

# George Investment View

Spring, 1997

Volume 3, Number 2

Welcome to the Spring 1997 edition of the George Investment View. Our focus during the Spring is to evaluate the bonds we hold in our portfolio and stay apprised of the status of our stocks. Our state-of-the-art investment analysis technology gives us the opportunity to review current market conditions and occurrences that affect the companies we are holding. Market conditions have been generally positive, but we must be aware of action by Greenspan and his cohorts. We hope and pray that we can defend or flee in case of ambush.

The Roland George Investments Program is now operating in its 17th year. We are proud to say that the portfolio is at its all-time high and valued at \$1.7 million. The continued success of the program is contingent on the support and insight of the advisor. For the past

three years, the Roland George Investments Program has been fortunate to have had Ned Schmidt as advisor. He has made stock selection and bond analysis fun as his hands-on approach lends to this result. Advisors of the Program must change every three years, so there will be a new advisor in the Fall. Stetson and the Roland George Investments Program will miss Ned as he leaves to pursue other business interests. Thanks, Ned.

As of publication, no new stocks have been selected to add to the portfolio. Students are actively rating and analyzing prospective stocks. To ensure quality selections, the stocks are put through a rigorous screening process that we hope will add to the success of the Program. A high standard has been set, but current George students believe they will uphold that standard and make

selections that will yield positive returns.

A thorough bond analysis was undertaken this semester to ensure that our holdings were secure. We studied the companies held to measure their abilities to meet their current and future obligations. Our work concluded that the bond holdings are fundamentally secure.

The Roland George Investments Program has been honored to have a fine list of guest speakers for this semester. Carter Randall, Bob Stovall, Robert Schumacher, Ed Evanouskas, and Beth Collins are friends of the George Program, and add significantly to the Program by sharing their expertise.

by Tom Jackson  
and Jimmy Cannon

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## REVIEW OF MARKET ACTION

The market landscape is littered with stocks attempting to recover from the recent volatility. The Bears are coming out of hibernation to say that the market is ready for a major correction. The Bulls still continue to chirp happily noting that the market has been quick to recover from these minor slides. Yet despite these wrinkles, the mutual fund market continues to draw in funds at a startling rate. The economy seems to be stronger than ever. GDP growth is expected to be between a healthy 3 and 4% for the first quarter. The Federal Open Market Committee raised interest rates by 0.25% on March 25, confirming their belief in the strength of the U.S. economy.

### The Bond Market

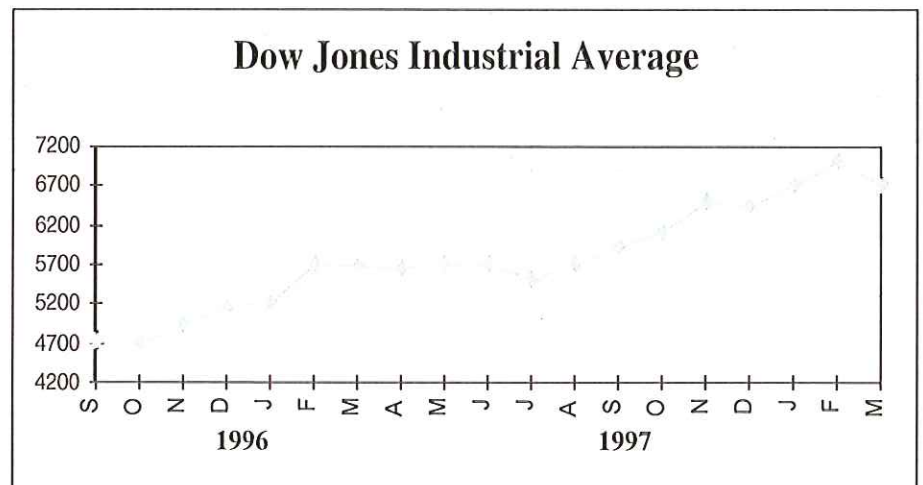
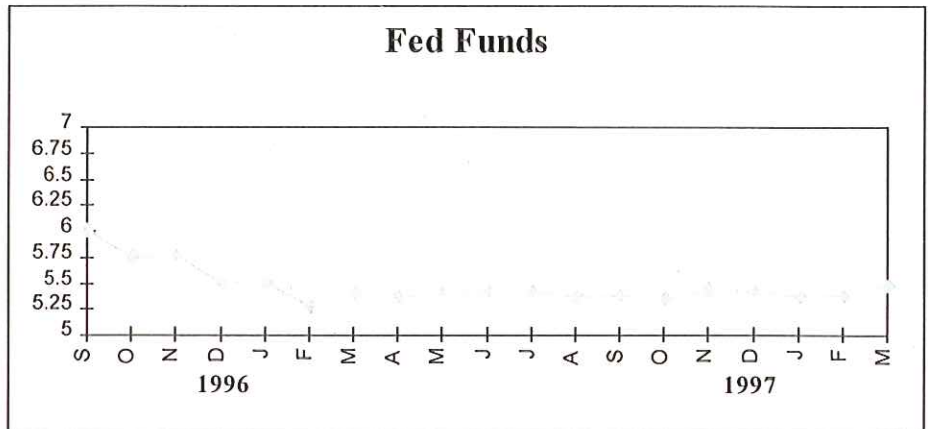
The increase in interest rates may break the down trend for rates that has existed since the historic peaks in the early 1980's. With the long term bond rising above 7%, the long-term down trend may be coming to a conclusion. Of crucial importance to bonds is the down trend line in the money market rates. An increase of 0.3-0.4 of a percentage point would change this critical down trend. More than just one interest rate hike is necessary, but these things usually happen in pairs. The question now is whether or not the Fed will raise rates again in May. This may be a good time to invest some money in Treasury Bills not only as a shield against inconsistent stocks but to take advantage of the upcoming break in the 15-year down trend of yields.

### The Stock Market

The Dow has been playing the zigzag game ever since it passed the historic 7000 mark on Feb 13th, a significant change from it's former confidence that it had during the four months that it moved from 6000 to 7000. The anticipation of higher interest rates suggests that this may be a good time to make sure that your portfolio is not over exposed to the stock market. However, there are plenty of reasons

to remain relatively positive about the stock market. Despite a healthy return in stocks inflation remains tame. Corporate profits are strong and expected to stay that way. Abby Cohen, the bullish strategist at Goldman Sachs, likened a Fed rate hike to a "flu-shot" saying it may actually do the market some good by moderating activity.

by Kim Khalsa  
and Paddy Lee



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## BULLISH ON STOCKS

Six better-than-par years have blessed our stock market since October 1990. The Dow has risen to currently something in the neighborhood of 7000 since that time. Now, the average investor is getting a little nervous that the bull may have overstayed its welcome.

For the average golfer, stringing together six pars in a row is a difficult task. After doing so, most of us would approach the next tee with apprehension and perhaps a bit of fear that our good luck may soon run out. Suppose you were a professional golfer. Would you swing each time worrying about whether you may dreadfully shank one into the woods? Or, might you have a bit more confidence in your skills and experience?

Those of us in the Roland George Investment Institute are not planning on pulling out of our equity positions based on a few pessimistic market concerns. Neither do we plan to stick to our guns if the notion that we are in fact doomed suggests that we do otherwise. Instead, we have confidence in our valuation approach to selecting stocks. We may not yet be professionals, but we do make our assumptions about investments based on more than intuition. Our fundamental analysis, aimed at performance over the long term, makes it easier for us to ignore implications of a possible bear market. Perhaps this is a mistake.

If you are among the many avid readers of the George Investment View you may recall that the Fall edition examined one such major implication. Our classmates (Cannon & Jackson) questioned whether the long-term bull market would go out with a bang or rather a whimper. According to Stephen W. Blair, executive Vice President of John

Hancock Funds, investors might as well throw all of the short sighted market performance indicators out the window in lieu of two widely discussed demographic peculiarities that will continue to impact the market's performance for the next 10-15 years. In terms of demographic trends, this dynamic duo is none other than the phenomenal population boom referred to as the post WWII Baby Boom and the historical trend of people age 45-50 years old to spend more money than any other age group.

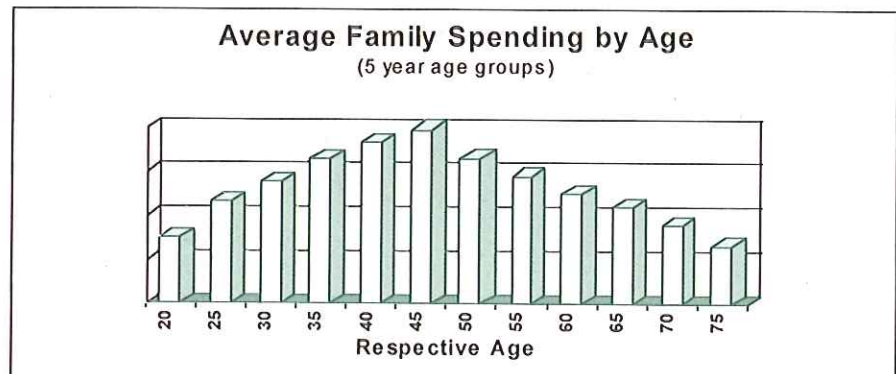
So, what do investors gain in return for dismissing quantitative short-term financial indicators of market performance? An optimistic 10-15 year outlook as the market gears up in anticipation of the influx of Baby Boomers reaching their peak spending years investing heavily in the market driven by the fear that their nest eggs won't suffice.

Today's investors are participating in an information economy. Internet homepages allow investors to track their favorite stocks, accessing up-to-the minute charts and breaking company news. Similar software packages enable investors to trade on-line, thereby greatly reducing their costs and dependence on brokers. In other words, less commissions which

translate into more shares of stock for this new breed of investors.

Within the information economy the investors aren't the only players utilizing the latest technology to gain a competitive advantage. Companies are also investing in technology to obtain their goals and compete globally. Expenditures in software, employee training, Internet marketing and the like are just a few of the initiatives companies have undertaken. So, how does this trend relate to the stock market you ask? Simple. Those companies investing heavily in information may own more than their books reveal. These investments in the future, software, worker training, etc., are not being capitalized because of the difficulty in assessing the value before the future actually arrives. Working knowledge of today's software prepares employees for tomorrow's software, but how can that be valued until its benefits are translated into dollars. Until the accounting gurus figure out how to deal with this one, we need to be aware of what the intangibles of today mean for tomorrow.

by James Campbell  
and Karen O'Connell



Source: John Hancock Funds, Inc.

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## BEARISH ON STOCKS

The U.S. stock market has been experiencing the longest and strongest Bull market in history. Emphasizing this, the Dow recently broke the 7,000 point barrier but there are growing concerns that these surges are not going to be backed by corporate profits and the surges in the indices are only being led by a minority of stocks. The market has been breaking records faster than those keeping track of them can report the numbers. The dumping of billions of dollars into mutual funds is continuing and the fears that people once had of losing money in the stock market have receded into mild concerns.

What people have failed to see is that these records are being broken with the help of only a minority of the stocks in the market. Moreover these few stocks are the strongest corporations, but their prices are being inflated by mutual funds. By looking at the graph below one can

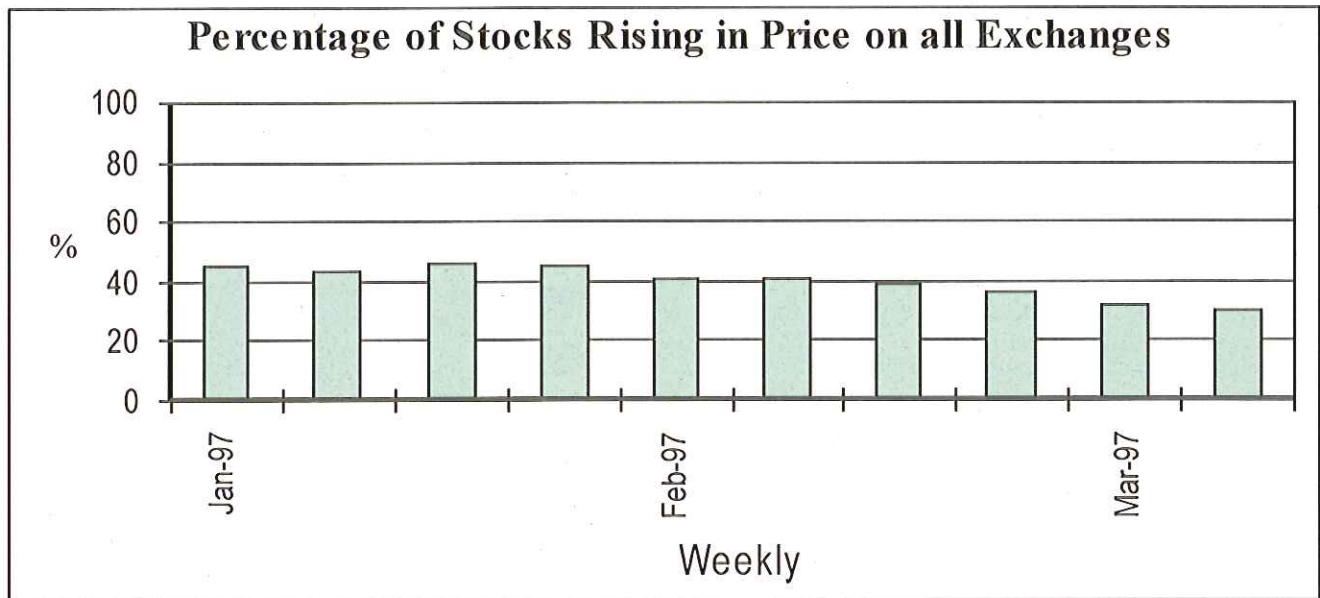
see that only a total of 29% of all stocks are rising. This suggests that the recent level that the market has attained may not have a strong enough following by individual stocks to maintain such a high level during the foreseeable future. Additionally, during the past few weeks, the NASDAQ market has been in a clear down trend. At the end of February, the market broke below the rising trend line from July and the 40-day moving average. This is causing many to believe that the small cap market is moving into bearish territory and if NASDAQ breaks below the 150-day moving average many investors feel there will be a correction in this market.

Recently a sense of overvaluation has been finding its way onto Wall Street and some investors feel as though the ride on the Tech stocks may soon be slowing. We have seen Chairman of the Fed Alan Greenspan state his opinion as to

the market being overvalued, to which the response was a 160 point drop in the Dow on that day. Also, investment whiz Warren Buffet let his belief of the market being overvalued be known.

The time might be appropriate to look at the foundation of this tidal wave of money we are riding on and see if it is strong enough to support the weight being placed on it by mutual funds. In the near future the large cap stocks will hold on to their extraordinary gains, but they will eventually follow the small caps as dollars from mutuals pore in slowly and corporate earnings are less than expected. There may be a new set of stocks rising in the distance but it looks as though the current set of "Tech's" has started to break and the ride may be over.

By A. J. Warren  
and Jim Schwartzel



## COCA-COLA COMPANY (KO)

The Coca-Cola Company's beverage business is the largest manufacturer, marketer, and distributor of soft drinks, non-carbonated beverage concentrates, and syrups in the world. They also have substantial ownership interests in numerous bottling and canning operations. Currently, 60% of the world's population live in markets where the average person consumes less than 10 servings of Coca-Cola's product, per year, offering high-potential growth opportunities for their company and its bottlers. They distribute many major brands like Coca-Cola, Sprite, Fanta, Tab, etc. through bottlers throughout the world. Coca-Cola's foods business produces, markets, and distributes principally juice and juice-drink products. They are the largest marketer of juice and juice-drink products in the world. Minute Maid, Five Alive, and Hi-C are examples of some of the juice products they produce and distribute throughout the world. Foreign (non-U.S.) operations accounted for 71% of net sales and 82% of profits in 1995. Although foreign sales and profits are very large, domestic sales in the U.S. still provide the best single source of revenue for the company.

The Company has received final approval of the sale of its 49% interest in Coca-Cola & Schweppes Beverages Ltd. to Coca-Cola Enterprises Inc. The Company expects to complete this transaction within the next several weeks. Upon closing, the Company expects to record a gain and realize a significant cash inflow due to the increase in the value of this investment since the formation of the joint venture in 1986. This gain is expected to

### STOCK DATA

Current Price:	\$ 57.00
1997 E EPS:	\$ 1.65
P/E Ratio:	34.25x
Dividend:	\$ 0.50
Return On Equity:	35%
Annual Growth Rate:	17.6%

contribute to earnings per share growth generously in the first quarter of 1997.

In July 1992, Coca-Cola's Board of Directors authorized a plan to repurchase up to 100 million shares of the Company's common stock through the year 2000. In 1995 they repurchased 29 million shares under this plan at a total cost of approximately \$1.8 billion. As of December 31, 1995, they have repurchased 67 million shares under the July 1992 plan. Coca-Cola's financial figures show definite signs of growth. In 1996, net revenues increased 3% while gross profit increased by 7%. Net income

increased 17%, while earnings per share increased 19%, due to fewer shares outstanding as a result of the stock repurchase plan in July 1992.

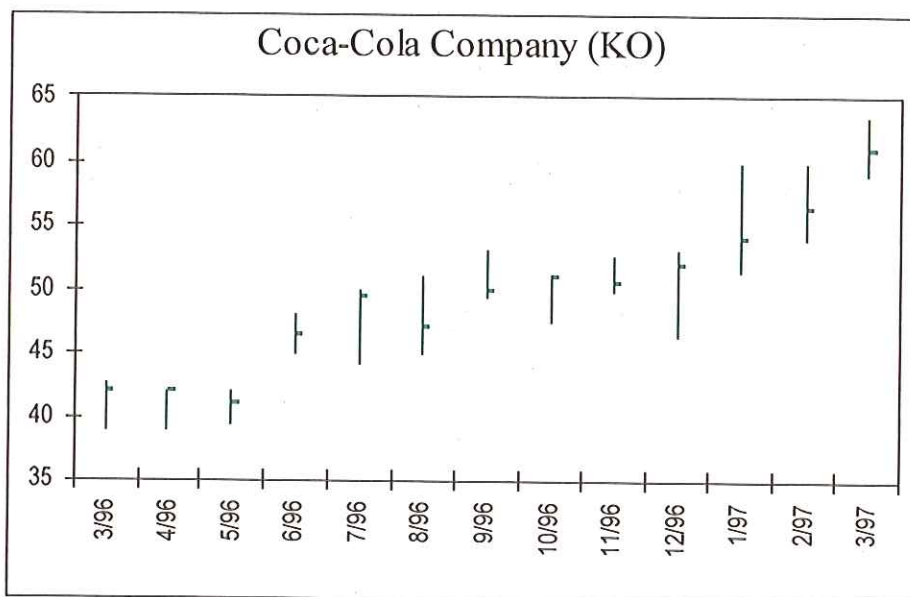
The company's goal is to increase profits 15%-20% a year, and analysts think it will be successful in doing that in the coming 3 to 5 years. The price of the stock has moved up steadily for nearly three years, almost tripling in that time, and both the absolute and relative price/earnings ratios are now much above the historical levels. However, investors with a cautious bent might consider investing elsewhere.

by Jason Wolford  
and Tina Tsounis

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### Coca-Cola Company (KO)



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## DANKA BUSINESS SYSTEMS (DANKY)

Danka Business Systems is one of the world's largest and fastest growing suppliers of photocopiers, fax machines and other related automated office equipment. Danka markets directly to retail customers and on a wholesale basis to dealers. The Company is now in 31 countries and employs more than 20,000 people around the world. Since the acquisition of Eastman Kodak's Office Imaging division in December 1996, Danka is now the main distributor of Kodak-brand office copiers and printers worldwide.

Danka's achievements in 1996 were well heralded, expanding their business revenue to over \$1.2 billion while still expanding to Continental Europe. Danka is now the second largest independent distributor of photocopiers and facsimiles in North America and Continental Europe. As a result of competent management and sizzling growth, operating profits grew 32% with an average growth rate on profits of 12% for the past 4 years. Much of Danka's success can

STOCK DATA	
Current Price:	\$ 32
1996 E EPS:	\$ 1.13
P/E Ratio:	28x
Dividend:	\$ 0.18
Return on Equity:	12%
Annual Growth Rate:	32%

be attributed to a market based solutions approach to development and sales of its product while keeping a solid financing position as evidenced by a new \$1.275 billion credit agreement. Danka's service reputation is well known while the company attributes much of its strength to its intensive training of personnel. Because of its position in the world market, Danka is now ready to pursue a strategy of long-term growth.

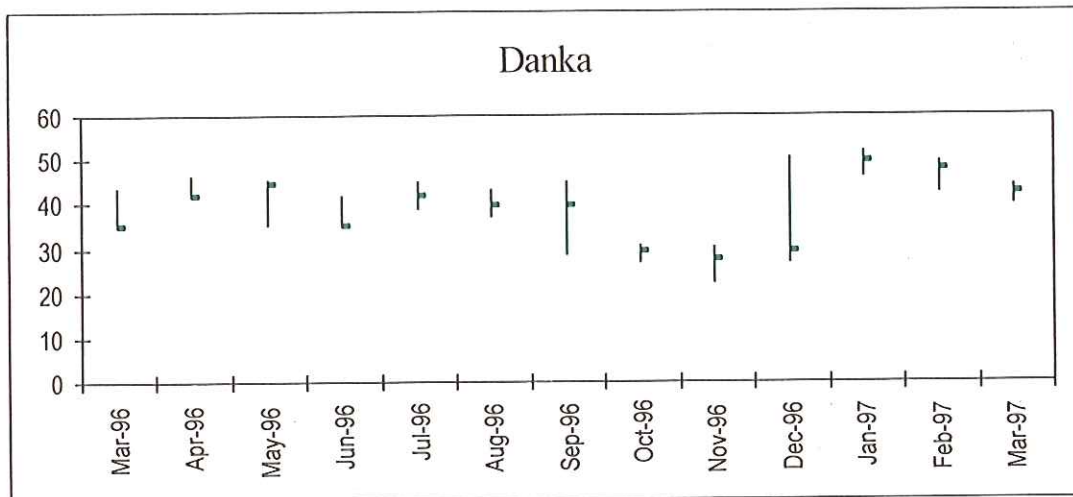
Danka's stock price has risen from \$32 in late 1995 to \$45 in early 1997 but retreated to \$32.50 in March of 1997. Because much of this fall can be attributed to the

NASDAQ market correction, we feel the stock is undervalued due to its long-term growth and earnings potential. One brokerage house recommends Danka as a strong buy, one recommends as a moderate buy while two recommend a hold position. Although one can associate significant risk related to the stock especially due to currency changes, we would recommend the stock to potential investors as a long-term growth investment.

*by Brian Caldarelli,  
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## BONDS

### Risk Free Returns Part II

Last semester, we commented on how overvalued the stock market was. And with no published academic studies substantiating any of the causes for the valuation we are all left to hypothesize that baby-boomer's moneys are flowing rampantly into the stock market; regardless of risk levels. As Alan Auerbach of Berkeley reasons, boomers have only saved 30% of what they will need to fulfill retirement objectives. This may offer an explanation for why money is flowing so rapidly into the market without considering risk. But we cannot turn our heads to the proposition of what could happen when this same money is pulled out of the market? Will it be a gradual decline or an abrupt slash and burn in a marketplace filled with fear? Perhaps history, or Mr. Greenspan, can answer that question.

The recent stock market declines can be attributed to fears of rising interest rates. Judging from the graph below, it seems eminent that interest rates will rise even further, since there has never been a period in history where the Fed didn't raise the Fed Funds rate consecutively. If the "man of power" doesn't pull the trigger, the yield on 30-year Treasuries will undoubtedly fall, but if there is an increase in interest rates, yields will continue to grow making bond markets less attractive in the future.

Likewise, junk bonds, mortgage pass-throughs, and high grade corporates may be even less attractive than pricey stocks. Perhaps the fear of rising interest rates and general "irrational exuberance" in other markets have caused these securities to be frantically lost like a child without his mother. How else can you explain why junk bond spreads over Treasuries are around 3.2% points now compared to a 4.2% spread last October.

Similarly spreads on corporates and mortgage pass-throughs are tight compared to a year ago. One bond researcher for a large insurance company was recently quoted as saying spreads have become ridiculously tight and that there was nothing left to buy.

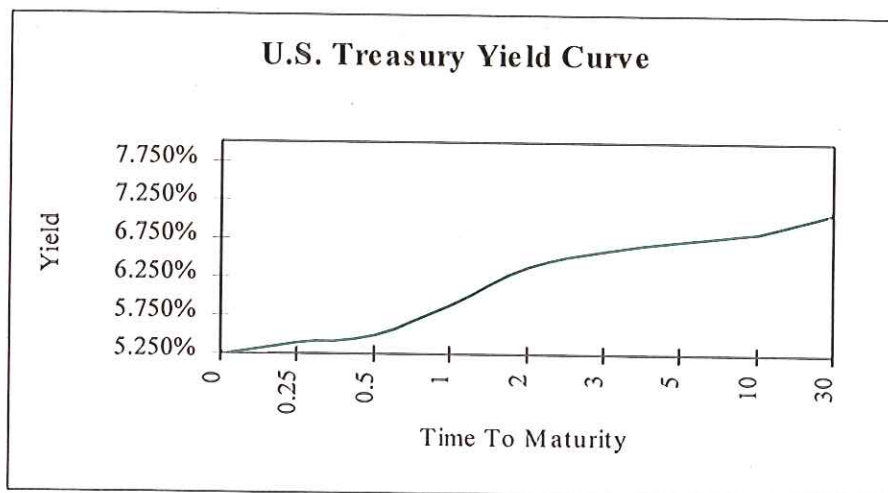
Following the news on March 25th that the Fed has indeed raised the Fed Funds rate to 5.5%, the yield on the 30-year Treasury soared to 7.08% (losing 1.25 points). Surely, any less than a savvy investor can see that the U.S. bond market is not the place to be; not now anyway. So what else is there?

Randall W. Forsyth of Barron's suggests prime rate funds – funds that invest in bank loans that float with the prime rate or

LIBOR (London Interbank Offered Rate). The beauty of these funds is that as rates rise, so do loan interest rates and the underlying value of the loan doesn't decline as a bond's value would. Returns for some of the better known funds are shown below for the past three years.

In conclusion, the stock market has already started to react to the Fed's actions and the U.S. bond market should be avoided as well. Cash gained from liquidated bond portfolios should be placed in prime-rate funds to avoid the adverse affects of rising interest rates and inflation. But what do most people do when inflation is expected to rise? Gold may be the answer for now.

by Karl Kletzing  
and Thomas Wilkins



<b>Biggest Prime Rate Funds</b>	<b>1994</b>	<b>1995</b>	<b>1996</b>
Eaton Vance Prime Rate	6.07%	8.07%	6.84%
Merrill Sr Fltg Rate	6.24%	7.79%	6.18%
Pilgrim Amer Prime Rate	8.20%	9.19%	8.29%
Prime Income Trust	7.56%	8.39%	7.27%
VKM Amer Prime Rate	6.52%	7.98%	6.82%
Average of all funds	7.03%	8.19%	7.14%



## ADVISOR'S COMMENTS

The analysts in the George Investment Program are, like many young people of today, taken by the vast capabilities of today's computers. Software for presentations and internet research are now simply part of the tools they use, like the pencil and paper with which they occasionally take notes. For one written assignment this term, all the footnotes were websites on the internet, admittedly a first for this instructor.

But, technology, of today or tomorrow, is inert. A Pentium chip can do nothing itself. What makes things happen is the user, and the creative ability and inquisitive nature of that user. Several years ago a movie, *The Last Starfighter* I believe, portrayed a teen with incredible skills on video games that was carted off to a far galaxy. That civilization had the spacecraft

technology but lacked a pilot capable of utilizing it, for some reason not remembered. Obviously, he saved the day and won the war. The person is what makes technology creative, not technology that makes the person creative.

The students, though, are far more than the slaves of today's exciting technology. They retain that special energy that makes them exciting to be with, and that is reassuring. One team for a simulated portfolio project owns two stocks, one a technology stock and the other was IBI. While technology might fascinate, traditional interests continue strong.

Over the past three years a casual observer would note that a fundamental shift in attitudes is quietly taking place in the modern schools of business. Students generally work as part of a team.

The composition of those teams is often not a matter of choice. They learn that when working together what really matters is what each contributes, not any observable characteristics of the person. Today's men and women attending business schools, particularly at Stetson University, will work together in the future because they have learned to respect individual contributions rather than some observable characteristic.

Their ability to grab hold of technology and each other does mean that maybe things really are different this time.

The George Investment View is intended to be an educational document. Investment views belong to the authors and not Stetson University.



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