George Inve$tment View

Fall, 1997 Volume 4, Number 1

Welcome to the Fall 1997 edition of the *George Inve$tments View.* We begin our fourth year with a new visiting Roland and Sarah George Professor of Applied Investments - Dr. Christopher K. Ma. Changing visiting professors in the Roland George Investments Program is similar to a football team changing coaches: new plays, but the students must still carry the ball. This new approach is outlined in this fall's edition of our newsletter.

By Professor James E. Mallett, Director

Style, Stock Selection, and Performance

On September 1997, the year-to-date return of the George Growth Portfolio was 29.1%, compared with 27.7% for the Standard & Poor's 500 and 23.0% for the Russell 2000. For the fiscal year end 5/31/97, however, the George portfolio return was 2.5%, with 26.8% for S&P 500 and -0.23% for Russell 2000. The sharply different comparison in returns led us to examine the source of the return contribution. Since the George portfolio contained mainly small-cap stocks, it was more appropriate to compare its performance with that of Russell 2000. To that end, George students did a good job in stock selection, as shown by the excess returns over Russell 2000 returns. On the other hand, the overwhelmingly low returns of both the George portfolio and the Russell 2000, compared with the S&P 500 return strongly suggest the importance of picking the correct style for the portfolio at the onset. The difference is striking! More than 27% return difference between the large-cap and small-cap universes makes the contribution of return from superior stock selection, less than 3%, almost insignificant. We therefore are convinced that a best effort should be devoted to select a proper style for the portfolio.

Sector Weights and Number of Stocks

The overall style for the George Growth Portfolio selected by this year's students is medium to large capitalization value stocks. The benchmark we seek to beat is the S&P 500 index. The Standard and Poor's 500 index is diversified in all sectors of the market. Our target is to beat the S&P 500 by an annual excess return of 2% with a tracking error of less than 2.5%. While this goal may seem modest, very few funds were able to beat the S&P 500 this year. To reduce tracking error, it is extremely important to select the proper sector weights and the number of stocks for the George portfolio.

Tracking error is an important factor with which we must be concerned. Tracking error is the standard deviation of excess returns, compared with the S&P 500. Since we seek to stay close to the benchmark for a low tracking error (around 2.5%), this decision dedicates how close the George portfolio must invest in each sector, compared with the sector weights in the S&P 500. Since the main source of tracking error is from the portfolio sector bet (different from the sector weight in the benchmark), we elect to stay close to the sector allocation of the S&P 500. That is, the sector percentages are divided in roughly the same manner as the S&P 500 index which is composed in this fashion: as of September 1997, Utilities 2.7%, Energy 9.4%, Financials 16.1%, Industrials 15.3%, Durables 4.0%, Staples 10.5%, Services 12.2%, Retail 5.2%, Health 10.4%, and Technology 14.1%. In the current George portfolio, the only sectors that deviate largely from the benchmark index are services, durables, and staples.

For all practical purpose, the George portfolio is only able to hold approximately 25-30 stocks for the semester, theses stocks are divided into their appropriate sectors. The number of stocks chosen was partly determined by the number that could be followed and watched closely at the same time. If we had any more in our portfolio, keeping track of each of them would become more difficult. Each sector includes 2-3 stocks, depending on the percentage weight of the particular sector. Twenty-five to thirty stocks are enough to allow full diversification of our portfolio.

by Wendy Pylman

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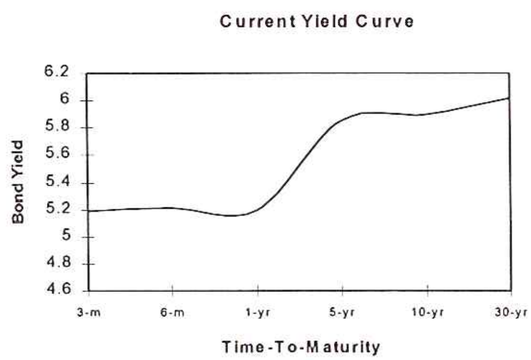
Market Analysis

Although the U.S. economy is still growing at a steady rate, the stock market is presently experiencing increasing volatility. In the past few years, the real gross domestic product has seen growth rates of four to five percent, but presently, the GDP is growing at a rate around three percent. The economy is close to full employment and it has been widely expected that the wage-induced inflation will soon become reality. The recent volatility in the stock market, in contrast with a stable economy, is largely due to the international turmoil that continues in the Asian markets. With sharply deteriorating foreign currency values, capital flows into U.S. financial markets occurred. As a result, the imported deflation is responsible for some of the recent decline in U.S. inflation. The general consensus for 1998, however, is that the economy will grow faster and inflation will rise. Consequently, it is expected that short-term interest rates may rise slightly in the future, as seen in the following graph of the U.S. Treasury's yield curve.



Sector Analysis

Based on the conditions described above, we decided to more closely look at our stock portfolio to see if we had the most appropriate strategy and style for the given economy. We studied numerous historical trends and other portfolio performances in order to determine what type of equities would perform the best in this environment. We researched the conditions in which stocks with small capitalization out perform those of large capitalization. This result would occur in periods with the following criteria of high growth in the economy, low interest rates - or not increasing rates, and less uncertainty.

Next, we identified the conditions when value stocks tend to out perform growth stocks. The following are observed from past experience: lowered growth; market volatility; and interest rates not consistently low.

Based on the results of this research and the current status of the economy, we concluded that large-medium cap, value-blend stocks would dominate the market in the next six months. Therefore, we are readjusting our portfolio accordingly. This adjustment required a set definition of large-medium cap, value-blend stocks in order to judge student recommendations. In doing so, the entire 7000 stock universe is first divided into three groups based on the ranking of a value measure (Price/Book Value ratio). The lowest (top) group is considered value (growth) stocks. Next we re-rank the stocks based on their market capitalization. Of course, the bottom (top) group is classified as small-cap (large-cap) stocks. Using this framework, we are able to derive the selection criteria for a certain style of the stocks. That is, a large-medium cap, value-blend stocks should conform to the following conditions:

- Price/Earnings Ratio < 25
- Price/Book Value < 3.0
- Price/Cash Flow < 14
- Price/Sales < 3.0
- Market Capitalization > 500 million

At the beginning of the Fall 1997 semester, our portfolio consisted mostly of small-cap growth stocks, exactly opposite of the what we felt would be best. The following displays the allocation of our portfolio according to the style of each stock with respect to the size and the type.

Value	Blend	Growth	
5% (30%)	5% (37%)		Large Cap
17% (19%)	12% (14%)		Medium Cap
24%		37%	Small Cap

Although much of our portfolio falls within the bottom right box of the style allocation chart, our goal is to be within the top left four boxes.

Since September, we have performed a complete analysis of all the stocks in our portfolio and decided which ones to sell based on whether or not they were able to be characterized as the best available. As we were selling them, we were also purchasing replacement stocks, making sure they fulfill our criteria. Because we were planning to have a portfolio consisting of mostly large-medium cap, value-blend stocks, we chose the S&P 500 as our benchmark. Therefore, when recommending buys and sells we are bound to sector allocations similar to that of the S&P 500.

by Akel Akel

Boeing Company (BA)

Recommendation
Buy

Exchange
NYSE

Current Price
$52

Beta
0.49

P/E on S&P Est. 1997
23.1

S&P EPS Est. 1998
3.70

Market cap (B)
$51.9

Company Description

The Boeing Company is the leading manufacturer of commercial jet aircraft. Also producing fighters (F-15, F/A-18), C-17 cargo carrier, helicopters, E-3 AWACS, E-4 command post, E-6 submarine communicator, ground transportation systems, develops the space station, and does work on the B-2 (ATB) and the F-22 (ATF). Foreign sales: 42%; R & D: 4.3%. 1996 depreciation rate: 6.8%. Absorbed McDonnell Douglas Corporation on Aug. 1st 1997. Boeing has 220,000 employees, 125,000 stockholders.

Leader of its industry

After the merger with McDonnell Douglas completed in August, Boeing has become the absolute leader of the commercial and military aircraft producers. It even has a significant role in the space station project. It's only civilian rival, Airbus, mired in political battle to form corporate structure to replace unwieldy multinational consortium. Some other airplane manufacturers only cover a segment of the industry (including: Bombardier Inc.; CAE Inc.; General Dynamics; Gulfstream Aerospace; Lockheed Martin; Northrop Grumman; etc.).

Industry outlook favors Boeing

Domestic airlines work through a replacement cycle and foreign markets are expanding. Growing demand for commercial aircraft in Asia is especially strong. Although the military business is currently being squeezed because of cuts the in defense budget, Boeing is still the producer of the current most popular fighter jets (F-15 for the Air Force; F/A-18 for the Navy). Also, Boeing's participation on the B-2 and the F-22 puts it in the next generation of the military aircraft. In other words, Boeing already gained position in the upcoming competition arena.

Current issues have driven the price down to a value level

Current news releases showed some of Boeing's production was interrupted by parts shortage, inefficient newly hired labor. On the surface, it seems Boeing has gone over its limit. But if we look further, these causes are temporary. New labor will be trained quickly to produce efficiently. Parts shortage is mostly caused by the sudden increase in Boeing's order volume. I believe soon, Boeing will have enough parts for production either by finding more suppliers or by following up on production of the suppliers. We should realize the current issues are caused by the unexpected favorable situation for Boeing rather than management problems or other internal problems. We have no reason not to believe Boeing will eventually catch up on production and increase to the planned level.

Boeing Company is the solid leader in its industry. Its stock is definitely an excellent choice for long-term investors.

by Lizhou Hong

NATIONS BANK (NB)

RECOMMENDATION
BUY

EXCHANGE
NYSE

CURRENT PRICE
$62.06

12 MONTH RANGE
$71.69 - $44.81

INDUSTRY
Banking

MARKET CAP
$42,538.80 M

CURRENT FY EPS EST
4.20

COMPANY DESCRIPTION

NationsBank is a superregional bank operating in 16 states and Washington, D.C. It provides commercial and retail banking services in addition to offering investment and brokerage services, insurance, and mutual funds. NationsBank, which has expanded aggressively through the acquisition of Boatman's Bancshares, is buying the Florida-based Barnett Banks, becoming the third largest U.S. bank. NationsBank has recently moved into investment banking through its NationsBank Montgomery Securities subsidiary.

RECOMMENDATION

We think that investors should consider investing in NationsBank. NationsBank is an attractive stock that has a niche in attractive financial services, such as investment banking, that is expected to be strong in revenue growth over the next year. According to Standard and Poor's, NationsBank is a low risk stock with an Earnings/ Dividend Rank of A-. Noninterest expense is expected to increase 3% due mainly to the increased spending on technology and infrastructure. The company's current ROE is 18%, ROA is 13%, with an EPS of 4.20 and a price/earnings ratio of 14.

INDUSTRY ANALYSIS[1]

The banking industry will continue to have higher earnings, but momentum should slow a bit in the coming year. Loan charge-offs are at historically low levels due mainly to the strong economy, and the expansion of banks into nontraditional banking services. Various stock repurchase programs have enhanced earnings per share over the last few years. As far as credit card lending is concerned, banks are becoming more selective which should lead to fewer credit card losses in the next year. Although the Banking industry has become more competitive, P/E's should remain fairly "healthy". Investors, however, should be selective in looking at those banks who are surpassing traditional banking services like that of NationsBank.

VALUATION

Using the Walter's Model for expected price of $68.09 for NationsBank stock, we found that the stock is somewhat under priced. In addition, the stock is slightly undervalued at an expected P/E of 16.43 to the actual P/E of 14. In addition, we think that with the rather strong economy, and the fact that the banking industry is in a strong position, this stock is worth purchase. We realize that the banking industry tends to be interest rate sensitive, but with the diversification within the company's products and the fact that NationsBank is a "superregional bank", small fluctuations in interest rates should not have an extremely positive or negative affect on the company's ability to perform in the industry.

[1] All information for this report was obtained from the following sources...Morning Star, Standard and Poor's, Value line, and the NationsBank Annual Report for 1996.

NationsBank Corporation

NationsBank has enjoyed high growth over the last few years. Net income grew 21.87% over the past year from $1950.0 million in 1995 to $2375.0 million in 1996. Revenues increased 16.6% from $8638.0 in 1995 to $10069.0 in 1996. We expect this growth to continue, but slow a bit as the economy levels off in the next year. We do, however, see that this company is continuing to grow and thus will continue to be profitable in the next year. This year's annual target is 12-15% in earnings growth. Due to the positive results over the past few quarters, the company recently raised its internal financial goals to between 17 and 20% ROE with an efficiency ratio of under 50% by the year 1999.

The company recently expanded from 9 to 16 states through the acquisition of Boatman's Bancshares. This expansion made NationsBank the fourth largest US bank. They profit from an aggressive management style as well as large reinvestment in the corporation through massive technology improvements and the recent move into nontraditional banking services like investment banking, PC banking, insurance, and mutual funds.

NationsBank recently announced the acquisition of Barnett Bank. Barnett Bank is the largest bank in the state of Florida with 20% of the states deposits. This merger will make NationsBank the largest in the state of Florida and the third largest U.S. bank. NationsBank expects to see $915 million in annual cost savings from the merger. With Florida's rapid population growth and a strong, forward-moving Florida economy, NationsBank is sure to see continued growth and success which should be reflected in the stock price.

	Nations Bank		**Industry**	
	1996	1995	1996	1995
ROA	1.3	1.0	1.19	1.17
ROE	17.2	15.2	14.5	14.7
Book Value/ Share	18.4	19.1	19.7	20.3
Net Interest Margin[2]	4.71	4.20	4.27	4.29
Loans to TA[3]	65.4	61.9	65% or more considered high	
LT Debt (% of debt & Equity)[4]	62.6	58.1	50% is generally the upper limit	
Beta	1.28			
EPS	14.0			
Price/Book	2.1			
Price/Sales	2.3			
Price/Cash Flows	11.5			

By Brandy Slaughter

[2] NationsBank's Net interest margin is widening, which according to Standard and Poor's Industry Analysis, is a sign of successful management of assets and liabilities. The industry falls between 3% (low) and 6%(high).

[3] With a ratio of loans to total assets of 65% indicates that there are good business opportunities in the bank's market.

[4] Long-term debt as a percentage of debt and equity is rather high at 62.6%, which could suggest that further borrowing may be difficult. This however, should not be a problem, since NationsBank has no near future plans for any more acquisitions other than the Barnett Bank merger that is pending.

Nipsco Industries (NI)

Recommendation
Buy

Exchange
NYSE

Current Price
$44.25

Beta
.48

Market Cap
$2.56 Billion

Dividend Yield
4.1%

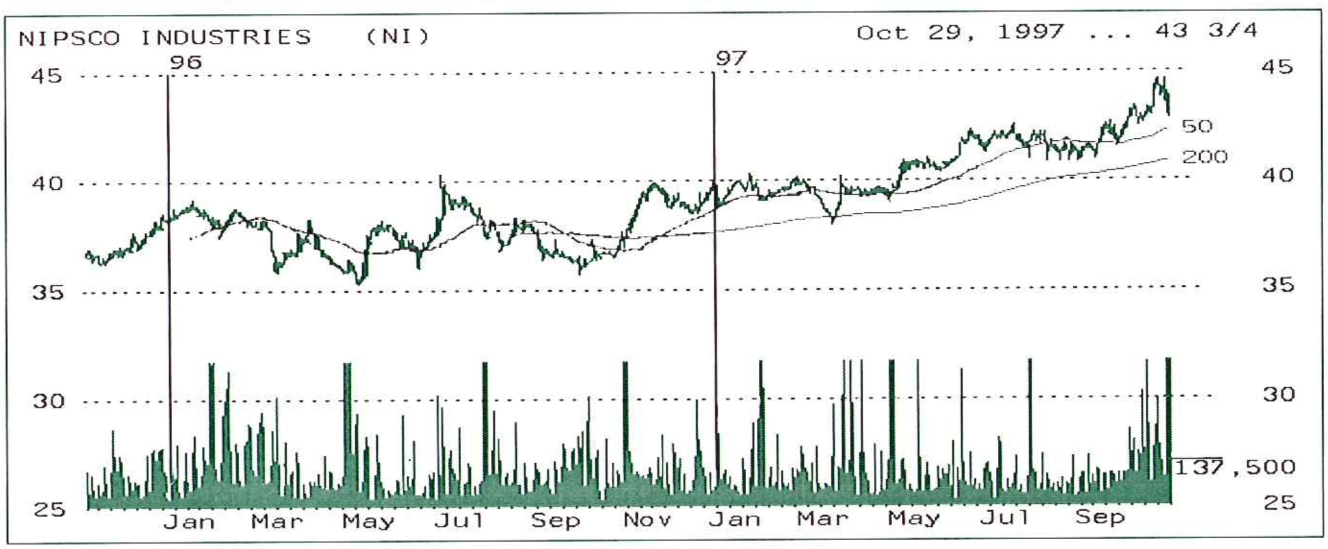
EPS Growth
8.32%

Company Description

NIPSCO is an energy/utility-based holding company that has both regulated and non-regulated subsidiaries. Its regulated subsidiaries provide electricity and natural gas in northern Indiana, water in central Indiana, and interstate natural gas pipeline services. The Company's four regulated businesses are Northern Indiana Public Service Company, Kokomo Gas and Fuel Company, Northern Indiana Fuel and Light Company, Inc., and Crossroads Pipeline Company. NIPSCO's non-utility subsidiary, Primary Energy, Inc., provides the management of engineering, construction, operation and/or ownership of energy-related projects for industrial, electric and gas consumers. They currently have four projects under contract, including two facilities in operation. Other businesses include marketing and trading; power generation; oil and gas exploration and development; gas transmission, supply and storage; and related products of comfort, convenience and security. NIPSCO purchased IWC Resources Corp., another utility firm, on March 25, 1997.

Industry Analysis

Low betas and high dividends characterize the utilities industry. Due to the recent market volatility, the utilities sector should outperform on a total return basis as the market violently jostles up and down hundreds of points each day. P/E, P/B, P/S, P/C for the industry are far below the S&P 500. The Dow Jones Utility (DJU) index is at a four-year high and will soon break its all-time high set in September 1993. For the past 3 months, the utilities sector has risen 5.4%, while the S&P 500 lost 1.4%. For the past 30 days, the sector lost 1% while the S&P 500 fell 2.8%. Earnings and dividends should continue to grow as the economy continues its expansion. Many utilities firms have implemented cost-cutting tactics to improve efficiency and reduce operating costs leading to higher margins. Many large utilities firms, including NIPSCO, have been acquiring smaller utilities firms, and future consolidation is expected to result in greater economies of scale. Deregulation is forcing utility firms to be more competitive and to manage costs effectively.



Selecting the Ideal Utilities Firm

The criteria used to select the best candidates in the utility sector were: Mid-Large Cap; Value-Blend; U.S. ownership; 3-year average positive earnings growth; positive earnings growth each year for the past 5 years; and, total 5-year annualized return above 10%.

This screening reduced the field to 6 companies. These 6 companies were further screened by 5 different valuation models and analysts' recommendations which all pointed to NIPSCO as the ideal candidate.

Company Analysis

NIPSCO, a holding company formed in 1988 by Northern Indiana Public Services Co., supplies electricity and gas to 2.2 million people in Northern Indiana. Forty-two % of revenues come from industrial customers, 26% residential, 24% commercial, and 7% other. In 1996, the steel industry accounted for 22% of electric revenues and 1% of gas revenues. Thus, NIPSCO depends heavily on the steel industry's continued production. NIPSCO's highly efficient plants are likely to help compensate for weak steel cycles. Future growth for NIPSCO is not dependent on steel making — rather the steel industry serves as a cash cow. Growth will come from expanding residential and commercial customers, entry into water services, and a focus on energy-related opportunities with attractive returns.

Since 1988, earnings have increased 10% per year; since 1992 dividends have grown 7.7% per year. EPS growth should continue in 1997 as NIPSCO's commercial and residential customer base expands. The company has also initiated aggressive marketing programs with competitive prices to expand its number of customers. Earnings will also be improved through newly implemented cost controls and increased plant efficiency. In addition, management compensation is tied directly to earnings growth and share price appreciation. As a result of high expectations for future profitability, NIPSCO has instituted a share repurchase program. Since 1989, the company has repurchased almost 20 percent of its common stock. NIPSCO reports to have very positive relations with its governing body, the Indiana Utility Regulatory Commission. The company is also in full compliance with the Clean Air Act of 1990.

The March 1997 acquisition of IWC Resources enabled NIPSCO to become a significant provider of water services in Indiana. IWC had revenues of approximately \$170 million per year, and NIPSCO paid about \$290 million in cash and stock for this revenue stream.

NIPSCO expects to spend \$774 million on new construction over the next 5 years but does not plan to add new electric generating facilities. In addition, NIPSCO has no plans to enter the nuclear power industry.

On October 30, NIPSCO reported third-quarter earnings of .57 per share, a 2% rise over the same quarter last year. However, the quarters are not directly comparable because of the addition of IWC Resources. NIPSCO is above the 50-day and 200-day moving average lines.

NIPSCO has 17 analysts following the stock.

Recommendation	# Analysts
Strong buy	8
Moderate buy	4
Hold	5
Moderate sell	0
Strong sell	0

by Eric Kissel

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Comments & Disclaimer

The Roland George Investments Program was created in 1980 by Sarah George to provide a unique experience for future investment professionals. This bequest was intended to honor her husband, Roland, who, after traveling the standard academic path, began to ply his trade and promptly lost money. Mr. George decided that serious flaws were evident in the traditional educational process for future investors since by overcoming his formal education he was able to master investing, and in short get rich.

From this start, Mr. George formed the ideas of creating an investment curriculum that combined academic theory with real world experience. This dream came true when Sarah George funded the Roland George Investments Program. This program provides support for the applied investments program at Stetson University where students manage a $1.8 million dollar portfolio. Insights are gained through contact with professionals such as B. Carter Randall and Robert Stovall of Stovall/Twenty-First Advisors.

For information on the Roland George Investments Program contact Dr. James Mallett at 904-822-7442.

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