade certification, testing & loss adjustment services
Exxon	US	2.7%	Premier global oil company
ABB	SWITZ	2.7%	Leading worldwide capital goods company with focus on power generation
Colgate	US	2.6%	Leading global consumer products company
Baxter International	US	2.6%	Leading medical products supplier focused on: renal, biotech, cardio, & intravenous systems
Wolters Kluwer	NETH	2.6%	Dutch publisher of legal, tax, medical & business information
Wrigley, Wm. Jr.	US	2.6%	World's largest producer of chewing gum
Pfizer	US	2.5%	US Pharmaceutical, medical equipment, veterinary, specialty chemicals & toiletries company
Rentokil Initial	UK	2.4%	Provider of wide range of services to commercial sector
Gaz et Eaux	FRA	2.4%	Investment company in Lazard Group, holding strategic stakes in major listed companies
Nestlé	SWITZ	2.4%	World's largest food company
Mitsubishi Corp	JAP	2.2%	One of Japan's leading trading companies
Daimler-Benz	GER	2.2%	One of Europe's largest industrial concerns
Johnson Electric	HK	2.2%	Manufacturer of small precision motors used in cars & consumer products
Allied Signal	US	2.1%	Aerospace, auto, chemical & fibre manufacturing company
Deere & Co	US	2.1%	World's leading producer of farm equipment
Motorola	US	2.1%	Electronics company producing semiconductors, communications equipment & computers
Boeing	US	2.1%	World's largest manufacturer of jet aircraft, & America's largest exporter
Rio Tinto	UK	1.9%	One of world's largest & most diversified mining companies
Bayer	GER	1.9%	World's fourth-largest chemicals company & tenth-largest pharmaceuticals company
Canon	JAP	1.8%	World's leading producer of wide range of visual image & information equipment
Partner Re	BERM	1.5%	Bermuda's most strongly capitalized property reinsurer
Railtrack	UK	1.4%	Owner of UK's railway infrastructure
Airgas	US	1.3%	Largest independent distributor of industrial, medical & specialty gases in the US
Kimberly-Clark Mex.	MEX	1.1%	Mexican subsidiary of US-based Kimberly-Clark Corporation
Libsil	S AFR	1.0%	Holding company with investments in South African Breweries & Standard Bank
Quilmes	ARG	1.0%	Leading producer of beer & soft drinks in Latin America
Wellman	US	0.9%	Producer of chemical-based polyester fiber & fibers for recycled plastics
Hirose Electric	JAP	0.8%	Leading Japanese manufacturer of electrical connectors & components
Bangkok Bank	THAI	0.8%	Thailand's largest & strongest bank
Nestlé Malaysia	MAL	0.7%	Importer & manufacturer of branded food products such as coffee, cereals & candy
Atlantis Japan	JAP	0.7%	Closed-end fund invested in smaller Japanese companies
Wisconsin Central	US	0.7%	Railroad operator in US & overseas
Union Pacific Resources	US	0.7%	Domestic oil & gas exploration & production company
Siam Cement	THAI	0.4%	Thailand's largest industrial group
Scania	SWE	0.0%	World class heavy-duty truck & bus manufacturer

## GLOBAL EQUITY COMPOSITE PERFORMANCE SUMMARY

as of December 31, 1997

	Annualized Returns for Trailing Periods (%)				Volatility
	1 Year	3 Years	5 Years	Since Inception*	Annual Standard Deviation (%)
<b>HLM Global Equity Composite</b>	<b>11.0</b>	<b>15.7</b>	<b>14.0</b>	<b>14.4</b>	<b>11.6</b>
<i>Financial Times World Index</i>	15.4	16.0	15.2	8.8	14.2
<i>Morgan Stanley Capital International World Index</i>	16.2	17.1	15.9	9.2	13.8
<i>Lipper Global Fund Index</i>	14.0	15.0	14.6	10.5	12.3

\*Inception Date: 11/30/89

	Calendar Year Returns (%)							
	1997	1996	1995	1994	1993	1992	1991	1990
<b>HLM Global Equity Composite</b>	<b>11.0</b>	<b>17.4</b>	<b>19.0</b>	<b>-0.1</b>	<b>24.2</b>	<b>9.1</b>	<b>31.6</b>	<b>3.6</b>
<i>Financial Times World Index</i>	15.4	13.2	19.6	5.9	22.6	-5.1	19.6	-17.0
<i>Morgan Stanley Capital International World Index</i>	16.2	14.0	21.3	5.6	23.1	-4.7	18.7	-16.4
<i>Lipper Global Fund Index</i>	14.0	16.3	14.0	-2.2	32.8	0.1	20.3	-9.1

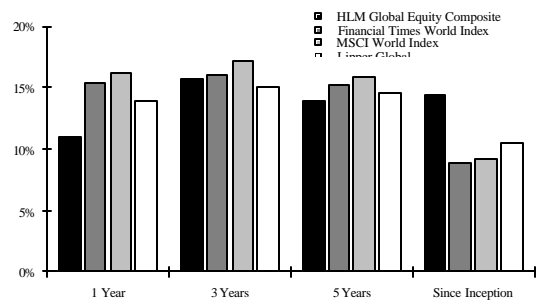
	Composite Information								
	1997	1996	1995	1994	1993	1992	1991	1990	1989
Number of accounts included in the composite	15	13	13	17	17	14	7	†	†
Total market value of accounts included in composite (\$M)	\$249.3	\$188.0	\$147.1	\$112.7	\$93.2	\$64.5	\$36.6	\$15.3	\$1.6
% of total firm assets represented by composite	16.3%	15.0%	23.4%	30.7%	38.2%	32.9%	20.0%	23.0%	5.5%
Internal dispersion: standard deviation of calendar year returns	1.6%	0.8%	2.1%	1.4%	6.8%	3.5%	5.8%	†	†

† Five or fewer accounts

### NOTES :

- Composite includes all fee-paying global equity accounts under discretionary management, including accounts no longer in existence. Accounts are included from the first full month following the date on which the account is deemed to be fully invested.
- Returns shown are time-weighted total returns in US\$, and reflect reinvestment of dividends and interest. Returns are weighted by account size in the composite.
- All cash equivalents, bonds and/or convertible securities used in place of equities are included in return calculations.
- Composite returns are presented after brokerage commissions but before management and custodial fees and foreign withholding taxes. Management fees are described in our Form ADV Part II. Inclusion of standard management fees would reduce composite returns by approximately 1.0% per annum.
- Returns of all indices (except Lipper) are presented before foreign withholding taxes, and do not reflect commissions or fees that would be incurred by an investor in the index portfolios. Lipper Index returns are reported after all fees and expenses.
- Annual standard deviations of returns (volatility) is estimated from monthly returns using a continuous return model to derive annual periodic standard deviation.
- A complete list and description of the firm's composites is available upon request.

**Annualized Returns for Trailing Periods (%)**



**INTERNATIONAL EQUITY HOLDINGS**  
as of December 31, 1997

Company	Country	Weight	Description
Royal Dutch ADR	NETH	4.4%	Premier oil company operating worldwide
Investor	SWE	4.2%	Holding company for Wallenberg family interests in Swedish industrial concerns
Nestlé	SWITZ	4.1%	World's largest food company
Rentokil Initial	UK	4.1%	Provider of wide range of services to commercial sector
Deutsche Bank	GER	4.0%	One of Europe's premier universal banks
ABB	SWITZ	3.8%	Leading worldwide capital goods company with focus on power generation
Bankinter	SPA	3.7%	High quality Spanish bank concentrating on services to individuals & small businesses
Hutchison Whampoa	HK	3.4%	Conglomerate involved in container terminals, housing, energy, telecoms, & retailing
Wolters Kluwer	NETH	3.2%	Dutch publisher of legal, tax, medical, & business information
Bayer	GER	3.1%	World's fourth largest chemicals company & tenth largest pharmaceuticals company
Surveillance	SWITZ	3.0%	Worldwide provider of trade certification, testing & loss adjustment services
Michelin	FRA	3.0%	World's largest & most innovative tire manufacturer
Novartis	SWITZ	2.9%	Swiss multinational pharmaceutical & specialty chemicals company
Imperial Oil	CAN	2.9%	Canada's largest integrated petroleum company
Canon	JAP	2.9%	World's leading producer of wide range of visual image & information equipment
Railtrack	UK	2.8%	Owner of UK's railway infrastructure
Rio Tinto	UK	2.5%	One of world's largest & most diversified mining companies
Johnson Electric	HK	2.4%	Manufacturer of small precision motors used in cars & consumer products
Glaxo Wellcome	UK	2.4%	Global manufacturer & purveyor of pharmaceuticals
Daimler-Benz	GER	2.3%	One of Europe's largest industrial concerns
Kimberly-Clark Mex.	MEX	2.3%	Mexican subsidiary of US-based Kimberly-Clark Corporation
Gaz et Eaux	FRA	2.3%	Investment company in Lazard Group, holding strategic stakes in major listed companies
ING	NETH	2.3%	Global financial service group with strong emerging market exposure
Denso	JAP	2.2%	Global manufacturer of auto parts for Toyota & other leading car makers
DBS Bank	SING	2.1%	Singapore's largest & most diversified bank
IHC Caland	NETH	1.9%	World's premier manufacturer of dredging vessels & mooring equipment
Hirose Electric	JAP	1.9%	Leading Japanese manufacturer of electrical connectors & components
Libsil	S AFR	1.9%	Holding company with investments in South African Breweries & Standard Bank
Mitsubishi Corp	JAP	1.9%	One of Japan's leading trading companies
Mitsubishi Heavy	JAP	1.8%	Leader of the industrial segment of the Mitsubishi group
Partner Re	BERM	1.6%	Bermuda's most strongly capitalized property reinsurer
Kurita Water	JAP	1.2%	Large manufacturer of water treatment equipment & specialty chemicals in Japan
Quilmes	ARG	1.1%	Leading producer of beer & soft drinks in Latin America
Luxottica	ITA	1.1%	World's largest & lowest cost producer of high-quality eyeglass & sunglass frames
Tokio Marine & Fire	JAP	1.0%	Largest & best capitalised non-life insurer in Japan
Bangkok Bank	THAI	0.9%	Thailand's largest & strongest bank
Keppel FELS	SING	0.8%	Leading contractor for offshore oil & power businesses
Nestlé Malaysia	MAL	0.8%	Importer & manufacturer of branded food products such as coffee, cereals & candy
Atlantis Japan	JAP	0.7%	Closed-end fund invested in smaller Japanese companies
Allianz	GER	0.6%	One of world's leading general insurance companies
Siam Cement	THAI	0.6%	Thailand's largest industrial group
Acer Computer	SING	0.2%	Distribution arm of Taiwan's Acer Inc., for sales, marketing & technical service of PCs

## INTERNATIONAL EQUITY COMPOSITE PERFORMANCE SUMMARY

as of December 31, 1997

	Annualized Returns for Trailing Periods (%)				Volatility
	1 Year	3 Years	5 Years	Since Inception*	Annual Standard Deviation (%)
<b>HLM International Equity Composite</b>	<b>-3.7</b>	<b>8.4</b>	<b>13.8</b>	<b>10.9</b>	<b>13.2</b>
<i>Financial Times World ex-US Index</i>	0.8	5.8	11.2	3.7	18.3
<i>Morgan Stanley Capital International EAFE Index</i>	2.6	7.1	11.9	4.4	18.2
<i>Lipper International Fund Index</i>	7.3	10.5	13.3	7.8	13.4

\*Inception Date: 9/30/89

	Calendar Year Returns (%)							
	1997	1996	1995	1994	1993	1992	1991	1990
<b>HLM International Equity Composite</b>	<b>-3.7</b>	<b>17.0</b>	<b>13.2</b>	<b>2.5</b>	<b>46.3</b>	<b>9.9</b>	<b>21.9</b>	<b>-12.9</b>
<i>Financial Times World ex-US Index</i>	0.8	6.5	10.4	8.4	32.1	-13.1	13.3	-23.1
<i>Morgan Stanley Capital International EAFE Index</i>	2.6	6.4	11.6	8.1	32.9	-11.9	12.5	-23.2
<i>Lipper International Fund Index</i>	7.3	14.4	9.3	-0.9	39.2	-4.3	13.2	-12.4

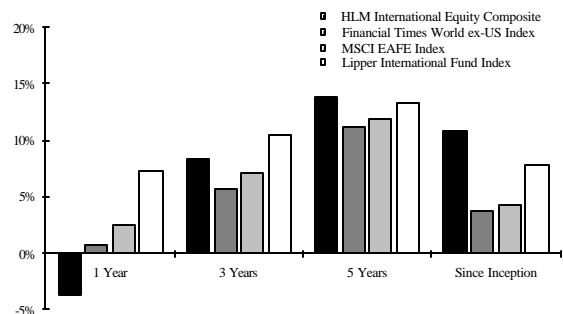
	Composite Information									
	1997	1996	1995	1994	1993	1992	1991	1990	1989	
Number of accounts included in the composite	71	54	26	14	†	†	†	†	†	
Total market value of accounts included in composite (\$M)	\$1073.3	\$882.2	\$347.1	\$110.4	\$23.0	\$12.1	\$6.7	\$10.6	\$10.9	
% of total firm assets represented by composite	70.2%	70.3%	55.3%	30.1%	9.4%	6.2%	3.7%	15.9%	37.8%	
Internal dispersion: standard deviation of calendar year returns	0.7%	1.2%	1.9%	1.7%	†	†	†	†	†	

† Five or fewer accounts

### NOTES:

- Composite includes all fee-paying international (non-US) equity accounts under discretionary management, including accounts no longer in existence. Accounts are included from the first full month following the date on which the account is deemed to be fully invested.
- Returns shown are time-weighted total returns in US\$, and reflect reinvestment of dividends and interest. Returns are weighted by account size in the composite.
- All cash equivalents, bonds and/or convertible securities used in place of equities are included in return calculations.
- Composite returns are presented after brokerage commissions but before management and custodial fees and foreign withholding taxes. Management fees are described in our Form ADV Part II. Inclusion of standard management fees would reduce composite returns by approximately 1.0% per annum.
- Returns of all indices (except Lipper) are presented before foreign withholding taxes, and do not reflect commissions or fees that would be incurred by an investor in the index portfolios. Lipper Index returns are reported after all fees and expenses.
- Annual standard deviations of returns (volatility) is estimated from monthly returns using a continuous return model to derive annual periodic standard deviation.
- A complete list and description of the firm's composites is available upon request.

**Annualized Returns for Trailing Periods (%)**



## MULTI-ASSET GLOBAL - EQUITY HOLDINGS

as of December 31, 1997

Company	Country	Weight	Description
Exxon	US	3.3%	Premier global oil company
Dover	US	3.2%	Diversified capital goods manufacturer
Fannie Mae	US	3.2%	Government-sponsored agency that buys & repackages mortgages
Royal Dutch ADR	NETH	3.2%	Premier oil company operating worldwide
Deutsche Bank	GER	3.0%	One of Europe's premier universal banks
Investor	SWE	2.9%	Holding company for Wallenberg family interests in Swedish industrial concerns
Colgate	US	2.8%	Leading global consumer products company
Nestlé	SWITZ	2.7%	World's largest food company
Thermo Electron	US	2.4%	World leader in environmental monitoring, analysis instruments & biomedical products
Allied Capital	US	2.3%	Financial institution making equity linked loans to small businesses
ABB	SWITZ	2.2%	Leading worldwide capital goods company with focus on power generation
Johnson & Johnson	US	2.1%	Leading consumer healthcare and pharmaceutical company
Boeing	US	2.0%	World's largest manufacturer of jet aircraft, & America's largest exporter
Gaz et Eaux	FRA	2.0%	Investment company in Lazard Group, holding strategic stakes in major listed companies
Surveillance	SWITZ	2.0%	Worldwide provider of trade certification, testing & loss adjustment services
Hutchison Whampoa	HK	1.8%	Conglomerate involved in container terminals, housing, energy, telecoms, & retailing
Schlumberger	US	1.8%	Premier supplier of technical services and equipment to the petroleum industry
Mitsubishi Corp	JAP	1.8%	One of Japan's leading trading companies
Royce Micro-Cap Fund	US	1.7%	Closed end investment fund focused on very small companies
Bayer	GER	1.7%	World's fourth-largest chemicals company and tenth-largest pharmaceuticals company
Rentokil Initial	UK	1.6%	Provider of wide range of services to commercial sector
Rio Tinto	UK	1.6%	One of world's largest & most diversified mining companies
Deere & Co	US	1.6%	World's leading producer of farm equipment
Dairy Farm	SING	1.4%	Asian food retailer with main operations in Hong Kong, Australia, Taiwan, & Singapore
Wrigley, Wm. Jr.	US	1.2%	World's largest producer of chewing gum
Canon	JAP	1.1%	World's leading producer of wide range of visual image & information equipment
Wolters Kluwer	NETH	1.0%	Dutch publisher of legal, tax, medical & business information
Motorola	US	1.0%	Electronics company producing semiconductors, communications equipment & computers
Michelin	FRA	0.9%	World's largest & most innovative tire manufacturer
Wisconsin Central	US	0.7%	Railroad operator in US and overseas
Keppel FELS	SING	0.7%	Leading contractor for offshore oil & power businesses
Bangkok Bank	THAI	0.6%	Thailand's largest & strongest bank
Atlantis Japan	JAP	0.5%	Closed-end fund invested in smaller Japanese companies
Siam Cement	THAI	0.3%	Thailand's largest industrial group
Scania	SWE	0.0%	World class heavy-duty truck & bus manufacturer

## MULTI-ASSET GLOBAL COMPOSITE PERFORMANCE SUMMARY

as of December 31, 1997

	Annualized Returns for Trailing Periods (%)				Volatility
	1 Year	3 Years	5 Years	Since Inception*	Annual Standard Deviation (%)
<b>HLM Multi-Asset Global Composite</b>	<b>13.2</b>	<b>17.5</b>	<b>15.7</b>	<b>14.1</b>	<b>9.3</b>
<i>60/40 Global Balanced Index**</i>	<i>9.4</i>	<i>12.8</i>	<i>12.2</i>	<i>9.2</i>	<i>10.1</i>
<i>Lipper Global Flexible Fund Index***</i>	<i>12.2</i>	<i>14.7</i>	<i>12.1</i>	<i>9.2</i>	<i>7.5</i>

	Calendar Year Returns (%)							
	1997	1996	1995	1994	1993	1992	1991	1990
<b>HLM Multi-Asset Global Composite</b>	<b>13.2</b>	<b>17.9</b>	<b>21.4</b>	<b>1.7</b>	<b>25.6</b>	<b>7.9</b>	<b>25.6</b>	<b>3.4</b>
<b>Equity Component</b>	<b>15.3</b>	<b>22.1</b>	<b>21.8</b>	<b>2.5</b>	<b>29.9</b>	<b>8.1</b>	<b>34.6</b>	<b>-6.0</b>
<b>Bond Component</b>	<b>8.8</b>	<b>8.6</b>	<b>26.7</b>	<b>-2.5</b>	<b>14.6</b>	<b>5.6</b>	<b>18.7</b>	<b>11.5</b>
<i>60/40 Global Balanced Index**</i>	<i>9.4</i>	<i>9.7</i>	<i>19.5</i>	<i>4.6</i>	<i>18.8</i>	<i>-0.9</i>	<i>18.3</i>	<i>-6.0</i>
<i>Financial Times World Index</i>	<i>15.4</i>	<i>13.2</i>	<i>19.6</i>	<i>5.8</i>	<i>22.6</i>	<i>-5.1</i>	<i>19.7</i>	<i>-17.1</i>
<i>Salomon World Government Bond Index</i>	<i>0.2</i>	<i>3.6</i>	<i>19.0</i>	<i>2.4</i>	<i>13.3</i>	<i>5.5</i>	<i>15.8</i>	<i>12.0</i>
<i>Lipper Global Flexible Fund Index***</i>	<i>12.2</i>	<i>14.7</i>	<i>16.9</i>	<i>-4.5</i>	<i>23.0</i>	<i>2.2</i>	<i>16.1</i>	<i>-2.8</i>

\* Inception Date: 8/31/89

\*\* 60/40 Global Balanced Index is the weighted sum of 60% FT World Equity Index & 40% Salomon World Government Bond Index

\*\*\* Lipper Global Flexible Portfolio Average used from 8/31/89 to 12/31/89; Index commences 1/01/90

	Composite Information									
	1997	1996	1995	1994	1993	1992	1991	1990	1989	
Number of accounts included in the composite	8	8	9	9	†	†	†	†	†	
Total market value of accounts included in composite (\$M)	\$80.0	\$74.5	\$46.5	\$26.4	\$7.2	\$4.5	\$4.3	\$1.1	\$1.1	
% of total firm assets represented by composite	5.2%	5.9%	7.4%	7.2%	3.0%	2.3%	2.4%	1.7%	3.8%	
Internal dispersion: standard deviation of calendar year returns	2.2%	0.9%	3.1%	9.2%	†	†	†	†	†	

† Five or fewer accounts

### NOTES:

- Composite includes all-fee paying multi-asset global accounts under discretionary management, including accounts no longer in existence. Accounts are included from the first full month following the date on which the account is deemed to be fully invested.
- Returns shown are time-weighted total returns in US\$, and reflect reinvestment of dividends and interest. Returns are weighted by account size in the composite.
- Composite returns are presented after brokerage commissions but before management and custodial fees and foreign withholding taxes. Management fees are described in our Form ADV Part II. Inclusion of standard management fees would reduce composite returns by approximately 1.0% per annum.
- Returns of all indices (except Lipper) are presented before foreign withholding taxes, and do not reflect commissions or fees that would be incurred by an investor in the index portfolios. Lipper Index returns are reported after all fees and expenses.
- Annual standard deviations of returns (volatility) is estimated from monthly returns using a continuous return model to derive annual periodic standard deviation.
- A complete list and description of the firm's composites is available upon request.
- This product and its corresponding composite performance were previously named Tax-Exempt Global Balance.

### Asset Allocation

