

December 14, 1966

Mr. John W. Bristol  
John W. Bristol, Inc.  
233 Broadway  
New York, New York 10007

Dear John:

Dr. Kaysen has expressed an interest in the monthly Security reports. Would it be a lot of trouble to send us two, one to his attention and one to mine?

Will you also add his name to the list of recipients of any Finance Committee materials that are sent before or after Finance Committee meetings?

Cordially yours,

Minot C. Morgan, Jr.

MCM: jws

FILE NOTE: Nov. 22nd meeting of Finance Committee not held.

JOHN W. BRISTOL & CO.  
INCORPORATED  
233 BROADWAY  
NEW YORK, N. Y. - 10007  
CORTLANDT 7-1137

Memo to Mr. Leidesdorf  
Mr. Schur  
Mr. Hochschild  
Mr. Shanks  
Mr. Strauss  
Mr. Dilworth  
Mr. Hansmann

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November 16, 1966

INSTITUTE FOR ADVANCED STUDY

Agenda for Meeting of the Finance Committee  
Tuesday, November 22, 1966 at 12:00 noon  
At the Pinnacle Club, Room B, Socony Mobil Building, 42nd St., N. Y. C.

1. Report by the Chairman.
2. Ratify investment changes since the last meeting.  
(Schedule attached)
3. Investment Review:
  - List of holdings as of October 31, 1966;
  - Discussion of Investment Policy:
    - Background for Investing and Investment Policy  
(Memo dated October 6, 1966)
    - Measure of the Portfolio's Defensive Characteristics  
(Memo dated November 15, 1966)
    - Review of Stock Holdings  
(Statistical Data Enclosed)
4. Suggested Investment Changes:  
  
See enclosed memorandum.
5. For Information:
  - Norwich Pharmacal Company  
(Progress Report dated November 2, 1966)
  - Hawthorn-Mellody, Inc.  
(Progress Report dated October 27, 1966)
  - Florida Gas Company  
(Progress Report dated November 10, 1966)
  - International Flavors & Fragrances  
(Progress Report dated November 16, 1966)

John W. Bristol & Co., Inc.

# INSTITUTE FOR ADVANCED STUDY

## SUMMARY OF PURCHASES AND SALES OF EQUITIES

### Since April Meeting

<u>PURCHASES</u>	<u>Unit Cost</u>	<u>Market Price</u>	<u>Cost</u>
5,000 shs. Middle South Utilities	21 3/4	25 1/4	\$ 109,375
3,000 shs. Sinclair Oil	58	65 1/2	175,119
4,000 shs. General Telephone & Electronics	40	44 1/2	160,882
5,000 shs. Armour & Co.	38	30	191,246
2,000 shs. American Metal Climax	44	39	88,191
10,000 shs. Reynolds Metals	48	49	481,448
2,500 shs. Schlumberger Limited	52	47	130,341
5,000 shs. Becton Dickinson	70	67	351,799
5,000 shs. Chrysler Corporation	34	33	172,176
2,000 shs. Celanese Corporation	63	46	126,906
2,000 shs. Monsanto	61	40	122,902
5,000 shs. Freeport Sulphur	34 1/2	37 1/2	171,800
			<u>\$2,282,185</u>
250 M IEC Corp. Sub. Notes 6 1/2%, due 6-30-81 with warrants			<u>\$ 250,000</u>
<u>Short Term</u>			
500 M F.I.C.B. 4.35%, due 6-1-66			\$ 499,335
400 M F.I.C.B. 4.45%, due 8-1-66			399,187
500 M First Nat'l City Bank 5 1/2%, due 4-11-67			500,000
1,200 M Federal Home Loan Bank 5.55%, due 4-25-67			1,198,671
500 M F.I.C.B. 5.60%, due 3-1-67			500,139
500 M U.S. Treasury Bills 4.89%, due 5-31-67			475,346
300 M F.I.C.B. 5 7/8%, due 5-1-67			299,906
			<u>\$3,872,584</u>



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SALES

Proceeds

6,400 shs. Amerada Petroleum	\$ 429,281
16,000 shs. Gulf States Utilities	419,522
1,700 wts. Home Oil Co. Ltd.	7,225
4,000 shs. Upjohn	244,363
	<u>\$1,100,391</u>

250 M Abitibi Power & Paper 4 1/2%, matured 9-15-66	<u>\$ 231,875</u>
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Short Term

750 M U. S. Treasury Bills, due 4-14-66	\$ 741,680
500 M U. S. Treasury Notes 4%, due 8-15-66	498,750
215 M U. S. Treasury Notes 4%, due 5-15-66	215,000
132M U. S. Treasury Notes 4%, due 11-15-66	132,422
1,000 M Federal Home Loan Bank 4.35%, due 5-25-66	1,000,000
500 M F. I. C. B. 4.35%, due 6-1-66	500,000
500 M U. S. Treasury Bills due 6-1-66	494,565
500 M Federal Home Loan Bank 4.40%, due 6-24-66	499,953
400 M F. I. C. B. 4.35%, due 7-5-66	400,000
400 M F. I. C. B. 4.45%, due 8-1-66	399,953
500 M U. S. Treasury Bills, due 5-31-67	475,346
1,000 M U. S. Treasury C/I 5 1/4%, due 8-15-67	995,312
	<u>\$6,352,981</u>

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October 6, 1966

BACKGROUND FOR INVESTING AND INVESTMENT POLICY

The purpose of this memorandum is to discuss the current investment environment as we see it and hopefully to suggest an appropriate course of investment consistent with our views.

1967 FORECAST

1. Economic Activity: Deterioration in the private sector, particularly in the durable goods area and in the accumulation of inventories, more than offset by sharply higher defense expenditures and the traditional growth of consumers non-durable goods.

2. Money Markets: The anticipated slowdown in capital investments, including inventories, should ease somewhat the pressure on interest rates which will stabilize at a high level until economic and political conditions allow a deliberate easing of money rates without accompanying inflationary pressures. Residential construction, after an attrition which may reach agonizing proportions during the forthcoming winter, may start recovering gradually in the Spring.

3. Taxes: Economically speaking, tax increases are no longer necessary or justified. The present sharp step-up in defense expenditures at the annual rate of \$12 billion, however, will make imperative raising the corporate tax rate from 48% to 52 - 53%, together with a corresponding increase in the personal tax rate.

4. Wages: Labor cost will increase 6 - 7% in 1967 and the cost of living will continue to increase at an above average rate.

5. Corporate Profits: Increased financial and depreciation charges, higher taxes and labor cost, will not be offset by productivity gains or increased prices. Corporate profits, thus, will decline in 1967, possibly as much as 15%. ND

INVESTMENT ENVIRONMENT

Equity markets do not thrive during periods fraught with uncertainties. Confidence will be restored only after the causes for these uncertainties have been removed or are fully discounted.

Background for Investing and  
Investment Policy (continued)

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Three main concerns may already have run their course:

- Fears of a credit squeeze which were alleviated by the recent stabilization of interest rates;
- Fears of a devaluation of sterling which seems to have been temporarily postponed, at least until the next crisis;
- The prospective increase in both corporate and personal taxes over the next three months which seems to be accepted now more as a probability than a possibility.

Other uncertainties might not be solved or dissipated for some time:

- The extent of the much feared wage inflation;
- The trend of pre-tax corporate profits.

The biggest concern, of course, remains the war in Vietnam, whose cost has been largely responsible for the disruption of the economic, monetary, and price equilibrium in the U. S.

Even preliminary peace negotiations in Vietnam would restore confidence immediately as it would alleviate the very tight money conditions now prevailing, would help dispense with tax increases and with the suspension of tax incentives to industry, and arrest the escalation in the cost of living. The prospective return to normalcy and stability, even at the cost of deflation, would be extremely constructive for both the bond and equity markets.

In the meantime, it is becoming growingly apparent that the economic growth is being restrained by the high cost and scarcity of credit and by labor shortages which are putting increasing pressure on profit margins. The forthcoming interim earnings statements for the third quarter are likely to create much disappointment and concern. They will cause many downward revisions of 1966 earnings estimates and create much confusion as to possible earnings in 1967.

The impossibility of accelerating economic growth without inflation, the restrictive implications of the shortage of credit, wage inflation which offsets gains in productivity, all symptoms much in evidence in Europe since the early Sixties, are now part of the American scene. Judging by the behavior of the equity markets of Continental Europe since 1962, these economic restrictions lead to erosion of price/earnings ratios. The 1966 drastic correction in the P/E of U. S. equities may thus be more permanent than generally believed.

Background for Investing and  
Investment Policy (continued)

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INVESTMENT POLICY

TAX EXEMPTS

With the arrest of the heavy liquidations of tax exempt holdings by banks throughout the first 8 months of 1966 and with the prospects of a tax increase in 1967, the outlook of tax exempt bonds has improved considerably. Banks account normally for about 40% of the purchase of new tax exempt issues; although they are not in a position to do it now, the banks will eventually replenish their tax exempt portfolios so as to reduce their effective tax rate.

CORPORATE BONDS

It appears now that the bond market reached its bear market bottom on August 29. Interest rates are likely to remain at a high level for a long period, as long as the demand for credit persists. The restrictive lending policies of the banks, now supervised by the Federal Reserve Board, and the increasing depletion of corporate liquidities to be compounded by the removal of the 7% investment credit and of accelerated appreciation, as well as by the prospective tax increase, may force more and more companies to issue new fixed income securities either publicly or privately. A tax increase will be beneficial to the bond market inasmuch as the tempo and size of new government issues will be greatly reduced.

CONVERTIBLE FIXED INCOME SECURITIES

The combined impact of the slide of stock prices and of sharply rising interest rates have forced an unprecedented large number of companies to issue convertible issues. Result: the large premium over conversion value which convertibles traditionally command due to their scarcity has been drastically reduced; they now provide a long term call on equities whose prices are depressed and the returns they provide are quite attractive.

Helped, too, by the stabilization of interest rates, convertible issues ought to be considered as attractive.

EQUITIES

On the average, equities have declined 25% since February and many individual issues have suffered considerably higher declines.

A new leadership of the market will take over when the equity markets eventually stabilize.

Background for Investing and  
Investment Policy (continued)

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Most logical candidates:

1. The principal victims of rising interest rates, thus logically the main beneficiaries of the stabilization of the money markets; i. e. the so-called "money stocks".

Electric Utilities  
Telephone Companies

Banks  
Life Insurance Companies

(Avoid temporarily natural gas due to deteriorating regulatory climate; finance companies and savings and loan associations, both due to increased competition on the part of the banks.)

2. The oils on account of their low labor factor and of their relatively sheltered tax status (These characteristics apply also to the bank industry).

3. The casualty companies, recovering from a nightmarish period, however only for relatively short term investment objective.

4. The groups participating in the continuous growth of consumers' expenditures for non-durable goods and for services:

Airlines  
Leisure Time  
Textile Apparel  
Proprietary Drugs

Soft Drinks & Breweries  
Food Processors\*  
Toiletries and Cosmetics

\* Exceptions: meat packers, canners; millers, bakers, sugar refiners, possibly dairy companies due to declining milk production.

5. Eventually the "growth" stocks, as their prices erode and their hefty market premiums become more reasonable, will have to be accumulated aggressively as their long term potential of capital appreciation will outperform all other groups:

Electronics & other applied sciences  
Office Equipment  
Chemical Water Treatment  
Specialty industry leaders  
Electrical Equipment

Glass technology  
Hospital Equipment  
Publishing  
Business Services  
Air Freight

6. Among the so-called cyclical groups limit investments to:

Sulphur - in short supply  
Nickel - prospective increase in price  
Farm Equipment - needed to remedy increasing shortage of food.

**Background for Investing and  
Investment Policy (continued)**

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**7. Avoid temporarily the following groups:**

- **Aerospace:** outstanding prospects marred temporarily by disruption of production schedules by Vietnam's requirements, by high labor cost factor and by shortage of skilled labor;
- **Automobiles:** trend of sales of 1967 models;
- **Ethical Drugs:** conflict between high priced brand names and low priced generic name drugs;
- **Color TV:** forthcoming transition from a sellers' market to a buyers' market;
- **Construction:** possible recovery in 1967.

**8. Avoid:**

- **Industries heavily dependent on government business and on high level of capital expenditures;**
- **Most cyclical stocks;**
- **Any company which has not a "franchise" in its field.**

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Encs.

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## BACKGROUND FOR INVESTING

The level of stock prices is the function of several factors the respective weight of which varies widely according to whether the general trend of the market is up or down:

- a) economic and monetary outlook;
- b) corporate earnings and their trendline;
- c) stock yields and money market rates;
- d) confidence factor and price/earnings ratios.

### a) ECONOMIC AND MONETARY OUTLOOK

The economic outlook is the sum of the prospects for (1) consumers expenditures for goods and services; (2) of public expenditures at the federal, state, and local levels, and (3) of domestic investments such as capital expenditures, construction, and changes in inventories. The aggregate trend is reflected in the figures of the Gross National Product and in the FRB Index of Industrial Production.

	<u>1961</u>	<u>Annual Rate 2nd Quarter 1966</u>	<u>% Gain</u>
Gross National Product	\$520.1 billion	\$732.3 billion	40.8%
Personal Consumption	335.2	458.9	37.3
- Durable Goods	44.2	67.1	55.0
- Non Durable Goods	155.9	205.6	32.0
- Services	131.1	187.4	38.0
Business Investment	49.0	90.5	84.7
Residential Construction	22.6	28.0	23.9
Federal Expenditures	57.4	74.0	28.9
State & Local Expenditures	50.2	75.0	49.4

It can be readily seen that capital goods and consumers durable goods have been the most dynamic factors in the booming economy of the Sixties. Combined, these two segments of the economy have accounted for 25.5% of the increase in G. N. P. during the period under consideration, as their share of the latter was rising from 18% at the end of 1961 to 21.5% at the end of the second quarter of 1966.



Background for Investing  
(continued)

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Capital expenditures and inventories were stimulated by increased demand, by the need for new and efficient capacity and by tax incentives such as the 7% investment credit and accelerated depreciation. Such expenditures gained momentum in 1964 and 1965 when the corporate tax rates were cut and when credit and prospects for profits were excellent. As the very same incentives which prompted the boom for capital expenditures are about to be suspended or reversed, a decline is bound to take place in 1967 when the present programs are completed, the more so as they have run consistently ahead of G. N. P. itself over the past three years.

Also stimulated by a tax cut for individuals, expenditures for consumers' durables rose over the past two years at more than twice their traditional rate. It is thus unsustainable, the more so as higher prices, the accumulation of debt in recent years, and the high cost and stringency of credit should dampen consumers' propensity to buy and borrow. It is interesting to note in this respect that consumers' credit outstanding rose 53% between 1961 and June 1966, exactly in line with consumers' durables, and faster than disposable personal income which rose 37% during the period.

Hence these two sectors of the economy are likely to decline in 1967, at the most \$8 - 15 billion. A decline in the rate of accumulation of inventories could bring the above figures to \$12 - 20 billion. Such a decline will be more than offset by the trendline of other consumers' expenditures. In addition defense expenditures are likely to increase \$10 - 14 billion. Lagging residential construction may start rising after the Spring of 1967.

We conclude, therefore, that the economic outlook, as a whole, remains favorable although the quarter to quarter gains in G. N. P. will continue to subside as it has been the case since 1965. However, deterioration in the private sector should be expected, while the public sector will be substantially higher. These shifts will affect quite differently the respective prospects of industry groups.

The lifeline of the economy is the money supply, thus the availability of credit. Although the money supply increased sharply throughout the first six months of 1966, the demand for credit has been such that interest rates rose sharply. As the cost of money has not discouraged so far the thirst for money, a de facto control by the Federal Reserve Board of the big money center banks' lending policies is in the offing. Although such intervention has disturbing implications, it might help stabilize bank rates. It should be most helpful to the tax exempt market which has been drastically and repeatedly affected in 1966 by heavy liquidations on the part of banks to provide loanable funds.

Curbing the banks will make credit less available and thus may divert the unsatisfied demand for credit to the market place. At some point, however, that demand will subside as capital expenditures are curtailed and inventories are trimmed to a level more in line with demand. This will help stabilize interest rates, which eventually will decline together with the now so conspicuous inflationary pressures. This will lead to a new upsurge in economic growth, possibly in 1968, an election year, when political considerations will call again for strong economic conditions even at the cost of renewed inflation.



Background for Investing  
(continued)

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b) EARNINGS AND THEIR TRENDLINE

Overall economic activity will remain near term at a high plateau while Gross National Product continues to rise. These two prominent indicators, however, do not carry any specific market appraisal.

What counts are corporate profits and their trend. They are the net result of the following factors:

	<u>Trend</u>
Revenues and prices	Mostly Rising
less cost of:	
material	Mixed
labor	Rising
debt service and credit	Rising
depreciation charges	Rising
Pretax income (adjusted for inventory profits)	Trend declining
Taxes	Prospective Increase
Net profits	Flattening out or declining
Productivity	Stable to declining

Sustained prosperity eventually causes prices to rise after industry has mopped up excess manufacturing capacity, available skilled labor, and established at least partial balance between demand and production of materials. The leverage inherent to a period of expansion has been underlined recently by President Johnson when he noted that since 1960 profit had risen 83%, wages 17%, and prices 10%. These figures, incidentally, are an invitation to labor to get ready for the kill.

For corporate profits to continue to increase, either realization prices continue to increase faster than overall costs and/or productivity rises faster than the cost of doing business. In a Government-supervised economy, particularly during a period of emergency as it is the case now, industry is expected to absorb at least part of the rise in costs. As far as productivity is concerned and as expressed in cost per unit, it has not yet shown any marked deterioration.

The two main unknowns in the 1967 profit equation are still wages and taxes.

Wages have been increasing as labor, well aware of the current level of corporate profits and of the sharp increase in the cost of living over the past 12 months, is adopting a more and more uncompromising attitude at a time when many large labor contracts are coming up for negotiation. There are evidences that the rank and file is revolting

Background for Investing  
(continued)

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against their union leaders. The U. S. may be now facing a period of "wage inflation" similar to that witnessed in Europe since the late 50s. The numerous forthcoming wage settlements are likely to be costly. Labor is well aware that it is in short supply and thus that its bargaining position is extremely strong. It might well be that the cost of labor will go up 6 - 7% during 1967.

The closest line to that of net profits in a P & L statement, i. e. taxes, entails the highest leverage: a 2% increase in corporate taxes means a 4% reduction in profits, and a 4% increase in taxes an 8% reduction in profits. As the Administration will need an additional \$10 - 14 billion for financing the continuous escalation of the war in Vietnam at a time when inflationary pressures are so evident, an imminent increase in the corporate tax rate seems, as the Secretary of the Treasury put it recently, "within the realm of probability". A two point increase in the present corporate tax rate would only provide an additional \$1.5 billion at the current level of corporate pretax profits. It would thus seem more likely that the old 52% tax rate will be restored.

The combination of wages rising faster than productivity, of the sharply increased depreciation charges required by record capital expenditures, of the sharply higher level of interest charges and debt service assumed by industry, and of rising taxes, precludes much if any increase in corporate profits in 1967. Expressed in terms of Dow-Jones earnings, we guess that corporate profits will be down 5 - 15% in 1967, representing a decline from an estimated \$60 in 1967 to \$51 - \$57.

A tabulation of 100 leading companies indicates that 42 of them had lower pretax earnings during the second quarter of 1966 than in the first. This represents an increase from 37 during the first quarter and 35 for the fourth quarter of 1965. It would appear that the percentage has increased sharply during the third quarter of 1966 and that that trend will continue for several quarters.

c) STOCK YIELDS AND THE MONEY MARKET

We have pointed out repeatedly that rising interest rates have bearish implications for the equity markets. This is now evidenced for the fourth time since World War II and for the third time since 1957.

The yield differential between stocks and bonds is largely ignored during periods of rising economic activity when the focus is on growth in earnings, irrespective of the fact whether dividends are increased in line with the trend of profits. During periods of uncertainties, however, rising interest rates attract attention to yield, a concrete and tangible concept unlike equity values. Fixed income securities, at a price, offer an alternate investment medium considered attractive and with limited downside risk. Hence the switching of equities into bonds or into other savings media.

Background for Investing  
(continued)

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Ironically enough, the equities which provide the safest and fairest income are generally the first and main victims of rising interest rates. These so-called "money" or "defensive" stocks, whose stable and consistently rising earnings allow periodical increase in their dividends, thus giving them a good hedge over fixed income securities, nevertheless tend to decline together with bond prices. Eventually the so-called growth stocks which generally provide little or no return also suffer from the comparison with bond and savings rates. Hence the sequence: declining bond prices, declining stock prices.

As the worst credit situation in the U. S. for 40 years evolves toward some sort of climax, the differential between bond and stock yields is still in excess of 2% as returns of better than 6% are currently available on long treasury bills, notes of government agencies, and on quality bonds carrying lesser ratings than AA. During the equity market breaks of 1960 and 1962 the yield of common stocks (as expressed by the Dow Jones Industrial Average) rose above bond yields before equity prices started their recovery.

As underlined in a previous memorandum, the present situation bears little resemblance to the 1957 and 1960 experiences when the equity markets declined as a result of tight money conditions which culminated in mild recessions. In both cases, the equity markets' initial decline coincided with the trough of the bond market, at the exact time when the FRB Index of Industrial Production turned downward. The 1966 experience is unique to the extent that equity prices started their slide seven months before bond prices stabilized at the end of August, while the FRB Index is still moving up. Precedents, therefore, cannot be used for guidance.

The bear market for long term bonds might have bottomed out on August 29, 1966. Although it is too early to be sure on account of the peak seasonal demand for credit just ahead of us, should it be the case, one major uncertainty and concern would have been removed from the economic picture. The tremendous accumulation of debt which has drastically curtailed the availability of funds loanable by banks and other institutional lenders, precludes a drastic reversal of the trend of interest rates. The combination, however, of the arrest in liquidations of tax exempt bonds, of the lesser needs for credit for capital expenditures and inventory building purposes, might gradually restore orderly monetary conditions and possibly easier money conditions some time in 1967.

Background for Investing  
(continued)

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d) CONFIDENCE FACTOR

Equity markets do not thrive during periods of uncertainties.

The disturbing credit situation, the unpopular war in Vietnam, the sharp rise in the cost of living and especially of essential food staples, the floundering leadership of President Johnson, increasing labor and social unrest, the probability of higher taxes, the perils of sterling, etc... are enough reasons for having shaken up the most intangible factor, confidence, which has a crucial bearing on equity valuations. The simultaneous downtrend of the equity markets and of the standing of the President in the public polls is not a mere coincidence.

Confidence will be restored as the present uncertainties are removed one by one:

- Credit situation: the stabilization of the long term bond market at or near current levels and eventually easier money conditions, as economic conditions cool off and the enactment of a responsible fiscal policy alleviate the pressures now borne single-handedly by the monetary authorities, would be, short of a truce in Vietnam, the most constructive development;
- Tax increases: earlier this year, an overheating economy called for an immediate tax increase. At present, when the demand from the private sector may be slowing down, the sharply increased cost of Vietnam makes such tax increases imperative. The many recent pronouncements to this effect by the President and by members of his Administration have prepared both corporations and the public to what is forthcoming. Therefore a tax increase is anticipated. The enactment of such new legislation will also help remove a major uncertainty, although corporate earnings and individuals' take home pays will be affected;
- Sterling: the perils of the pound are chronic. Its crises are now endemic. Although everyone agrees that its exchange rate is unrealistic, its devaluation is obviously postponable thanks to the increasing cooperation of central banks. The Wilson austerity program, if successful short term, will alleviate the recent apprehensions as to the pound which thus will have survived a new crisis until the next one. In the meantime, a major threat will have faded away.

Background for Investing  
(continued)

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Even with Vietnam, the removal of these three uncertainties would go a long way to restore a large part of the confidence lost since the start of 1966.

A solution to Vietnam would of course be the most constructive factor notwithstanding its deflationary implications. It would restore confidence in President Johnson, alleviate the pressures on wages and on the cost of living, allow tax cuts and the restoration of tax incentives to industry, make money easier and credit more readily available. The return to normalcy would indeed be most bullish, even if temporarily the economy slows down during the inevitable period of transition which would follow.

ARE PRICE/EARNINGS RATIOS IN A DOWNWARD CYCLE?

In November 1961, when the Dow-Jones Industrial average reached its pre-1962 record high of 730, its current earnings were capitalized at 24X, three times their average appraisal of the early Fifties and almost double the level of 1958. By hindsight it is easy to state that stock prices had reached in 1961 aberrant proportions.

At the trough of the 1962 correction, earnings were briefly capitalized at 16X but they rose rapidly to 18X. Between 1963 and until early 1966, the average price/earnings ratio fluctuated within the narrow range of 18 - 19X current earnings, notwithstanding a 70% increase in corporate profits during the period.

As of now, with the Dow-Jones approximating 780, current earnings are capitalized at 14X earnings, which, by 1959 - 1966 standards, would appear to be quite a low evaluation and a buying level.

Making ourselves the devil's advocate, we would like to argue the case for the justification for lower price/earnings ratios under present economic, political, and social conditions.

First and obviously, the equity markets are anticipating lower earnings in 1967. It is premature, however, to estimate the extent of the possible decline until more elements of judgment are available as to the forthcoming changes in the principal variables for corporate profits (prices, wages, tax increases, etc.). If the assumption that 1967 earnings will be lower than in 1966 proves to be correct, it would be unrealistic to use now prevailing price/earnings ratios as a case for buying equities.

Second and more importantly, we entertain the proposition that the seeds of the now four year old downward trend of continental Europe's price/earnings ratios have taken roots here.



Background for Investing  
(continued)

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Why did price/earnings ratios on the Continent steadily decline in the midst of a long period of GNP growth, earnings progress and dividend increases as well as inflation? The most logical reason is that the Continent has lacked since 1960 the financial means to finance the extra economic growth caused by the wage explosion and the demand of modern societies for welfare, schools, roads, homes, etc. The real problem is that too much was to be done in a very short period of time. This outburst of affluency led to inflationary pressures and to credit stringency which have required in several countries programs of austerity.

We contend that the same pattern is now emerging in the United States which being wealthier than any other country in the world was able to withstand prosperity longer than Continental Europe. Over the past two years, however, all the great social problems which face a nation -- public health, education, housing, minimum income, unemployment, economic growth, aid to the underprivileged, etc. -- came to the fore as top priorities. As evolution was judged too slow or too ineffective, the Administration and Congress moved into such fields as education, mass transportation, rent subsidies, "Medicare", even water and air pollution -- which until 1965 were none of the central Government's concern. At the same time the Government was initiating novel programs for its war on poverty.

Over the past 18 months the U. S. Government has taken up more roles and assumed more new responsibilities than it did during all of the past 15 years. The country has thus accelerated its trend toward semi-socialism.

The new legislation passed by Congress over the past 18 months entails annual outlays of several billions of dollars and became law at a time when the cost of the escalation of the war in Vietnam was rising sharply and is due to rise further. This also came about at a time when the U. S. economy was going through an unprecedentedly long period of prosperity which by itself was taxing the financial and credit resources of the country.

The U. S. may thus have reached the same stage as Europe in the early Sixties. Compounded by the requirements of the war in Vietnam, normal economic growth and expansion of credit resources without inflation are no longer sufficient to carry the burden of the present programs. The latter will require new sources of revenues which logically and naturally should be provided by increased taxation. Corporations will be called upon to contribute their fair share of taxes and, as in Europe, to absorb at least part of the increase in the cost of doing business.

For all of these reasons, we believe that evaluation of corporate profits will in the future be more discriminate than in the past seven years and thus that appreciation of equities will not be commensurate with their growth in earnings. Along this line of reasoning, the "growth" stocks commanding hefty earnings multipliers may in the future enjoy lesser premiums than in the past.

## INVESTMENT POLICY

Questions: within the framework of the economic profile previously outlined, what would be the more favorably situated groups and companies in 1967? Are such groups and companies now so attractively priced as to justify purchase?

## NEAR-TERM EARNINGS PROSPECTS

Third quarter earnings statements will be released throughout October and November.

Undoubtedly many will be good but there are indications that many disappointments are in the offing. Pressures on profit margins will be blamed variously on the scarcity and high cost of credit, on labor shortages and overtime pay, on the impact of strikes, on lower demand in some industries, on squeeze due to rising commodity and raw material prices, on deteriorating price structure in certain cases, and on start-up expenses in many others. Most of these factors can be identified with the syndromes of an overheated economy and of inflation.

The parade of disappointments will include many bellwethers of U. S. industry, such as DuPont and most leading chemical companies, Motorola and Zenith, Xerox, possibly IBM, the automobile companies and their suppliers, textile companies, food processors, etc. in addition to all those companies which are being hurt by the tightness and high cost of money.

The trend of pre-tax margins during the third quarter will probably cause many downward revisions of 1966 earnings estimates and add to the difficulty of gauging 1967 prospects pending finalization of the corporate tax rate for that year.

## 1967 MARKET OUTLOOK

- Premises:
1. barring a truce and peace negotiations in Vietnam the corporate tax rate will be increased in 1967 to 52 - 53%;
  2. labor cost will increase 6 - 7%;
  3. industry will be forced to absorb part of the rising cost of doing business;
  4. the 1967 annual increase in productivity will not offset rising costs;
  5. thus corporate earnings will decline.

Investment Policy  
 (continued)

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Which are the groups and companies which will be able to buck the trend and to resist the best to the set of conditions outlined above?

First, industries with a low labor factor.

Out of 35 large industry groups, only four can boast total salaries and wages lower than their operating income; factor which restricts the leverage on net profits in case of any sharp increase in wages:

	Net Sales (Mill.)	Operating Income (Mill.)	Salaries & Wages (Mill.)	Salaries & Wages as a % of Sales	Effect of hypo- thetical 6% Wage Increase	
					Amount (Mill.)	% of Oper. Inc.
Oil	\$35,863.1	\$7,647.6	\$4,494.5	12.5%	\$270.0	3.5%
Tobacco						
Products	321.7	64.0	43.9	13.6	2.6	4.0
Banks	12,386	3,491	3,260	26.3	195.0	5.5
Utilities						
Electric	12,672	4,680	1,862	14.7	112	2.4

Second, industry groups enjoying sheltered tax position.

Oil industry (due to depletion allowances)  
 Many banks (due to tax exempt holdings)

Third, all companies with a predictable, superior rate of earnings growth in 1967 which would more than offset any increase in costs or charges, even under most adverse conditions.

Fourth, companies which are the leaders of secondary industries enjoying an actual franchise in their field, and small enough to escape governmental scrutiny, thus best able to pass along their own cost increases to their customers.

OUTLOOK BEYOND 1967

A whole new set of assumptions:

1. The economy will have cooled off and interest rates and credit conditions will have eased by then.
2. Even if peace negotiations in Vietnam have not been initiated, the bulk of the cost of the escalation of the war will be behind us.



Investment Policy  
 (continued)

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3. Fiscal incentives to industry will be restored and the 1967 tax increases could be rescinded.
4. In case of sluggishness, the Administration, concurrently with the Federal Reserve Board, will attempt to stimulate the economy as the Presidential elections approach.

\*  
 \*       \*  
 \*

To sum up, the short and intermediate short term outlook for the economy, corporate profits and the stock market is at best fraught with uncertainties. Beyond the first half of 1967, the equity markets may start anticipating the more constructive outlook for 1968 and then attempt to reach and exceed the previous high in the Dow Jones average.

EQUITY GROUPS AFTER THE MARKET DECLINE

Question: What do equity prices discount at current levels?

Merrill Lynch has computed the price/earnings ratios and yields of the industry groups which make up their own 540 stock composite index. The figures given on the next two pages are based respectively on 1965 earnings and market prices on December 31, 1965 (Dow Jones was 969) and on estimated 1966 earnings and market prices as of September 9 (Dow Jones was 776).

On the average, price/earnings ratios declined 29% over the past nine months, while market prices declined only 20% since December 31. The discrepancy is due to the estimated 10 - 12% increase in earnings in 1966 related to lower stock prices.

The extent of the correction in price/earnings ratios can be measured readily by the following statistics:

	Groups Commanding		
	<u>20X or more</u>	<u>10 - 20X</u>	<u>less than 10X</u>
December 31, 1965	11	45	1
September 1966	3	31	23

Not since 1958, when a general upward revaluation of price/earnings ratios started, have the stock indexes reflected such a moderate appraisal of current earning power. In terms of the Dow-Jones Industrial Average, the average price/earnings ratios approximates now 13X - 13.5X estimated 1966 earnings vs. 24X at its 1962 peak and the relatively narrow range of 16 - 18X during the period from June 1962 to early in 1966.

Investment Policy  
(continued)

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Significance of the correction:

1. Anticipation of lower corporate profits in 1967 (Based on our expectations, the Dow-Jones reflects an average price/earnings ratio of 14 - 16X possible 1967 earnings).
2. Anticipation of topping off of unprecedented 5 1/2 years of continuous prosperity.
3. Fears of "wage inflation" and of the impact of labor shortage.
4. High interest rates here to stay until inflation pressures subside.
5. A downward cycle in price/earnings ratios until a return to normalcy or stability, or, put another way, higher stock yields in the case of high interest rates.

The extraordinary financial developments of 1966 have injected a new unfavorable development for the equity markets to result from the flow of new convertible fixed income securities creating, potentially, substantial dilution of per share earnings.

New selections of equities require, therefore, a close examination of their capitalization and particularly of the strength of their liquid assets. Preference, thus, should be given to companies generating internally enough cash to support and finance their expansion and growth objectives.

After an average 25% decline in prices, all equities, whatever their quality, investment standing and prospects, are sufficiently depressed to create a favorable opportunity for upgrading holdings. This favorable period, therefore, should be used for switching out of the least favorably situated industries and equities into more promising situations with outstanding long term prospects.

It is therefore imperative to search for companies which have a "franchise" in their fields, i.e. occupy a position of leadership which precludes the inroads of newcomers. This should exclude such companies as DuPont, which, whatever its "quality" and size may be, is the leader of many fields facing fierce competition on a price basis and, therefore, erosion of profit margins. "Franchise" companies can be big (Xerox, Corning Glass, Polaroid, IBM, Avon, public utilities, etc.), or be relatively small (International Flavors & Fragrances, A.C. Nielsen, Simplicity Pattern, Emery Air Freight, etc.), provided they occupy a position of leadership difficult to be challenged.

Investment guidelines are suggested in the introductory pages of this memorandum.

EC/hm

John W. Bristol & Co., Inc.

# AVERAGE YIELDS AND PRICE/EARNINGS RATIOS

Merrill Lynch, Pierce, Fenner & Smith has computed the average yields and price/earnings multiples for the industry groups that make up its stock price index. They are presented here as a measure of the correction in price/earnings ratios which has taken place between the end of December 1965 and prices prevailing in mid-September.

	Yield		P/E Ratio		% Change
	Dec. 31 1965	Sept. 9 1966	Dec. 31 1965	Sept. 9 1966	
Aerospace Mfg.	2.6%	3.4%	14.0X	8.8X	- 37.1%
Agricultural Machinery	2.6	3.3	12.1	9.1	- 24.8
Airlines	1.0	1.4	13.9	14.1	+ 1.4
Aluminum	2.2	2.5	18.6	12.2	- 34.4
Apparel Mfg.	2.7	3.3	14.3	10.9	- 23.8
Auto Equipment	4.3	5.6	11.7	8.5	- 27.4
Auto Finance	5.4	6.8	10.9	8.8	- 19.3
Automobiles	3.3	4.4	12.5	8.4	- 32.8
Banks - New York City	3.8	4.9	13.9	10.2	- 26.6
Banks - Outside N. Y. C.	3.5	4.3	13.5	10.2	- 24.4
Beer	3.1	4.0	16.7	11.6	- 30.5
Biscuits	4.2	4.8	17.1	11.4	- 33.3
Bread Baking	2.3	2.9	17.2	8.1	- 52.9
Chemicals	2.7	3.7	18.7	12.7	- 32.1
Cigarettes	5.2	5.9	12.5	10.0	- 20.0
Construction Machinery	3.2	4.8	12.4	8.3	- 33.1
Containers - Paper	3.8	4.7	16.4	9.1	- 44.5
Copper	3.8	4.9	10.8	7.3	- 32.4
Cosmetics	1.9	2.2	19.6	15.4	- 21.4
Dairy Products	2.7	3.6	18.9	13.3	- 29.6
Department Stores	2.7	3.7	16.4	11.7	- 28.7
Discount Chains	1.2	1.9	12.3	8.4	- 31.7
Drugs	1.9	2.5	27.2	19.3	- 29.0
Electrical Equipment	2.0	2.8	17.0	10.9	- 35.9
Electronics	0.8	0.8	26.2	21.9	- 16.4
Food Chains	3.8	4.8	13.9	10.9	- 21.6

	Yield		P/E Ratio		% Change
	Dec. 31 1965	Sept. 9 1966	Dec. 31 1965	Sept. 9 1966	
Gold	3.4%	2.8%	20.2X	23.0X	+ 13.9%
Home Furnishings	3.1	4.5	14.2	9.0	- 36.6
Insurance - Fire & Casualty	2.9	3.4	32.3	18.9	- 41.5
Insurance - Life	1.0	1.7	23.9	14.1	- 41.0
Machine Tools	2.8	4.6	12.0	7.1	- 40.8
Machinery, Heavy	3.4	5.2	14.5	7.6	- 47.6
Mail Order	2.2	2.8	23.4	16.2	- 30.8
Metal Fabricating	3.5	4.8	15.6	8.9	- 42.9
Movie Producers	1.7	2.3	9.5	7.6	- 20.0
Natural Gas Pipe Lines	4.3	5.3	15.2	11.3	- 25.7
Office Equipment	1.3	1.3	29.9	24.3	- 18.7
Oil Field Equipment	3.1	4.4	13.4	9.5	- 29.1
Packaged Foods	2.7	3.6	20.1	14.5	- 27.9
Paper - Composite	3.5	4.4	15.4	9.9	- 35.7
Paper - Diversified Producers	3.7	4.5	14.7	10.3	- 29.9
Petroleum	3.0	3.5	14.9	12.0	- 19.5
Printing & Publishing	2.3	2.4	17.4	15.5	- 10.9
Radio & TV Mfg.	1.5	1.9	22.7	13.1	- 42.3
Railroad Car Leasing Cos.	3.1	4.4	17.0	11.2	- 34.1
Railroad Equipment Mfg.	3.8	5.1	12.2	8.9	- 27.0
Railroads	3.6	4.9	12.6	7.7	- 38.9
Rubber	3.2	3.4	13.2	11.4	- 13.6
Small Loans	3.8	5.3	14.6	9.8	- 32.9
Soap, Detergents, Toiletries	3.0	2.8	18.3	14.5	- 20.8
Soft Drinks	2.3	3.2	22.8	15.1	- 33.8
Steel	3.7	5.1	10.9	7.7	- 29.4
Textiles	2.8	4.0	12.7	8.2	- 35.4
Utilities:					
Electric	3.6	4.5	19.5	14.9	- 23.6
Gas Distributors	4.2	5.4	15.6	12.4	- 20.5
Communications	3.6	4.6	20.1	14.5	- 27.9
Variety Chains	2.7	3.8	13.2	9.4	- 28.8

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November 15, 1966

INSTITUTE FOR ADVANCED STUDY

MEASURE OF THE PORTFOLIO'S DEFENSIVE CHARACTERISTICS

Our memorandum dated October 6 (Background for Investing and Investment Policy) was completed at a time when heavy liquidation of so-called glamor stocks was creating an impression of market panic. Actually the Dow Jones Industrial average which measures the market behavior of 30 blue chips acted considerably better during that period than the general market. The improved tone of the blue chips became quite apparent after October 9, when a new leadership of the market finally emerged.

The so-called "money" or defensive stocks, characterized not only by their unspectacular but stable growth, but also by their market vulnerability and sensitivity to rising interest rates, responded favorably to the stabilization of interest rates. These equity groups - public utilities, banks, life insurance, blue chips, and oils - are now leading the market, a highly constructive factor although the rapidity and extent of the recovery of these groups may be breeding new setbacks until a solid base is established. In any event, the new leadership confirms that the speculative fever of the past 18 months has subsided.

Interest rates will be stabilized by either or by both an economic slowdown and increase in taxes, irrespective of how tight the credit situation will remain. Another favorable factor for the U. S. money markets is the indication that European interest rates are finally peaking out. Therefore the money markets may continue to fluctuate within a narrow range pending clarification of the fiscal and economic situations.

Trust's Breakdown of "Money" or Defensive Risks

	<u>October 31, 1966</u> <u>% of Assets</u>
Cash & Short Term Investments	12%
Other Fixed Income Securities	8
Equities:	
- Public Utilities	17
- Banks & Finance	2
- Insurance	4
- Oils	17
<u>Total</u>	<u>60%</u>

Measure of Portfolio's Defensive  
Characteristics (continued)

- 2 -

The present product mix of the portfolio would thus seem favorable in the present market and economic environments.

Overall equity risk as of September 30 was close to 80%, which is high, although not excessive. There is, therefore, no compulsion of adding to equities at this time notwithstanding the substantial liquid reserves which will be used whenever the economic and market outlook clarify. In the meantime, the many disappointing earnings statements for the third quarter clearly reveal that the five year old expansion in corporate profits is coming to an end. As the situation is likely to continue to worsen before it improves, the deteriorating prospects for earnings will continue to dampen the outlook for individual equity prices, except, of course, when earnings are quite predictable.

EC/hm

John W. Bristol & Co., Inc.

REVIEW OF STOCK HOLDINGS

INSTITUTE FOR ADVANCED STUDY



ELECTRIC UTILITIES	Per Share Earnings			Trend of Earnings				Present Price	1965-66 Price Range	Price/Earnings Ratio	Current Dividend	Yield
	1964	1965	Est. 1966	9 months		3rd Quarter						
				1965	1966	1965	1966					
American Electric Power	\$1.66	\$1.78	\$1.95	12 mos. Sept.:		\$1.75	\$1.90	42	48 - 32	21.5X	\$1.32	3.1%
Carolina Power & Light	1.60	1.80	1.90	12 mos. Sept.:		1.73	1.86	45	52 - 38	23.7	1.28	2.8
Central Illinois Light	1.45	1.60	1.70	12 mos. Sept.:		1.54	1.66	26	32 - 21	15.0	1.00	3.8
Central & South West	1.94	2.07	2.20	12 mos. Sept.:		1.99	2.19	47	54 - 35	21.4	1.50	3.2
Columbus & South. Ohio	2.04	2.31	2.35	12 mos. Sept.:		2.26	2.33	36	48 - 32	15.3	1.52	4.2
Louisville Gas & Electric	1.75	1.87	2.10	12 mos. Sept.:		1.85	2.05	35	42 - 27	16.7	1.18	3.4
Middle South Utilities	1.10	1.11	1.23	\$ .84	\$ .92	.24	.26	26	27 - 21	21.1	.68	2.6
Southern Company	1.31	1.39	1.45	12 mos. Sept.:		1.36	1.43	30	36 - 24	20.7	1.02	3.4
Virginia El. & Power	1.72	1.95	2.10	12 mos. Sept.:		1.90	2.07	48	53 - 38	22.9	1.28	2.7
TELEPHONE												
Continental Telephone	.67	.85	1.07	6 mos. June:		.34	.49	24	30 - 19	22.4	.52	2.2
General Tel. & Electron.	1.56	1.87	2.20	1.31	1.57	.48	.56	42	49 - 36	19.1	1.28	3.0
GAS & PIPE LINES												
Arkansas Louisiana Gas	2.32	2.57	2.90					37	49 - 33	13.0	1.50	4.1
Florida Gas	.92	.86	1.00	.63	.73	.09	.18	10	15 - 9	10.0	.20	2.0
Peoples Gas Light	2.35	2.62	2.70	12 mos. Aug.:		2.63	2.68	37	51 - 34	13.7	1.84	5.0
Pioneer Natural Gas	1.05	1.00	1.10	12 mos. Sept.:		.76	.83	15	23 - 13	13.6	.68	4.5
Tenneco	1.51	1.72	1.90					22	25 - 19	11.6	1.20	5.5
Southern Union Gas	1.70	1.70	1.75	12 mos. Sept.:		1.66	1.71	26	37 - 22	15.0	1.04	4.0
CHEMICALS												
Allied Chemical	3.08	3.14	3.25	2.30	2.36	.67	.73	36	58 - 33	11.1	1.90	5.3
Betz Laboratories	1.23	1.57	1.80	1.15	1.38	.38	.49	34	39 - 20	18.9	.36	1.1
Celanese Corp.	4.25	5.10	4.60					45	92 - 42	10.0	2.00	4.4
Freeport Sulphur	1.00	1.40	2.05	.94	1.49	.36	.55	35	45 - 21	17.1	1.25	3.6
Int'l Flavors & Fragr.	1.24	1.43	1.75	1.05	1.27	.40	.44	58	64 - 35	33.0	.50	.9
Monsanto Chemical	3.65	3.89	3.50	3.10	2.81	.74	.42	42	93 - 38	12.0	1.60	3.8
Union Carbide	3.14	3.76	4.00					50	76 - 49	12.5	2.00	4.0
Wallace & Tiernan	1.78	2.23	2.50	1.65	1.90	.56	.60	34	47 - 29	14.0	1.10	3.2



DRUGS	Per Share Earnings			Trend of Earnings				Present Price	1965-66 Price Range	Price/Earnings Ratio	Current Dividend	Yield
	1964	1965	Est. 1966	9 months		3rd Quarter						
				1965	1966	1965	1966					
Becton Dickinson	\$1.29	\$1.56	\$2.00					69	77 - 36	35.0X	\$ .40	0.6%
Norwich Pharmacal	1.98	2.29	2.65					58	59 - 42	21.9	1.30	2.2
Parke Davis	1.76	2.20	2.30	\$1.46	\$1.51	\$ .52	\$ .54	25	44 - 22	10.9	1.45	5.8
FOOD & BEVERAGES												
Armour & Co.	3.72	2.88	3.50					29	53 - 27	8.3	1.60	5.5
Hawthorn-Mellody	2.33	2.51	2.55					19	36 - 15	7.5	1.00	5.2
Russell Stover	1.68	2.03	2.45A					35	49 - 29	14.0	1.00	2.9
ELECTRICAL & ELECTRONICS												
Schlumberger Limited	3.18	3.52	3.85	2.44	2.62	.87	.92	46	61 - 40	11.9	1.20	2.6
OFFICE EQUIPMENT												
I. B. M.	8.20	9.03	9.60	6.65	7.07	2.23	2.40	319	375 - 269	33.2	4.40	1.4
AUTOMOBILE												
Chrysler Corp.	5.50	5.44	5.00					34	62 - 33	6.8	2.00	5.9
MACHINERY												
Harris-Intertype	1.76	2.05	2.51A	1st Q. Sept.:		.43	.56	28	39 - 23	9.2	1.00	3.6
Massey Ferguson	3.04	2.66	3.00	1.57	2.01	1.03	.64	22	37 - 19	7.0	1.00	4.7
NON-FERROUS METALS												
American Metal Climax	3.03	4.00	4.40					42	65 - 34	9.5	1.90	4.5
Falconbridge Nickel	4.51	5.47	5.75					78	104 - 75	13.6	3.50	4.5
Magma Copper	4.15	4.72	6.50					50	65 - 40	7.7	3.60	7.2
Newmont Mining	2.45	3.77	5.25					50	70 - 39	9.5	2.20	4.4
Reynolds Metals	1.96	2.92	3.60					48	66 - 34	13.3	.75	1.6

OIL AND NATURAL GAS	Per Share Earnings			Trend of Earnings				Present Price	1965-66 Price Range	Price/Earnings Ratio	Current Dividend	Yield
	1964	1965	Est. 1966	9 months		3rd Quarter						
				1965	1966	1965	1966					
Coastal States Gas	\$1.82	\$2.12	\$2.44A					25	40 - 20	10.2X	\$ -	-
Gulf Oil	3.81	4.12	4.80					60	60 - 49	12.5	2.20	3.6%
Louisiana Land	1.79	1.89	2.15	\$1.39	\$1.61	\$ .46	\$ .55	50	60 - 42	23.3	1.60	3.2
Royal Dutch	3.61	3.87	4.15	2.88	3.04	1.02	1.06	38	50 - 30	9.2	1.79	4.7
Shell Oil	3.27	3.85	4.15	2.83	3.09	.93	1.02	65	68 - 56	15.7	1.90	2.9
Sinclair Oil	3.92	5.04	6.20					67	70 - 52	10.8	2.40	3.6
Skelly Oil	5.25	6.97	7.75	4.88	5.45	1.70	1.83	109	118 - 81	14.1	2.00	1.8
Texaco	4.27	4.71	5.10	3.43	3.73	1.16	1.26	71	88 - 61	13.9	2.55	3.6
<u>SERVICES</u>												
Dun & Bradstreet	1.39	1.52	1.65	1.12	1.22	.40	.43	26	39 - 25	15.8	.95	3.7
U. S. Freight	2.72	3.20	3.65					41	62 - 37	11.2	1.90	4.6
<u>PRINTING &amp; PUBLISHING</u>												
Crowell-Collier	1.77	2.25	2.60					36 1/2	52 - 25	14.0	-	-
<u>PAPER</u>												
Mead Corporation	3.00	3.45	4.30					48	56 - 39	11.2	1.70	3.5
West Virginia Pulp & Paper	2.59	3.71	4.35					40	56 - 38	9.2	1.70	4.3
<u>BUILDING</u>												
DeSoto Chemical	1.30	1.45	1.60					16	26 - 15	10.0	.70	4.4
Georgia Pacific	2.31	2.42	2.45	1.89	2.06	.61	.63	34	55 - 30	14.0	1.00	2.9
MacMillan Bloedel	1.91	1.95	2.00	1.50	1.56	.49	.49	25	38 - 25	12.5	1.00	4.0
Weyerhaeuser	2.21	2.72	2.65					33	43 - 28	12.7	1.40	4.2
<u>RETAIL</u>												
Federated Department S.	3.10	3.40	3.70					59	77 - 55	15.9	1.70	2.9
Montgomery Ward	1.66	1.83	2.00					23	40 - 22	11.5	1.00	4.3

STEEL	Per Share Earnings			Trend of Earnings				Present Price	1965-66 Price Range	Price/Earnings Ratio	Current Dividend	Yield
	1964	1965	Est. 1966	9 months		3rd Quarter						
				1965	1966	1965	1966					
Hanna Mining	\$3.29	\$3.84	\$4.20					54	67 - 43	13.0X	\$1.00	1.9%
TOBACCO												
General Cigar	1.75	1.60	1.65	\$ .89	\$1.17	\$ .48	\$ .51	20	55 - 19	12.0	1.20	6.0
BANKS												
F. N. C. B. New York	3.26	3.52	3.85	\$2.57	\$2.87	\$ .87	\$ .98	53	63 - 40	13.8	1.80	3.4
Marine Midland	2.30	2.40	2.62	1.74	1.91	.60	.64	30	37 - 24	11.5	1.30	4.3
Morgan Guaranty	5.98	6.55	6.85	4.93	5.07	1.62	1.76	86	110 - 72	12.6	4.00	4.7

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Memo to Mr. Leidesdorf  
Mr. Schur  
Mr. Hochschild  
Mr. Shanks  
Mr. Strauss  
Mr. Dilworth  
Mr. Hansmann

November 16, 1966

POSSIBLE INVESTMENT CHANGES

	<u>SELL</u>	
	<u>Book Cost</u>	<u>Present Market Value</u>
a) 5,000 shares Freeport Sulphur	\$171,800	\$190,000

Holding was bought in August 1966. New elements of judgment reviewed in the enclosed memorandum prompt recommendation to sell this initial holding as a precautionary measure.

b) 8,000 shares U. S. Freight	\$390,279	\$390,000
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Messrs. Schur and Hansmann are raising valid questions as to the prospects of this leading company in the freight forwarding field. 1) U. S. Freight's President, Mr. Forgash, who built the Company to what it is now, died suddenly in September 1966. Will the Company lose its momentum under its less dynamic successors? 2) What will be the impact on the Company's operations of a slowdown in economic activity? As these two questions cannot be answered at this time, the committee may consider the sale of this holding, also as a precautionary measure.

ADDITIONS TO CURRENT HOLDINGS

As stressed in another memorandum, the present equity exposure of the portfolio approximates now 80%, an historically high ratio which creates little compulsion of adding equities at this time.

The following equities, all depressed by disappointing earnings causing heavy tax selling, could be considered as additions to current holdings:

General Cigar (Ralph Hansmann)  
Celanese Corporation  
Monsanto  
Massey-Ferguson

Possible Investment Changes  
(continued)

- 2 -

Celanese and Monsanto

The profits of Celanese and Monsanto are depressed by the weakening price structure of synthetic fibers.

	<u>Monsanto</u>	<u>Celanese</u>
1965 Earnings	\$3.89	\$5.10 (on 11,889,000 shs.)
Est. 1966 Earnings	3.70*	4.60 (on 13% more shs. outst.)
Est. 1967 Earnings	3.50	5.00

\*Before special write-off of \$.19 per share.

Monsanto is faring less well than Celanese whose operations are supported by strong chemical and oil operations. Hence the possibility of an improvement in earnings in 1967 for Celanese vs. a further decline for Monsanto.

Massey-Ferguson

Out of the blue, June quarter results were down 30% after having risen sharply during the previous six months.

Reasons for decline:

1. Slowness in the German and U. K. farm equipment markets;
2. Exchange problems;
3. Higher marketing and selling expenses;
4. Less than expected benefits from cost-reduction programs;
5. An unusually good third quarter 1965.

As a result, earnings for fiscal 10/31/66 will be about \$2.60 - \$2.70 per share, the same as the previous year. This would indicate fourth quarter earnings of \$.55 - \$.62 per share vs. \$1.08 for the corresponding period of 1965.

Although prospects for farm equipment are outstanding, Massey's current problems may not be fully resolved in 1967 so that earnings are tentatively projected at the same level as in 1966.

At 20 the stock is possibly unduly depressed by the sale of large blocks to realize losses.

EC/hm  
Enc.

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November 15, 1966

FREEPORT SULPHUR COMPANY

Common Stock

Investment Review

1965-66		Earnings Per Share			P/E Ratio		Mean P/E		Dividend	Yield
Market Price	Price Range	1965	1966 E.	1967 E.	1966 E.	1967 E.	1960-65	1955-60		
37	45 - 21	\$1.41	\$2.10	\$2.45	17.6X	15.1X	17.5X	11.6X	\$1.00	2.7%

SUMMARY AND CONCLUSION

Reflecting the strong trend of business activity in U. S. and world economies as well as the sharp rise in demand by the commercial fertilizer industry, the growth in world-wide demand for sulfur since 1962 has exceeded the rate of total production. As a consequence, the price of domestic delivered sulfur has gone from \$23.50 per long ton as recently as 1964 to over \$26 per ton currently, and actual realizations have shown somewhat more improvement. The increase in export sulfur prices during this period has been more marked, rising almost 65%.

It is well to remember that the historical trend of the sulfur industry has been quite cyclical. In this review, we examine preliminary evidence suggesting that free world sulfur supplies may build up rapidly within the next two years and therefore help bring about a balance in the supply/demand relationship sooner than expected. Furthermore, awareness of mounting phosphate fertilizer capacity may also induce some postponement in new projects and, to that extent, limit new sulfur outlets. Some softening in phosphate prices has already been evident in this respect. This factor as well as the expected slowdown in business activity forecast for 1967 could retard growth in free world sulfur demand during the next several years.

The implications of this viewpoint, which we spell out below, are not encouraging for intermediate term investments in Freeport Sulphur. The present valuation of the stock is in line with the average multiple of the past five years. But investors previously have marked down the price/earnings ratio of the stock during periods of rapid supply expansion as in the 1957-60 period. Under the circumstances, the stock would appear a neutral holding at this time with limited opportunity for appreciation barring new discoveries. It continues to represent a worthwhile means of investment for the very long term in the projected secular growth of fertilizer demand.

Freeport Sulphur Company  
 Common Stock (continued)

- 2 -

SULFUR OUTLOOK

The marked recovery in sulfur prices and expectations for further increases have stirred new interest in sulfur exploration and expansion. A comparable build-up from a shortage of sulfur in 1952 to oversupply in 1956 illustrates the cyclical risk of a secular nature that has characterized the industry. Market analysts are currently examining the publicized expansion of sulfur output throughout the world. The conclusions of some suggest that oversupply rather than shortages of sulfur may be the problem in a year or two.

Major sources of new supply are: 1) recovered output in Canada where plans to increase supplies have been accelerated and enlarged; 2) major new Frasch mines that will be developed in the United States; and 3) expectation of rising sulfur exports from Mexico in 1967 and beyond as the Mexican government reaches accord with Pan American Sulphur and Texas Gulf Sulphur.

The following table details projected increments of new sulfur production for the next three years as prepared by one influential analyst:

Estimated Annual Increases in Free World Sulfur Supply, 1966 - 1968  
 (000 long tons)

	<u>1966</u>	<u>1967</u>	<u>1968</u>
<u>Frasch</u>			
U. S.	965	625	1, 250
Mexican	(100)	350	250
<u>Recovered</u>			
Canadian	200	400	1, 100
French	-	50	100
U. S.	100	150	150
Other	150	300	400
<u>Non-elemental</u>	<u>400</u>	<u>500</u>	<u>900</u>
<u>Total Annual Increase</u>	1, 715	2, 375	5, 150

Commenting on these specific areas of new supply, this analyst indicates that the single most important addition of new sulfur supplies would be recovered HS<sub>2</sub> (sour gas) as a by-product of new Canadian gas production. The postponability of this output of new sulfur is severely restricted since recovery is entirely a by-product of gas production, the schedules for which have already been certified by the Canadian Conservation Board. Major sulfur recovery plants are in process of construction. While it is debatable to assume that by 1968 over one million tons of new Canadian recovered sulfur will be coming on the market, it is undoubtedly true that the prospective build-up in this area has accelerated and expanded recently. This factor by itself has brought nearer to the present an oversupply problem.



Freeport Sulphur Company  
Common Stock (continued)

- 3 -

As far as new U. S. Frasch production is concerned, both Freeport and Texas Gulf Sulphur will be bringing on stream major new supplies by 1968. In particular, Freeport's Caminada mine may contribute at least 400,000 tons of new sulfur by 1968, and overall the Company will probably bring on stream over 500,000 tons of new sulfur in that year. By 1968, Texas Gulf Sulphur is expected to increase production by 400,000 tons. Other companies with major new sulfur projects include Occidental Petroleum, the Phalen interests, Allied Chemical & Dye and Hooker Chemical. A substantial portion of the latter two companies' sulfur output will be used for internal fertilizer processing.

A third area of significant increases in sulfur supply - and by far the most unpredictable - is Mexico. Large deposits of Frasch processible sulfur exist there. It is believed by our sources that the Mexican government will attempt to increase sulfur production significantly for use in building a domestic fertilizer and industrial complex. Nevertheless, this supply of new Mexican sulfur will have its effect on export markets.

#### SULFUR DEMAND

Both fertilizer and industrial uses have accounted for the accelerated growth in sulfur demand during the past three years. Consumption by fertilizer manufacturers rose 10.1% per year during 1962-65 (16.1% annually in the U. S. alone) compared to 4% per year between 1955 and 1962. This reflects a continuing trend toward higher-analysis phosphate fertilizers, which require greater amounts of sulfuric acid in processing. It also reflects the heightened growth in world demand for all types of phosphate fertilizers. Of course, sulfur is the chemical industry's most widely used raw material. In the period of economic prosperity that extended from 1961, rising growth of demand was evident. Free world sulfur demand has surged ahead at an average compound rate of 8% per year during the past three years, compared with a 2.9% average annual rate during 1955-62.

Looking ahead, our sources suggest no major changes in the pattern of industrial consumption of sulfur notwithstanding reports of new processes to use substitute materials.

Sulfur experts regard the accelerated growth of sulfur consumption in fertilizers as somewhat unsustainable over the nearer term and are now forecasting a slowdown. Increasing concern about the level of industrial output in the United States in 1967 is another factor suggesting caution. In speeches of recent weeks, two spokesmen for Freeport and Texas Gulf respectively are now forecasting average annual growth rates of free world sulfur demand at 5 1/2% - 6% annually compared to an earlier consensus of 6 1/2%.



Freeport Sulphur Company  
 Common Stock (continued)

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SUPPLY/DEMAND RELATIONSHIP

These projections suggest that the current sulfur shortage may largely disappear in 1967 and that actual oversupply could develop in late 1968. The following table illustrates these expectations:

Free World Production and Consumption of Sulfur, 1965 - 1968 E.  
 (million long tons)

<u>Year</u>	<u>Production</u>	<u>% Increase</u>	<u>Consumption</u>	<u>% Increase</u>	<u>Increase (decrease) in inventories</u>
1965	22.4	-	23.3	-	-
1966 E.	24.1	6.7	25.1	7.7	(1.0)
1967 E.	26.4	9.2	26.5	5.5	(0.100)
1968 E.	31.5	13.4	28.0	5.5	3.5

The projected increase in inventories of 3.5 million tons by 1968 is equivalent to 2.4 months' consumption. According to L. B. Gittinger, Freeport Sulphur's total inventories on hand by the end of 1968 could approach 6 million tons which would be decidedly higher than normal.

PRICE EFFECT

The impact of the above supply/demand projections on domestic sulfur companies' price realizations is difficult to quantify. They imply, however, that by 1968 the risk of market price weakness in export sulfur operations would be apparent. Our sources suggest that in 1968 domestic realizations may remain around \$27 per ton (compared to \$25 or so in 1966), but that export realizations may drop from something like \$38 per ton in 1967 to \$36 per ton in 1968. Export realizations currently average about \$32.50. The net effect of this projection could be an actual reduction in revenues from sulfur operations in 1969. Regarding Freeport specifically, growing earning power from potash and phosphate developments would at best offset this potential reduction in sulfur revenues.

The following table presents estimates of pre-tax earnings by principal product groups of Freeport Sulphur for 1966-1968 under the above assumptions:

<u>Product Group</u>	<u>1965</u>	<u>1966 E.</u>	<u>1967 E.</u>	<u>1968 E.</u>
Sulfur	\$1.30	\$2.06	\$2.55	\$2.75
Kaolin	.11	.14	.15	.18
Oil and Gas	-	(0.05)	(0.07)	-
Potash	.08	.12	.30	.30
Phosphates	-	-	-	.07
Investments & Miscellaneous	.20	.21	.14	.14
Total pre-tax income	\$1.69	\$2.48	\$3.07	\$3.44
Tax Rate	16.8%	18.0%	23.0%	28.0%
Earnings per Share	\$1.41	\$2.10	\$2.40	\$2.50

Freeport Sulphur Company  
Common Stock (continued)

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### EVALUATION

How valid are these projections and the underlying assumptions of approaching supply/demand balance? Since the demand postulates involved are standard industry estimates, there are no strong grounds for questioning them. As for the supply projections, we believe that two moderating factors should be cited. First, it is improbable based on economic history to assume that all of the various new projected facilities will be operating on schedule and at optimal rates as assumed in these projections. Secondly, it is also likely that the "feedback" from a survey of these projections would induce some postponement of present plans for new sulfur sources. Granting these reservations, it is probably correct to assume that the general direction of the thesis discussed here is correct and that oversupply will be a definite risk within several years.

Another key consideration is simply that any postponement in sulfur production would largely be in the hands of the U. S. Frasch producers, including Freeport. Accordingly, any production cutback or postponement would have some immediate effect on Freeport's revenues in any event. Unlike previous experience, however, it seems probable that domestic price realizations may be maintained during such a period in this decade. This would represent a stabilizing factor since price fluctuations exert far more leverage on earnings than production changes.

Finally, it should be recognized that the Mexican government's program and policies are not only largely unpredictable but also removed from ordinary world trade analysis.

### INVESTMENT OPINION

In our opinion, Freeport Sulphur remains a suitable investment commitment for long term participation in the sulfur industry and, equally important, growth in rising world consumption of fertilizer. The foregoing analysis suggests that the Company's earning power will level off by 1968 and could even decline slightly in 1969. Earnings projections for 1967 are on the order of a 20% increase. Freeport Sulphur is protected by its six year contracts with many of its customers. In addition, the Company is developing a potential for a fully integrated fertilizer business in view of its commitments in phosphate and potash. The Company's financial resources are significant, and as a result of its tax credits, its tax rate while ascending slowly will still be at a relatively low level for the next several years. While management is regarded as financially conservative, it is highly regarded in the industry for its competence.

Despite these known virtues, it is also true that in previous periods of sulfur oversupply, namely 1960-1962, the market evaluation of Freeport Sulphur common stock involved an actual discount from the Standard & Poor's 425 Industrial Stock Index. This discount ranged on the order of 10-15% during these years. Assuming that another period of oversupply will recur, one can suppose that Freeport common stock may again sell at some discount on the order of 10-15% vis-à-vis the Industrials. In the face of the above considerations, we consider the stock a neutral holding at this time with limited prospects for nearer term appreciation.

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November 2, 1966

NORWICH PHARMACAL COMPANY

Progress Report

Present Price	1965-66 Price Range	Earnings Per Share			PER 1967 P.	Dividend	Yield
		1965	1966 E.	1967 P.			
55	59 - 42	\$2.29	\$2.70-\$2.75	\$3.00+(1)	18.4X	\$1.30	2.4%

(1) \$2.80+, assuming an 8% corporate tax increase, but excluding any contribution from Bonaid.

NINE MONTH RESULTS

Sales for the first nine months of 1966 totaled \$52.3 million, a 10.5% increase above the \$47.4 million reported for the comparable period last year. Earnings increased 24% from \$6.5 million to \$8.0 million. Earnings for the quarter ending September 30 showed a similar advance jumping from \$.69 a share to \$.83. Sales for the third quarter, however, experienced only a modest increase indicating that the product mix was particularly favorable with ethical lines and Pepto-Bismol showing strong gains. Earnings per share for the 12 months through September 1966 totaled \$2.71 per share.

1966 PROSPECTS

All of the Company's nitrofurazone products in the ethical human and veterinary markets have demonstrated favorable sales trends this year to date. Furadantin for the treatment of urinary infections has continued to experience creditable sales growth and profitable margins. Norwich is devoting impressive research efforts towards protecting its position in this market prior to the expiration of basic patents in 1969 through the development of a nitrofurazone product known as NF246. In crystalline form, NF246 may afford superior characteristics than Furadantin.

The most significant development in the latest 9 months is the approval last week by the Food and Drug Administration of Norwich's coccidiostat, Bonaid, which is reported to have substantial potential in the feed additive market. Merck's Amprol now dominates this market estimated at around \$30 million of annual sales domestically and \$20 million more overseas. Some earnings contribution from this product is anticipated in 1967. In this connection, Norwich has entered into a contract with Ralston-Purina to supply Bonaid for a significant portion of their poultry feed mixes. Assuming reasonable success - sales of \$5 million - Bonaid could contribute earning power of \$250,000 - \$300,000 to net in 1967. This is equivalent to per share earnings of \$.07 - \$.08 alone. Cumulatively, the contribution could reach \$.35 - \$.40 per share over the next several years. The degree of success will depend on the effectiveness of the new marketing force assigned to the Noraid Division and to some extent on the level of poultry prices.

Norwich Pharmacal Company  
Progress Report (continued)

- 2 -

At least half of Norwich's sales come from its proprietary drug line, mainly Pepto-Bismol. Deliveries of this product are concentrated in September and October. Volume at the end of September indicated a possible 12 - 14% increase this year to a level of \$16.0 - \$17.5 million. While competition in this field has intensified as a result of the Alka-Seltzer campaign, Norwich has obviously experienced excellent results in the third quarter.

Sales growth abroad continues to exceed that in the United States. In January the Company will begin to operate its own manufacturing facilities in the Common Market.

For the full year 1966, growth should be greater than originally anticipated with volume exceeding \$71 million and earnings surpassing \$10 million net or \$2.70 per share. Since the Company has reported approximately the latter figure for the 12 months through September, we are conservatively projecting very limited improvement in fourth quarter comparisons for the Company. This factor should not be overlooked as a short term market consideration.

#### 1967 PROSPECTS

For the coming year we believe that the present momentum of sales would suggest an increase of 10% in revenues and at least a similar gain in profits. As a result of costs of establishing the new Noraid marketing organization and the continuing promotional expenditures for proprietary lines, we would not anticipate any major profit margin improvement. The Company is not exposed, however, to risks of raw material price pressures or significant labor cost hikes. These projections would specifically be translated into a sales level of at least \$80 million and earnings per share of over \$3.00 (over \$2.80 assuming an 8% corporate tax increase). These estimates do not include any benefits from the introduction of Bonaid. As discussed above, this drug could capture 15% or more of the present coccidiostat market with consequent benefit to earnings per share on the order of \$.06 - \$.08.

#### INVESTMENT CONCLUSIONS

Norwich Pharmacal is a moderate sized pharmaceutical house with representation in both the ethical and proprietary fields. Proprietary sales have grown at roughly a 7 - 8% annual rate aided by Pepto-Bismol, a leading antacid product. Ethical volume based largely on the Company's research in nitrofurantoin chemistry has grown at approximately twice this rate. The principal products are nitrofurantoin derivatives used as topical and systemic antibacterial agents. Aided by significant new proprietary product introductions as well as continuing progress in veterinary and ethical drugs, Norwich has enjoyed a particularly favorable record since 1964. It seems likely - particularly with the introduction of Bonaid - that sales can grow at an 8 - 10% rate over the next several years while earnings could increase on the order of 12 - 14% annually.

Norwich Pharmacal Company  
Progress Report (continued)

- 3 -

The Company's common stock at 18.4X estimated 1967 earnings sells at a premium of approximately 25% above the price/earnings ratio projected for the Dow-Jones Industrial average next year. This premium is somewhat lower than the average prevailing for the past five years. Recognizing that there is some longer term risk in the Company's patent situation, we believe Norwich Pharmacal common stock offers above-average attraction in the "mixed" drug company group at this time.

RCL/hm

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October 27, 1966

HAWTHORN-MELODY, INC.

Progress Report based on interview with Mr. Norton, President

<u>Present</u> <u>Price</u>	<u>1966</u> <u>Price Range</u>	<u>Per Share Earnings</u>		<u>P/E</u> <u>Ratio</u>	<u>Dividend</u>	<u>Yield</u>
		<u>1966</u>	<u>E. 1967*</u>			
19	36 - 15	\$2.51	\$2.60	7.3X	\$1.00	5.2%

\* March 31 Fiscal Year.

BACKGROUND

Hawthorn-Mellody, a dairy company, offered its shares to the public for the first time in the fall of 1963 at \$21.50 per share, when the Company's earning power was \$1.70 per share.

Over the past three years sales and earnings increased 50%, largely due to acquisitions of other dairy companies and of two companies outside of the dairy field.

1966 IN REVIEW

During the fiscal year ended March 31, 1966 sales rose 16%; earnings, however, were only 8% higher. Actually the fourth quarter profits declined substantially as a 5% contraction in the production of milk in the U. S. put pressure on dairy companies' earnings.

This situation, attributed to the heavy slaughtering of cows and heifers since 1965, provoked a 2 cents per quart increase in the price of milk paid to farmers and ultimately a 3 - 4 cent increase in the retail price of this essential food staple. These increases were put into effect in the late spring and early summer of 1966.

In the meantime dairy companies' margins and costs suffered until retail prices could be adjusted.

Accordingly, Hawthorn-Mellody's first fiscal quarter as of June 30, 1966 was disappointing inasmuch as sales rose 30% from \$22.3 million to \$29 million, while net earnings decreased 10% from \$.69 per share to \$.62.



Hawthorn-Mellody, Inc.  
Progress Report (continued)

- 2 -

Second fiscal quarter results as of September 30 will not be released until November. Once again earnings will be down, probably no more than 5% below the 1965 September quarter. This time the moving expenses of the Chicago plant and executive headquarters to a new \$2 million structure will be responsible for the bulk of the decline in earnings.

According to Mr. Norton, the milk supply situation has improved since August so that margins are now back to normal. The present December quarter results should compare favorably with the corresponding 1965 quarter which was excellent.

Management expects to be able to report an increase in earnings for the fiscal year as of March 31, 1967, notwithstanding the poor start so far.

#### PROGRESS OF DIVISIONS

Since 1962, Hawthorn-Mellody has spent some \$7 million in modernizing its plants and those of companies acquired since. In the opinion of Mr. Norton, all facilities have now the most modern and efficient equipment.

Chicago Pickle Co. acquired in 1964 has proven to be a very rewarding investment. Production facilities were expanded, so that sales have about doubled (\$5 million +) since acquisition. The earnings gain has been more than commensurate with sales progress.

Town Square Foods, located in Lake City, Pennsylvania, processor of quality frozen pies and baked goods, is in the midst of the building program of a new refrigerated warehouse (\$400,000) which should enhance the efficiency of the division. Although contributing to earnings (\$50,000 +), its return is below earlier expectations.

#### FINANCES AND DIVIDEND POLICY

Hawthorn-Mellody's financial situation is adequate. The Board of Directors has, however, decided not to raise the \$.25 quarterly dividend paid since 1963 (notwithstanding the arguments advanced by this office for an increase).

Hopefully an increase will be considered in the spring of 1967, as the lagging dividend relative to the progress in earnings is, in our opinion, a major negative factor for the investment standing of the stock.



Hawthorn-Mellody, Inc.  
Progress Report (continued)

- 3 -

### CONCLUSION

Hawthorn-Mellody, a fast growing, efficient dairy company - its 1965 return on invested capital was 16.2%, the best in the industry - has been facing temporary problems common to the whole industry.

As the situation appears to be correcting itself and as earnings stand a good chance to exceed 1965-66 fiscal year, retention is recommended at current depressed levels.

EC/hm

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November 10, 1966

FLORIDA GAS COMPANY

Progress Report

<u>Present Price</u>	<u>1966 Price Range</u>	<u>Per Share Earnings</u>		<u>Price/Earnings Ratio</u>	<u>Current Dividend</u>	<u>Yield</u>
		<u>1965</u>	<u>E. 1966</u>			
11	14 - 9	\$0.85	\$1.00	11X	\$0.20	1.8%

Florida Gas has just released earnings for the third quarter and for the first nine months of 1966. Inasmuch as the Company's tax loss carry-forward was exhausted in April 1965 when the Company started accruing taxes, the progress of pre-tax income is far more significant at this point than net profits.

OPERATING RESULTS (in \$ million)

	<u>First Quarter</u>			<u>Second Quarter</u>			<u>Third Quarter</u>		
	<u>1965</u>	<u>1966</u>	<u>% Inc.</u>	<u>1965</u>	<u>1966</u>	<u>% Inc.</u>	<u>1965</u>	<u>1966</u>	<u>% Inc.</u>
Operating Revenues	\$14.0	\$15.0	7.2%	\$12.2	\$13.1	7.4%	\$12.0	\$15.2	27%
Net Before Taxes	2.1	3.2	52.0	1.0	1.9	90.0	.75	3.3	310
(Per Share)	(\$ .39)	(\$ .60)		(\$ .12)	(\$ .35)		(\$ .14)	(\$ .43)	
Income Tax	-	1.2		.2	.6		.264	1.1	410
Net Income	2.1	2.0	(4.8%)	.7	1.2	70.0	.561	1.5	265
Per Share*	\$ .39	\$ .36	(8.3%)	\$ .15	\$ .19	27.0	\$ .09	\$ .18	100

\* After preferred dividends.

12 MONTHS ENDING SEPTEMBER 30

	<u>1965</u>	<u>1966</u>
Operating Revenue	\$50,876,000	\$56,956,000
Net Before Income Taxes	5,041,000	9,296,000
Income Taxes	476,000	3,729,000
Net Income	4,565,000	5,567,000
Earned Per Common Share	\$.85	\$.94*
Common Shares Outstanding	5,323,684	5,323,762

Florida Gas Company  
Progress Report (continued)

- 2 -

As witnessed by the above figures, the Company's progress in revenues and earnings has been outstanding so far in 1966. Third quarter operations reflect the increased volume and profits due to the expansion of the pipeline's capacity which went on stream on July 1, 1966.

RECENT DEVELOPMENTS

1. - In July, the examiner for the Federal Power Commission rejected the Company's application for the 192,000,000 cubic feet per day expansion to serve Florida Power & Light starting in January, 1968. The examiner's opinion did not disclaim the elements of public convenience and of necessity and did not question the gas reserve position, the rates, and the ability to finance the project. His opinion was actually based on a technical consideration, namely that the supplier of gas, Pan American Petroleum, is not subject to FPC regulations and that an interstate pipeline cannot transport gas which does not come under the jurisdiction of the FPC. In the past, the FPC has approved applications which involved the transport of non-jurisdictional gas.

The Florida Gas project is now under consideration by the full Federal Power Commission whose decision should come now any day. It will either overrule the examiner in accordance with past precedence or grant the certificate in insisting upon certain changes. At this point the Florida Gas management is confident that the project will be approved.

2. - During the summer Florida Gas obtained \$15,000,000 of 5% 5-year bank loans and \$25,000,000 of 6% 1st Mortgage bonds. These funds cover fully the Company's financing requirements up to the spring of 1967, when money will have to be raised to finance the new pipeline.

3. - The investment tax credit for the present fiscal year will amount to \$1,100,000, equivalent to 21¢ per share. The temporary suspension of the investment tax credit would cause a decline in profits in 1967. However, the loss of the investment tax credit will be almost offset in 1968 by changes in the Company's accounting practices which so far have been most conservative. It has been the practice of the Company not only to capitalize interest charged to construction on the Company's books as is usual, but also to capitalize them for tax purposes. This means that interest expenses claimed for tax purposes have been reduced by the amount of interest charged to construction. The management now intends to start claiming the full amount of interest in 1967, which would reduce taxes by about \$1,000,000 or \$.90 a share.

Progress Report (continued)

4. - Walt Disney Production is planning a \$100,000,000 development in Florida which will include a new Disney Land. Florida Gas' transmission line runs through the large tract of land bought by Walt Disney near Orlando.

A new contract signed with the U. S. Gypsum paper mill in Jacksonville calls for deliveries of gas to add \$900,000 per year of revenues. The required pipeline extension will go through a heavily industrialized area not presently served.

5. - Taking into account the increased cost of money and the suspension of the investment tax credit, the revised projections of revenues and profits are presented below. They assume that the Federal Power Commission will approve the 192,000,000 cubic feet per day expansion to serve Florida Power & Light. Inasmuch as Florida Gas' management is confident that the Company's expansion can be financed mostly through debt, only a moderate increase in the number of shares outstanding has been taken into account in 1968.

Projected Operating Results  
 (000's)

	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>
Total Revenues	<u>\$60,000</u>	<u>\$68,000</u>	<u>\$77,900</u>	<u>\$89,600</u>	<u>\$100,500</u>
Operating Expenses	\$40,370	\$46,414	\$50,200	\$60,400	\$ 70,000
Amort. Debt Disc. and Exp.	1,266	1,266	840	-	-
Interest & Others	<u>9,700</u>	<u>12,400</u>	<u>13,000</u>	<u>13,000</u>	<u>12,500</u>
Total Expenses	<u>\$51,336</u>	<u>\$60,080</u>	<u>\$64,040</u>	<u>\$73,400</u>	<u>\$ 82,500</u>
Bal. Subj. to Tax	\$ 8,664	\$ 7,920	\$13,860	\$16,200	\$ 18,000
Prelim. Fed. Income Tax	\$ 4,565	\$ 3,680	\$ 6,650	\$ 7,800	\$ 8,700
Less: Inv. Tax Credit*	<u>1,100</u>	<u>-</u>	<u>1,680</u>	<u>1,970</u>	<u>2,200</u>
Net Fed. Income Tax	<u>\$ 3,464</u>	<u>\$ 3,680</u>	<u>\$ 4,970</u>	<u>\$ 5,830</u>	<u>\$ 6,500</u>
Balance	\$ 5,200	\$ 4,240	\$ 8,890	\$10,370	\$ 11,500
Int. to Construction	<u>800</u>	<u>2,100</u>	<u>160</u>	<u>100</u>	<u>-</u>
Net Income	\$ 6,000	\$ 6,340	\$ 9,050	\$10,470	\$ 11,500
Pfd. Dividend	<u>660</u>	<u>660</u>	<u>660</u>	<u>660</u>	<u>660</u>
Bal. for Common	\$ 5,340	\$ 5,680	\$ 8,390	\$ 9,810	\$ 10,840
Per Share	\$1.00	\$1.06	\$1.49	\$1.75	\$1.93
No. of Shares	5,323,690	5,323,690	5,623,690	5,623,690	5,623,690

- \* Assumes: (a) Investment Tax Credit is resumed on January 1, 1968;  
 (b) The Company utilizes carry-forward only to the extent of approximately one quarter of Federal income taxes each year instead of 50% as permitted under the new law. On this basis, there would still be a carry-forward, including new credits earned in 1968-70, or approximately \$1,350,000 at the end of 1970.

JOHN W. BRISTOL & CO.  
 INCORPORATED  
 233 BROADWAY  
 NEW YORK, N. Y. - 10007  
 CORTLANDT 7-1137

November 16, 1966

INTERNATIONAL FLAVORS & FRAGRANCES

Progress Report

<u>Present Price</u>	<u>1966 Price Range</u>	<u>Per Share Earnings</u>			<u>P/E Ratio</u>		<u>Dividend</u>	<u>Yield</u>
		<u>1965</u>	<u>E. 1966</u>	<u>Poss. 1967</u>	<u>1966E.</u>	<u>1967E.</u>		
63	64 - 46	\$1.43	\$1.75	\$2.00-\$2.10	36X	30X	\$0.50	0.8%

CAPITALIZATION (in \$ millions)

	<u>December 31, 1965 Book</u>	<u>Present Market</u>
Common Stock & Surplus (5,237,000 shares outstanding)	<u>\$19.5</u>	<u>\$330</u>

OPERATING RECORD

	<u>Net Sales</u>	<u>Pretax Income</u>	<u>Pretax Profit Margin</u>	<u>Tax Rate</u>	<u>Net Income</u>	<u>Return on Equity</u>	<u>Earnings Per Share</u>	<u>Dividend Per Share</u>
1959	\$32,240	\$ 5,471	17.0%	52.7%	\$2,587	15.6%	\$0.51	\$0.05
1960	34,195	5,860	17.1	50.0	2,928	15.6	0.57	0.19
1961	36,429	5,807	15.9	49.4	2,940	14.2	0.57	0.18
1962	41,145	7,230	17.6	51.3	3,520	15.0	0.69	0.20
1963	47,104	10,324	21.9	53.6	4,778	17.5	0.93	0.23
1964	52,205	12,746	24.4	50.9	6,257	19.3	1.21	0.30
1965	57,352	14,451	25.4	48.5	7,484	19.5	1.43	0.40

QUARTERLY RESULTS

<u>Quarter</u>	<u>Net Sales (\$ millions)</u>					<u>Per Share Earnings</u>				
	<u>1966</u>	<u>1965</u>	<u>1964</u>	<u>1963</u>	<u>1962</u>	<u>1966</u>	<u>1965</u>	<u>1964</u>	<u>1963</u>	<u>1962</u>
March	\$15.36	\$13.53	\$11.87	\$11.04	\$ 9.72	\$0.38	\$0.32	\$0.25	\$0.22	\$0.16
June	17.83	14.29	13.54	12.22	10.59	0.45	0.35	0.35	0.25	0.21
Sept.	16.80	14.68	13.18	12.52	10.98	0.44	0.40	0.33	0.29	0.20
Dec.		14.85	13.62	11.32	9.86		0.40	0.31	0.21	0.15

International Flavors & Fragrances  
Progress Report (continued)

- 2 -

BACKGROUND

International Flavors & Fragrances is the result of the 1958 merger of the U. S. fragrance firm of van Ameringen - Haebler with the Dutch concern of Polak & Schwartz, which was known as both a fragrance and flavor firm. At present IFF's revenues are derived 70% from fragrances, 30% from flavors.

Although IFF is a relatively small company with sales estimated at \$65 - 67 million in 1966, it is nevertheless the largest factor in its field. Two Swiss companies, Givandan (now a division of Hoffman - La Roche) and Firmenich, are IFF's main competitors, principally abroad.

CHARACTERISTICS OF THE FRAGRANCE AND FLAVOR INDUSTRY

The industry serves primarily the cosmetic, toiletry, food, beverage, and soap industries, basically stable and growing industries, inventive in the development of new products and applications.

The compounding of flavors and fragrances is an extremely complex operation requiring considerable human and technical skill and experience. Very modern installations are required. Quality control is foremost as flavors enter into many products subject to the supervision of the Food and Drug Administration. A single compound may contain 150 - 200 different components. As a result the ingress of newcomers in the field is restricted and may be further discouraged by the ever tightening Food and Drug Administration regulations.

Flavors and fragrances are expensive, but they account for a nominal portion of the sale price of the final products. The users, such as Avon or Procter & Gamble, have little incentive to manufacture their own fragrances. On the contrary they have interest in relying on the skill of the specialists who act in many ways as service companies in developing new flavors and fragrances according to clients' desiderata and specifications.

As old fragrances and flavors are abandoned and new ones are developed, the manufacturers must create and improve continuously. Research and development is an important aspect of the business. IFF is spending in R & D in 1966 some \$4.7 million or close to 7.5% of its revenues for this year.

The many fragrances and flavors in existence and being used require at all times very substantial inventories of raw materials and finished products. At the end of 1965 IFF was carrying inventories valued at \$15.5 million, more than 25% of the Company's sales volume during that year. It requires, therefore, companies with very strong and liquid financial situations.

International Flavors & Fragrances  
 Progress Report (continued)

- 3 -

The growth of the industries which IFF serves is superior to the average growth of the GNP. The trendline of growth of the perfume and cosmetic industry is 8% compounded annually and accelerating. Men's toiletries have been growing at an even faster pace during the sixties. Convenience foods and the attempt to develop new low cost protein rich food - algae, fish meal, etc. - have enhanced further the prospects for artificial flavors.

IFF is aiming at a 50 - 50% breakdown between fragrances and flavors revenues vs. the present 70 - 30% ratio.

GEOGRAPHICAL DIVERSIFICATION

At present IFF's revenues are provided almost equally by domestic and foreign sales. Domestic operations, however, are contributing more to earnings.

	Net Sales		Net Income		Net Income as a % Net Sales	
	Domestic	Foreign	Domestic	Foreign	Domestic	Foreign
	(000)	(000)	(000)	(000)		
1963	\$23,963	\$23,141	\$2,906	\$1,872	12.1%	8.1%
1964	26,767	25,438	3,993	2,264	14.9	8.9
1965	29,196	28,156	4,808	2,676	16.5	9.5

IFF has manufacturing plants in Holland, Great Britain, France, Switzerland, Argentina, Brazil, Mexico, South Africa, and West Germany.

RESEARCH & DEVELOPMENT EXPENDITURES

	R & D Expenditures	R & D Expenditures as a % of Sales	R & D Expenditures as a % of Pretax Income *	R & D Expenditures per share
	(000)			
1960	\$2,070	6.1%	26.1%	\$0.40
1961	2,145	5.9	27.0	0.42
1962	2,330	5.7	24.4	0.45
1963	2,570	5.5	19.9	0.50
1964	3,370	6.5	20.9	0.65
1965	4,030	7.0	21.7	0.77
1966 E.	4,700			

\* Before R & D expenditures.



International Flavors & Fragrances  
Progress Report (continued)

- 4 -

FINANCIAL SITUATION

With no debt outstanding and cash and equivalent of \$9 million in 1965, IFF is enjoying a strong financial situation.

1966 cash earnings, after payment of the dividend on the common, is estimated at more than \$9 million, more than twice the \$4 - 4.5 million spent in 1966 on new plant and equipment.

IFF, therefore, is more than able to finance internally its superior growth.

MANAGEMENT

In January 1966, A. L. van Ameringen, Chairman of the Board, died at the age of 75. Long considered a "one man show", the management had been built up in depth and responsibilities have been defined and the organization structure clearly outlined.

The estate of Mr. Ameringen, the families of the founders and the management are reported to own altogether some 50% of IFF's shares now outstanding.

REVENUES AND EARNINGS DEVELOPMENTS

IFF's revenues have grown at an annual rate of 10%. Net earnings have grown over the past five years at 20%. Management believes that a 15% rate is quite sustainable over the forthcoming years.

In 1966, the first quarter earnings increased 18%, while the second quarter earnings rose 28%, borrowing from the September quarter when earnings rose only 10% on a 14% increase in sales. For the first 9 months of 1966, sales rose 17.8% to \$50 million; pretax income was up 25% as profit margins increased to 26.9% from 25.2% the previous year. Net income increased 24%.

The prospects for the fourth quarter are favorable. It is estimated that earnings may be 20% higher than in 1965. Hence our earnings estimate of \$1.75 per share, 22% above 1965 results.

Profits for 1967 are estimated at \$2.00 - \$2.10, assuming no tax increase in the U. S.

International Flavors & Fragrances - 5 -  
 Progress Report (continued)

FUTURE PROSPECTS

IFF's industry leadership in a stable, fast growing field should maintain the Company's superior rate of growth in the foreseeable future. The growth rate of flavors is likely to outperform fragrances. Although improving, the profitability of the foreign operations leaves considerable room for further progress. Hence earnings should continue to grow at 15 - 20% per annum indicating a doubling in earnings every 4 - 5 years.

PRESENT INVESTMENT MERITS OF COMMON STOCK

The long term investment merits of IFF are increasingly recognized as the stock has defied the laws of market gravity in 1966 and is traded at its historical high. This reflects an earnings multiplier of 36X current earnings, 30X possible 1967 earnings.

The substantial premium which IFF commands is due to its uniqueness as the sole public participation in an industry with well defined and superior growth prospects and to the relatively small floating supply of stock which precludes trading for speculation. It is also recognized that IFF represents a blanket participation in several promising industries and that it is immune to the changes in fads and fashions which at times affect either favorably or unfavorably individual companies.

In the cosmetic group, IFF is now reaching a market valuation reserved up to very recently only to Avon Products, a much larger company with a very long record of earnings growth of better than 20% per annum. As Avon is probably IFF's largest single client, there is a definite tie-in between the two companies. Looking thus for guidance at the price fluctuations of Avon Products we notice the following range of price/earnings ratios:

	<u>Avon</u>	<u>Int'l Flavors &amp; Fragr.</u>
1964	41 - 31X	28 - 19X
1965	46 - 31	36 - 24
1966	45 - 32	37 - 26
Est. 1967 Earn.	\$2.40	\$2 - 2.10
Possible Price Range		
1967	108 - 74	75 - 53
Present Price	85	63

International Flavors & Fragrances  
Progress Report (continued)

- 6 -

Assuming no further increase in the price/earnings ratio of IFF, the stock would have still a 20% upside potential in 1967 and a lesser downside risk, unless results prove to be unexpectedly disappointing. The relative "scarcity" value of IFF may also lead to a further increase in the price/earnings ratio, possibility which would be also of some concern as, at a price, any investment becomes overpriced.

To sum up, notwithstanding its lofty levels, the common stock of IFF is still adequately priced in consideration of its outstanding long term prospects of continuous gains in earnings.

EC/hm  
Enc.

John W. Bristol & Co., Inc.

International Flavors & Fragrances  
 Progress Report (continued)

- 7 -

THE COSMETICS & TOILETRIES INDUSTRY EARNINGS ESTIMATES FOR 1966 and 1967

Comparative Statistics

	<u>1967 E.</u>	<u>1966 E.</u>	<u>1965</u>	<u>Recent Price</u>	<u>Price X 1966 E.</u>	<u>Indicated Dividend</u>	<u>Current Yield</u>
International Flavors & Fragrances	\$2.00	\$1.75	\$1.43	63	35.4X	\$0.50	0.79%
Alberto-Culver(Sept.)(a)	1.30	0.89	0.22	16	18.0	-	-
Avon Products	2.35	2.05	1.65	85	40.5	1.20	1.45
Beauty Counselors	1.00	0.90	1.20	9	10.0	0.60	6.67
Chesebrough-Pond's	1.40	1.25	1.08	25	20.0	0.68	2.72
Max Factor	2.25	2.05	1.83	39	19.0	0.70	1.80
Helena Rubinstein	3.00	3.00	3.06	29	9.7	1.30	4.48
Lanvin-Charles of the Ritz	1.95	1.75	1.53	35	20.0	0.50	1.43
Noxell	5.80	5.40	4.76	66	12.2	1.00	1.52
Rayette-Faberge'	3.05	2.80	2.51	31	11.1	0.48	1.55
Revlon (b)	3.25	3.15	3.04	45	14.3	1.30	2.89
Shulton	2.85	2.60	2.39	27	10.4	0.80	2.96

(a) Fiscal 1965 was 10-month year. Fiscal year changed from November to September.

(b) Earnings estimates assume full conversion of the convertible stock.

FILE NOTE: Nov. 22, 1966 meeting of  
the Finance Committee in New York was  
cancelled.

Meeting of the Finance Committee in  
New York City

	<u>Tuesday, Nov. 15</u>	<u>Tuesday, Nov. 22</u>
J. R. Dilworth	No	Yes
C.M. Shanks	No	Yes
I.A. Schur	Yes	Yes
S.D. Leidesdorf	Yes	Yes
R.E. Hansmann	Yes	Yes
J.W. Bristol	No	Yes
H.K. Hochschild	Yes	Yes



CHECK LIST

I would be able to attend a noon meeting  
of the Finance Committee of the Institute  
for Advanced Study in New York City on:

Tuesday, November 15

✓ Tuesday, November 22

✓. RICHARDSON DILWORTH  
Name

CHECK LIST

I would be able to attend a noon meeting  
of the Finance Committee of the Institute  
for Advanced Study in New York City on:

Tuesday, November 15

— *no*

Tuesday, November 22

— *yes*

Carol M. Shank  
Name

*Dear Mike - My own  
letter says the Bd. will  
meet Tuesday Oct. 13.  
My calendar says  
Oct. 13 falls on  
a Tuesday - which  
is the correct date?  
Mike*

CHECK LIST

I would be able to attend a noon meeting  
of the Finance Committee of the Institute  
for Advanced Study in New York City on:

Tuesday, November 15

*or*

Tuesday, November 22

*Ira A. Schur*

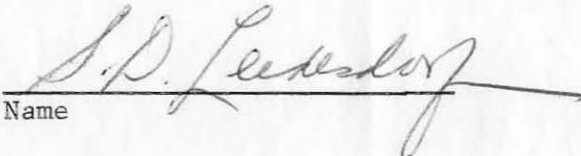
                      
Name

# CHECK LIST

I would be able to attend a noon meeting  
of the Finance Committee of the Institute  
for Advanced Study in New York City on:

Tuesday, November 15

Tuesday, November 22

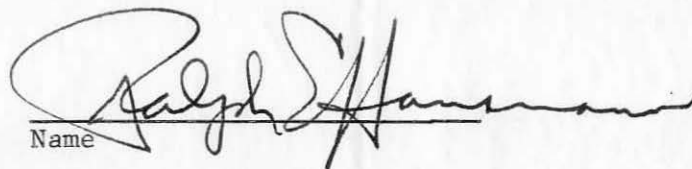
  
Name

CHECK LIST

I would be able to attend a noon meeting  
of the Finance Committee of the Institute  
for Advanced Study in New York City on:

Tuesday, November 15 O.K.

Tuesday, November 22 O.K.

  
Name

CHECK LIST

I would be able to attend a noon meeting  
of the Finance Committee of the Institute  
for Advanced Study in New York City on:

Either date would be  
O. K.

Tuesday, November 15

Tuesday, November 22

H. K. Hochschild  
Name *ah*



THE INSTITUTE FOR ADVANCED STUDY  
PRINCETON, NEW JERSEY 08540

September 9, 1966

To Members of the Board of Trustees of the Institute for  
Advanced Study

Gentlemen:

Pursuant to my communication of August 10,  
I can report that I have now heard from each member  
of the Board, and that the date convenient to the greatest  
number is Tuesday, October 13, 1966. The Chairman has  
asked me to confirm this as the date for the Regular Fall  
Meeting.

It will be held at The Pinnacle Club, 150 East  
42nd Street, New York City, at 12:30 p.m.

Cordially yours,

*M. C. Morgan, Jr.*  
Minot C. Morgan, Jr.  
Assistant Secretary

P.S. To Members of the Finance Committee:

Since both the Treasurer and the Chairman of  
the Finance Committee will be out of the country during  
the month of October, I have been asked to seek a  
mutually convenient date for a meeting of the Finance  
Committee in the month of November. The following dates  
have been suggested for a noon meeting in New York City:-  
Tuesday, November 15 and Tuesday, November 22.

Would personally  
prefer November 22,  
as I am committed  
to go to the Princeton  
meeting on Nov. 15.

Will you kindly fill out and return the enclosed  
questionnaire indicating the dates on which you will be  
able to attend.

John W. Bristol

Encl.

*P-1*  
*John: For your info.*  
*Wick*

JOHN W. BRISTOL & CO.  
INCORPORATED  
233 BROADWAY  
NEW YORK, N. Y. - 10007  
—  
CORTLANDT 7-1137

INSTITUTE FOR ADVANCED STUDY

Memo to Mr. Leidesdorf *ch.*  
Mr. Schur  
Mr. Hochschild  
Mr. Mitchell  
Mr. Shanks  
Mr. Strauss  
Mr. Dilworth  
Mr. Hansmann *Tras.*

The next meeting of the Finance Committee will be held  
on Tuesday, November 22, 1966 at The Pinnacle Club, 150 E. 42nd Street,  
New York City, Room B (luncheon meeting) 12:00 noon.

*9 people*

October 6, 1966

JOHN W. BRISTOL & CO.  
INCORPORATED  
233 BROADWAY  
NEW YORK, N. Y. - 10007  
CORTLANDT 7-1137

October 12, 1966

INSTITUTE FOR ADVANCED STUDY

THE ENDOWMENT FUND IN 1966

ASSETS

	<u>Total Assets at Market</u>	<u>% Inv. in Equities</u>	<u>Cash &amp; Equivalent</u>	<u>% of Assets</u>	<u>Indicated Income</u>
June 30, 1965	\$48,720,963	69.9%	\$10,374,000	21%	\$1,494,000
Dec. 31, 1965	48,533,914	74.3	9,058,000	18	1,521,000
June 30, 1966	45,399,201	75.3	7,706,000	17	1,577,000
Sept. 30, 1966	41,433,304	76.9	6,211,000	15	1,561,000

During the first 9 months of 1966, withdrawals from principal for operating expenses and for capital investments amounted to \$815,000, representing 1.8% of average assets during the period.

The balance of the reduction in cash reserves is due to increases in equities, the bulk of the purchases having taken place in August 1966. These purchases were effected while the Dow-Jones Industrial average was fluctuating between 851 - 767.

Since the beginning of 1966 until September 30, the Trust's assets, adjusted for the withdrawals of principal, declined 13.4%, as compared with a decline of 20.3% in the Dow-Jones Industrial average.

INVESTMENT POLICY

At its last meeting which took place on April 21, 1966, when the Dow-Jones Industrial average stood at 954, the Investment Committee resolved to increase equity investments only in case of sharp market weakness.

Hence the commitment in August of a portion of the Trust's cash reserves after the market had declined between 100 and 180 points.

Additional purchases will take place as the market stabilizes.

John W. Bristol & Co.'s present views on the economy and the market are summarized in the enclosed memorandum.

EC/hm  
Enc.

John W. Bristol & Co., Inc.

JOHN W. BRISTOL & CO.  
INCORPORATED  
233 BROADWAY  
NEW YORK, N. Y. - 10007  
CORTLANDT 7-1137

October 6, 1966

BACKGROUND FOR INVESTING AND INVESTMENT POLICY

The purpose of this memorandum is to discuss the current investment environment as we see it and hopefully to suggest an appropriate course of investment consistent with our views.

1967 FORECAST

1. Economic Activity: Deterioration in the private sector, particularly in the durable goods area and in the accumulation of inventories, more than offset by sharply higher defense expenditures and the traditional growth of consumers non-durable goods.
2. Money Markets: The anticipated slowdown in capital investments, including inventories, should ease somewhat the pressure on interest rates which will stabilize at a high level until economic and political conditions allow a deliberate easing of money rates without accompanying inflationary pressures. Residential construction, after an attrition which may reach agonizing proportions during the forthcoming winter, may start recovering gradually in the Spring.
3. Taxes: Economically speaking, tax increases are no longer necessary or justified. The present sharp step-up in defense expenditures at the annual rate of \$12 billion, however, will make imperative raising the corporate tax rate from 48% to 52 - 53%, together with a corresponding increase in the personal tax rate.
4. Wages: Labor cost will increase 6 - 7% in 1967 and the cost of living will continue to increase at an above average rate.
5. Corporate Profits: Increased financial and depreciation charges, higher taxes and labor cost, will not be offset by productivity gains or increased prices. Corporate profits, thus, will decline in 1967, possibly as much as 15%.

INVESTMENT ENVIRONMENT

Equity markets do not thrive during periods fraught with uncertainties. Confidence will be restored only after the causes for these uncertainties have been removed or are fully discounted.

Background for Investing and  
Investment Policy (continued)

- 2 -

Three main concerns may already have run their course:

- Fears of a credit squeeze which were alleviated by the recent stabilization of interest rates;
- Fears of a devaluation of sterling which seems to have been temporarily postponed, at least until the next crisis;
- The prospective increase in both corporate and personal taxes over the next three months which seems to be accepted now more as a probability than a possibility.

Other uncertainties might not be solved or dissipated for some time:

- The extent of the much feared wage inflation;
- The trend of pre-tax corporate profits.

The biggest concern, of course, remains the war in Vietnam, whose cost has been largely responsible for the disruption of the economic, monetary, and price equilibrium in the U. S.

Even preliminary peace negotiations in Vietnam would restore confidence immediately as it would alleviate the very tight money conditions now prevailing, would help dispense with tax increases and with the suspension of tax incentives to industry, and arrest the escalation in the cost of living. The prospective return to normalcy and stability, even at the cost of deflation, would be extremely constructive for both the bond and equity markets.

In the meantime, it is becoming growingly apparent that the economic growth is being restrained by the high cost and scarcity of credit and by labor shortages which are putting increasing pressure on profit margins. The forthcoming interim earnings statements for the third quarter are likely to create much disappointment and concern. They will cause many downward revisions of 1966 earnings estimates and create much confusion as to possible earnings in 1967.

The impossibility of accelerating economic growth without inflation, the restrictive implications of the shortage of credit, wage inflation which offsets gains in productivity, all symptoms much in evidence in Europe since the early Sixties, are now part of the American scene. Judging by the behavior of the equity markets of Continental Europe since 1962, these economic restrictions lead to erosion of price/earnings ratios. The 1966 drastic correction in the P/E of U. S. equities may thus be more permanent than generally believed.

Background for Investing and  
Investment Policy (continued)

- 3 -

INVESTMENT POLICY

TAX EXEMPTS

With the arrest of the heavy liquidations of tax exempt holdings by banks throughout the first 6 months of 1966 and with the prospects of a tax increase in 1967, the outlook of tax exempt bonds has improved considerably. Banks account normally for about 40% of the purchase of new tax exempt issues; although they are not in a position to do it now, the banks will eventually replenish their tax exempt portfolios so as to reduce their effective tax rate.

CORPORATE BONDS

It appears now that the bond market reached its bear market bottom on August 29. Interest rates are likely to remain at a high level for a long period, as long as the demand for credit persists. The restrictive lending policies of the banks, now supervised by the Federal Reserve Board, and the increasing depletion of corporate liquidities to be compounded by the removal of the 7% investment credit and of accelerated appreciation, as well as by the prospective tax increase, may force more and more companies to issue new fixed income securities either publicly or privately. A tax increase will be beneficial to the bond market inasmuch as the tempo and size of new government issues will be greatly reduced.

CONVERTIBLE FIXED INCOME SECURITIES

The combined impact of the slide of stock prices and of sharply rising interest rates have forced an unprecedented large number of companies to issue convertible issues. Result: the large premium over conversion value which convertibles traditionally command due to their scarcity has been drastically reduced; they now provide a long term call on equities whose prices are depressed and the returns they provide are quite attractive.

Helped, too, by the stabilization of interest rates, convertible issues ought to be considered as attractive.

EQUITIES

On the average, equities have declined 25% since February and many individual issues have suffered considerably higher declines.

A new leadership of the market will take over when the equity markets eventually stabilize.



Background for Investing and  
Investment Policy (continued)

- 4 -

Most logical candidates:

1. The principal victims of rising interest rates, thus logically the main beneficiaries of the stabilization of the money markets; i. e. the so-called "money stocks".

Electric Utilities  
Telephone Companies

Banks  
Life Insurance Companies

(Avoid temporarily natural gas due to deteriorating regulatory climate; finance companies and savings and loan associations, both due to increased competition on the part of the banks.)

2. The oils on account of their low labor factor and of their relatively sheltered tax status (These characteristics apply also to the bank industry).

3. The casualty companies, recovering from a nightmarish period, however only for relatively short term investment objective.

4. The groups participating in the continuous growth of consumers' expenditures for non-durable goods and for services:

Airlines  
Leisure Time  
Textile Apparel  
Proprietary Drugs

Soft Drinks & Breweries  
Food Processors<sup>\*</sup>  
Toiletries and Cosmetics

<sup>\*</sup> Exceptions: meat packers, canners; millers, bakers, sugar refiners, possibly dairy companies due to declining milk production.

5. Eventually the "growth" stocks, as their prices erode and their hefty market premiums become more reasonable, will have to be accumulated aggressively as their long term potential of capital appreciation will outperform all other groups:

Electronics & other applied sciences  
Office Equipment  
Chemical Water Treatment  
Specialty Industry leaders  
Electrical Equipment

Glass technology  
Hospital Equipment  
Publishing  
Business Services  
Air Freight

6. Among the so-called cyclical groups limit investments to:

Sulphur - in short supply  
Nickel - prospective increase in price  
Farm Equipment - needed to remedy increasing shortage of food.

Background for Investing and  
Investment Policy (continued)

- 5 -

7. Avoid temporarily the following groups:

- Aerospace: outstanding prospects marred temporarily by disruption of production schedules by Vietnam's requirements, by high labor cost factor and by shortage of skilled labor;
- Automobiles: trend of sales of 1967 models;
- Ethical Drugs: conflict between high priced brand names and low priced generic name drugs;
- Color TV: forthcoming transition from a sellers' market to a buyers' market;
- Construction: possible recovery in 1967.

8. Avoid:

- Industries heavily dependent on government business and on high level of capital expenditures;
- Most cyclical stocks;
- Any company which has not a "franchise" in its field.

EC/hm  
Encs.

John W. Bristol & Co., Inc.

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LOUIS BAMBERGER AND MRS. FELIX FULD FOUNDATION

PRINCETON, NEW JERSEY

Director: J. ROBERT OPPENHEIMER

OFFICE OF THE TREASURER

40 WALL STREET

NEW YORK 5, N. Y.

September 7, 1966

## TRUSTEES

JULIAN P. BOYD  
J. RICHARDSON DILWORTH  
PERRIN C. GALPIN  
LLOYD K. GARRISON  
EDWARD S. GREENBAUM  
BARKLIE M. HENRY  
HAROLD K. HOCHSCHILD  
SAMUEL D. LEIDESDORF  
WILMARTH S. LEWIS  
HAROLD F. LINDER  
SIDNEY A. MITCHELL  
J. ROBERT OPPENHEIMER  
LESSING J. ROSENWALD  
IRA A. SCHUR  
CARROL M. SHANKS  
LEWIS L. STRAUSS

## FOUNDERS

LOUIS BAMBERGER  
MRS. FELIX FULD

Dear Mike,

I spoke on the telephone this morning with Ira Schur about holding the Finance Committee meeting and he agrees that it would be well to put off the meeting until sometime in November. He plans to return ~~after~~ November 9th and any time after that would be satisfactory with him and also with me except November 10th.

Would you please canvass the members of the Finance Committee and set up a luncheon meeting at the Pinnacle Club on a date most convenient for the majority of the members.

With kind regards,

Sincerely yours,

  
Ralph E. Hansmann

Mr. Minot C. Morgan, Jr.  
Institute for Advanced Study  
Princeton, New Jersey

REH:BG

cc: Ira A. Schur

Nov.  
T-15 - 22  
~~W-16~~ - ~~23~~  
~~F-17~~ - ~~24~~

Memo to Mr. Leidesdorf  
Mr. Schur  
Mr. Hochschild  
Mr. Mitchell  
Mr. Shanks  
Mr. Strauss  
Mr. Dilworth  
Mr. Hansmann

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JOHN W. BRISTOL & CO.  
INCORPORATED  
233 BROADWAY  
NEW YORK, N. Y. - 10007  
CORTLANDT 7-1137

May 25, 1966

INSTITUTE FOR ADVANCED STUDY

Pursuant to the Committee's directions at its April meeting, Mr. Hansmann and Mr. Bristol have prepared the following list of securities which could be bought for the Trust in case of pronounced market weakness. The list has been discussed with and approved by Mr. Schur.

1. Prospective Increases of Current Holdings

American Metal Climax  
Armour & Co.  
Chrysler  
General Telephone & Electronics  
Sinclair Oil  
Wallace & Tiernan

2. Possible New Holdings

Becton Dickinson  
Cities Service  
C. B. S.  
Gillette Co.  
Trans World Airlines

Other names will be added as attractive opportunities arise.

\*  
\* \*

During recent market weakness, the following additions to current holdings were made:

	<u>Price Range</u>	<u>1966 Price Range</u>
5,000 shs. Armour & Co.	37 1/2 - 38	48 - 36 7/8
1,300 shs. Cities Service	57 5/8 - 58	65 7/8 - 55
2,000 shs. General Telephone	40 3/8 - 40 3/4	46 3/8 - 39 1/2

\*  
\* \*

Your comments would be appreciated.

EC/hm

John W. Bristol & Co., Inc.

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Memo to Mr. Leidesdorf  
Mr. Schur  
Mr. Hochschild  
Mr. Mitchell  
Mr. Shanks  
Mr. Strauss  
Mr. Dilworth  
Mr. Hansmann

April 29, 1966

INSTITUTE FOR ADVANCED STUDY

Minutes, Meeting of the Finance Committee  
April 21, 1966 at the Pinnacle Club, N. Y. C.

Present:

Mr. Dilworth	Mr. Hansmann
Mr. Hochschild	Mr. Morgan
Mr. Shanks	Mr. Bristol
Mr. Strauss	

1. Investment changes since the last meeting were ratified.  
(Schedule attached)
2. After a thorough review and discussion of the portfolio the following changes were authorized:

SALES:

16,000 shs.	Gulf States Utilities
6,400 shs.	Amerada
15,000 shs.	Harris-Intertype

PURCHASES:

10,000 shs.	General Telephone & Electronics
7,000 shs.	Sinclair Oil
\$250,000	International Equipment Co.
	6 1/2% subord. note due 1981 with warrants

3. The Committee noted reports submitted on:

Massey-Ferguson, Ltd.  
Wallace & Tiernan, Inc.  
Television Communications Corp.

John W. Bristol  
Secretary

Ira A. Schur  
Chairman

INSTITUTE FOR ADVANCED STUDY

SUMMARY OF PURCHASES AND SALES OF EQUITIES

Since December Meeting

<u>PURCHASES</u>	<u>Per Unit</u>	<u>Cost</u>	<u>Present Price</u>
<u>a) Authorized by Committee at December Meeting</u>			
30,000 shs. Florida Gas	12.65	\$ 379,361	12 3/4
10,000 shs. Chrysler Corporation	49.79	497,943	51
2,300 shs. General Waterworks 4.40% Cv. Pfd.	110	253,000	110
<u>b) New Holdings to be ratified</u>			
15,000 shs. Parke, Davis	34	509,985	41
12,000 shs. Massey Ferguson	31.63	379,538	33
20,000 shs. Middle South Utilities	21.88	437,500	22 1/4
		<u>\$2,457,327</u>	
<u>c) Short Terms &amp; Bonds to be ratified</u>			
2,000 M Export Import Bank 5 1/2% due 2-24-73	100	\$2,000,000	
1,300 M U. S. Treasury Bills due 12-30-65		1,295,991	
1,300 M U. S. Treasury Bills due 3-31-66		1,285,343	
750 M U. S. Treasury Bills due 4-14-66		741,680	
500 M U. S. Treasury Bills due 6-2-66		494,565	
500 M Federal Home Loan 4.40% due 6-24-66		499,257	
400 M F. I. C. B. 4.35% due 7-5-66		399,218	
500 M Federal Home Loan 4.35% due 5-25-66		499,453	
500 M F. I. C. B. 4.35% due 6-1-66		499,336	
		<u>\$7,714,843</u>	



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<u>SALES</u>	<u>Per Unit</u>	<u>Proceeds</u>	<u>Present Price</u>
<u>a) Authorized by Committee at December Meeting</u>			
5,250 shs. National Cash Register	78.89	\$ 414,180	90
2,000 wts. Falconbridge Nickel	100.06	201,231	95
<u>b) To be ratified by Committee</u>			
5,000 shs. Singer	57.01	285,056	57
10,666 shs. Unilever N. V.	28.90	308,195	27
6,000 rts. Celanese Corp. of America	.6875	4,125	
		<u>\$1,212,787</u>	
<u>c) Short Terms to be ratified by Committee</u>			
1,300 M U. S. Treasury Bills due 11-30-65		\$1,246,911	
200 M U. S. Treasury Bills due 2-28-66		193,668	
1,300 M U. S. Treasury Bills 3.70% due 12-30-65		1,295,991	
500 M CIT Financial 4.38% due 1-14-66		500,000	
750 M Sears, Roebuck Acceptance 4.39% due 1-17-66		750,000	
500 M U. S. Treasury Notes 3 7/8% due 2-15-66		500,000	
300 M U. S. Treasury Bills due 8-5-66		297,126	
300 M U. S. Treasury Bills due 2-28-66		291,143	
2,000 M U. S. Treasury Notes 4% due 8-15-66		1,990,312	
1,300 M U. S. Treasury Bills 4.46% due 3-31-66		1,285,343	
		<u>\$8,350,494</u>	

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INSTITUTE FOR ADVANCED STUDY

Memo to Mr. Leidesdorf  
Mr. Schur  
Mr. Hochschild  
Mr. Mitchell  
Mr. Shanks  
Mr. Strauss  
Mr. Dilworth  
Mr. Hansmann

The next meeting of the Finance Committee will be held  
on Thursday, April 21, 1966 at The Pinnacle Club, 150 E. 42nd Street,  
New York City at 11:30 A. M. (Room H).

April 11, 1966