

SCOMM

#9:25

FINANCIAL DIGEST



FRIDAY, OCTOBER 7, 1977

VOLUME XIV, NUMBER 41

FOREIGN BORROWINGS WEAKEN

In the first half of 1977, foreign borrowings in the U.S. slackened appreciably. In part, this reflects a lower volume of bond financing, which is traced, in turn, to a sharp cutback in Canadian issues that traditionally have accounted for the bulk of foreign bond activity, as well as a growing emphasis on the Eurobond market. The numbers are revealing: foreigners issued \$2.1 billion net in the bond market during the first half of 1977, about half the \$3.7 billion that was raised in the same period last year. Unless there is a sharp step-up in the second half of this year, something that is not expected in the face of sluggish economic activity abroad, "Yankee" bond issues may not amount to more than \$4-4.5 billion this year, or about half the record \$8.4 billion raised in 1976.

Foreign short-term borrowings also slowed appreciably in the first half of 1977, largely in response to weaker growth in international trade. However, as in the case of bond financing, there has also been a significant pick-up in short and intermediate borrowings in the Euro-dollar market, where borrowers are afforded more favorable terms than in the U.S. Commercial bank loans to foreigners showed no increase during the first half. Despite strong growth in the second quarter, the increase was not enough to offset the sharp run-off in the previous quarter. Moreover, little strength should be expected in this category of foreign borrowings as long as

the Eurodollar market continues competitive both in terms of availability and the price of credit.

STRONG MONEY FLOWS FROM ABROAD

The most startling development on the supply side thus far in 1977 has been the huge takedown of Government securities. Foreign holdings of Treasuries rose nearly \$10 billion in the first half, more than three times the increase in the same period a year ago, and almost matching the growth for 1976 as a whole. The bulk of this increase represents acquisitions by OPEC-nations, which are likely to continue to invest a substantial portion of their oil-surplus revenues in these instruments. Among other things, the U.S. economy is expected to outperform the other major industrial nations in terms of economic growth for the remainder of this year and during 1978. Other areas of strengthened foreign support on the supply of funds side include purchases of U.S. corporate bonds and open-market paper.

The strong inflow of funds from abroad has important implications for the U.S. In the first place, it will tend to mitigate upward interest rate pressures that are building up in the money markets. Even though this is not reflected in the weekly loan figures for money center banks, business short-term borrowings have increased strongly thus far in 1977, and there will be a further rise in the months and quarters ahead. Also foreign acquisitions of U.S. government securities are helping the Treasury reduce its dependence on the domestic financial marketplace overall, and the money market more particularly.

BUSINESS INVENTORIES

Further evidence that business is adopting a cautious approach toward the current expansion can be seen from a perusal of the latest statistics on inventories. Businessmen are keeping a close watch on the level of their inventories in order that they not get out of line with sales.

Although August's increase in factory inventories was the eighth monthly rise in a row, it was also the smallest

(continued on back page)

SELECTED FEDERAL RESERVE DATA

(Weekly Averages of Daily Figures—Millions of Dollars)

	Week Ending 10/5/77	Change Since	
		Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	111,525	+1,111	+ 9,352
Member Bank Borrowings	883	+ 164	+ 782
Float	3,323	+ 238	+ 666
Total Reserve Bank Credit	118,845	+1,555	+ 9,409
Treasury Deposits with			
Federal Reserve Banks	12,622	+ 533	+ 989
Currency Outside Banks	89,126	+ 521	+ 7,646
Member Bank Reserves			
Required	35,817	+ 436	+ 1,718
Excess (Deficiency)	396	- 43	+ 62
Total Reserves Held	36,213	+ 393	+ 1,780
Net Borrowed Reserves	487	+ 207r	+ 720r
Gov'ts held for Foreign Acct. by F. R. Banks (End-of-Week)	64,546	+1,739	+14,509
		r—Revised	
	9/28/77		
Money Supply (\$ Bil., SA) M1	329.4	- 1.2	
Money Supply (\$ Bil., SA) M2	792.6	- 0.6	

BANK LOANS

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Commercial and Industrial Loans		
	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (9/28/77)	120,213	- 108	+ 7,056
New York City (10/5/77)	34,232	+ 283	+ 521
	Total Loans Gross Adjusted		
	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (9/28/77)	308,275	-1,398	+27,445
New York City (10/5/77)	70,777	+1,317	+ 1,890

Member bank borrowings increased slightly on average during the latest statement period but remained well below the year's high levels established late in August. Generally, conditions tightened somewhat during the week, with net borrowed reserves increasing from the significantly revised level recorded for the preceding period.

The Federal Funds market was generally tight throughout most of the week. In the first four trading sessions the effective rate ranged between a low of 6.43% and a high of 6.60%, with Funds changing hands in a range of 6¼% to a high of 8%. On settlement day the effective rate declined to its low for the period, dropping to 6.03% as rates moved in a band from 6½% to 1%. The average rate for the week, rose from 6.35% to 6.41%. The current period began with an effective rate of 6.41% and a trading range of 6¾% to 6½%.

The rise in money market rates that has occurred throughout most of the year and has been particularly marked over the last several weeks has now carried the weekly averages of all of the principal rates reported by the Federal Reserve to levels significantly above the year's earlier lows as well as those rates prevailing only a few weeks ago. Currently, all rates are at their 1977 highs. The Federal Funds rate, which was at its 1977 low of 4.47% on the first banking week of the year, now stands 194 basis points above that level and 96 basis points higher than the figure reported in the final week of July, while three-month Treasury bill yields, which were also at the year's low average in early January, now are at the 5.98% level, some 157 basis points above the low and 79 basis points higher than in late July. In the case of 90-119 day dealer placed commercial paper, and three-month secondary market CDs, rates in the currently reported week averaged 6.31% and 6.43%, respectively, compared to 1977 first week lows of 4.63% and 4.68% and late July levels of 5.38% and 5.43%. Three-month Eurodollar rates, which set a 1977 low of 5.01% in mid-February and were at an average of 5.78% in late July, now stand at 6.98%.



SECURITY MARKETS

U.S. Governments, Closing Bid Prices:

	Friday 10/7/77	Week Ago	Year Ago
90-Day Bills (Discount Basis)	6.11%	+ .22	+ 1.19
180-Day Bills (Discount Basis)	6.39	+ .20	+ 1.35
Longest Bills (Discount Basis)	6.45	+ .19	+ 1.27
6½s 9/30/79	99.11	-10/32	
7½s 11/15/82 (W.I.)	99.13		
7½s 8/15/84	99.9	-15/32	
7½s 8/15/92	97.16	-15/32	
7½s 2/15/07-02	98.25	-25/32	

Municipals:

		Week Ago	Year Ago
Bond Buyer—20 Bond Index (10/6/77)	5.60%*	+ .09	- .73
Blue List Total (\$ Million)	\$1,186	-\$ 49	+\$ 181
30-Day Visible Supply (\$ Million)	\$2,022	-\$493	+\$ 471
Total	\$3,208	-\$542	+\$ 652

Corporates:

		Week Ago	Year Ago
Moody's Aa Composite (10/6/77)	8.22%	+ .04	- .07
Money Mgr.—30-Day Supply (\$ Million)	\$1,807	+\$ 6	-\$ 560

Stocks:

		Week Ago	Year Ago
Dow-Jones Averages			
Industrials	840.35	- 6.76	-111.93
Transportation	216.89	+ 1.41	+ 7.53
Utilities	114.04	+ .75	+ 15.88
65 Stocks	290.20	- .41	- 10.84
Standard and Poor's 500 Stocks	95.97	- .56	- 6.59
N.Y.S.E. Composite Index	52.59	- .22	- 2.26
N.Y.S.E. Avg. Daily Vol. for Week (000's)	18,670	- 850	+ 816

*48% Taxable Equivalent 10.77%

SHORT TERM PAPER OUTSTANDING (Millions of Dollars)

	Latest Week	Change Since	
		Week Ago	Year Ago
Negotiable Time CDs			
Weekly Reporting Banks			
Nationwide (9/28/77)	67,155	+1,910	+1,154
New York City (10/5/77)	21,157	+ 660	- 516
	End-of-Month Total	Change Since Month Ago	Year Ago
Commercial Paper	Aug. '77 59,397	+ 637	+ 9,297
Bankers' Acceptances	Aug. '77 23,091	- 407	+ 3,708

Yields on the **Government** three-month and six-month bills increased again in the regular Monday auction, and in subsequent trading rates in the market rose moderately on the . . . Prices of coupon issues moved . . . upward during most sessions, and the list as a whole closed off week-to-week.

New issues in the **corporate** market tended to meet a mixed reception during the week. A generously-priced, A-rated Carolina Power & Light Company issue, offered to yield 8.47% in thirty years, sold out the first day, while two other major offerings, priced somewhat closer to the market, moved rather slowly in the face of a sizable supply of unsold issues. Activity in the secondary market tended to be mixed on a day-to-day basis, with prices generally off somewhat on the week.

Faced with a heavy slate of new issues and a sizable forward calendar, the **tax-exempt** market put in an active week. Two major state names, Oregon and Tennessee, carrying realistic yield scales against the current easing market, moved well initially but met some resistance later. Prices of representative outstanding issues trended downward in most sessions, and the Bond Buyer twenty-bond yield index registered its largest one week increase in several months.

Prices on the New York **Stock Exchange** showed little in the way of a meaningful trend this week, although most leading industrial issues were on the downside. News on the inflation and interest rate fronts continued to be the major negative factors in market sentiment.

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)

Gross National Product (Current Dollars)*
 New Plant and Equipment Expenditures*
 U.S. Merchandise Trade Balance [Surpl. (s) or Def. (d)]†

Leading Indicators Composite Index (1967 = 100)†

Industrial Production Index (1967 = 100)†

Total Business Sales†
 Total Business Inventories†

Civilian Employment (Thousands of Persons)†
 Unemployment as % of Civilian Labor Force†

New Construction Expenditures*
 Private Housing Starts (Thousands of Units)*

Personal Income*
 Net Change in Consumer Instalment Credit†

Wholesale Price Index (1967 = 100)
 Consumer Price Index (1967 = 100)

*Seasonally adjusted annual rate

†Seasonally adjusted.

	Latest Period or End of Period	Previous Period	Year Ago Period
2nd Q'77	\$ 1,870	\$ 1,811	\$ 1,692
4th Q'77	\$ 142.02(a)	\$ 138.43(a)	\$ 125.22
Aug. '77	\$ 2.67(d)	\$ 2.53(d)	\$ 0.74(d)
Aug. '77	131.3	130.3	125.6
Aug. '77	138.2	138.9	131.3
July '77	\$ 213.4	\$ 214.3	\$ 193.3
July '77	\$ 317.4	\$ 315.5	\$ 290.9
Sept. '77n	91,095	90,771	87,794
Sept. '77n	6.9%	7.1%	7.8%
Aug. '77n	\$ 170.9	\$ 172.5	\$ 141.8
Aug. '77	2,022	2,076	1,530
Aug. '77	\$ 1,547	\$ 1,539	\$ 1,394
Aug. '77n	\$ 2.51	\$ 2.32	\$ 1.53
Sept. '77n	195.3	194.6	184.8
Aug. '77	183.3	182.6	171.9

n-Newly reported figure.

a-Anticipated.

NEW YORK MONEY MARKET

Offering Rates 10/7/77	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	6.07%	6.33%	6.37%
*Federal Agencies	6.10	6.40	6.80
*Project Notes (48% Taxable Equivalent)	5.38	5.87	6.44
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	6.55	6.85	

‡Finance Company Paper—Prime		‡*Bankers' Acceptances	
5- 14 days	6.00%	Oct.	6.10%
15- 29 days	6.125	Nov.	6.15
30- 89 days	6.25	Dec.	6.25
90-239 days	6.375	Jan.	6.30
240-270 days	6.50	Feb.	6.35
		Mar.	6.40
		Apr.	6.45
‡Industrial Paper—Prime		‡Federal Funds Effective Rate	
30- 89 days	6.25%		6.40%
90-119 days	6.375		

‡Discount Basis.

*Subject to Availability.

†Estimated.

Continued

increase during that eight-month period. The rise, 0.2 per cent, was the smallest since last December, when producers' inventories shrank 0.3 per cent. August's increase also compares with gains of 9.4 per cent in July and 0.7 per cent in June.

This caution on stock building is occurring even though new orders are climbing swiftly. In August, factory orders climbed 2.3 per cent. This is the largest monthly increase in new orders since March, 1977, when new orders increased 4.9 per cent. It follows four months of virtually no change or declining new orders. And while shipments of manufactured products also rose in August, they did not match incoming orders. As a result, the backlog of unfilled orders increased slightly.

DIMITRI N. BALATSOS

Vice President



MANUFACTURERS HANOVER TRUST
biographical data

Dimitri N. Balatsos, vice president and financial economist of Manufacturers Hanover Trust Company, joined the bank in 1971 as an associate economist responsible for financial matters.

He was elected an assistant vice president in the Economics Department in 1972 and vice president and economist in 1973. Prior to joining Manufacturers Hanover Trust, he was an associate economist with the Life Insurance Association, the trade association, and F. I. duPont & Co. in Wall Street. He also worked as an independent economic consultant specializing in government affairs.

Among his various responsibilities at the bank, he is the author of the quarterly publication, Financial Report and co-author of the weekly Financial Digest. In addition, he has contributed numerous articles to leading business publications, and maintains membership in several well-known academic and business organizations.

MHT-Balatsos-----2 /

A native of Athens, Greece, Mr. Balatsos came to the United States as a student in 1960. He did his undergraduate work in economics at Knox College in Galesburg, Illinois, graduating at the top of his class. His graduate training was at the University of California in Berkley, where he also served as a Research Fellow and a teaching assistant.

He is married, has four children, and resides in New York City.

.: THE END :.

6/77

HARALD S. de ROPP, VICE PRESIDENT

Birth Date: January, 1936

Education: MBA, Wharton Graduate School of Business
BS, University of Delaware

Business Experience: Manufacturers Hanover Trust Company

1962 to date: Portfolio Manager,
Employee Benefit Trust Investment
Department

1961-1962: Security Analyst, Investment
Research Department

Organizations: Bond Portfolio Managers Association

MHT Co. Committees: Portfolio Management Committee
Trust Investment Committee

J. L. McCandless, VICE PRESIDENT

Birth Date: December 1929

Education: AB Princeton University 1951
Princeton Graduate School of Psychology 1952
New York Trust School

Business Experience: 1973 to date: Manufacturers Hanover Trust
Company - Trust Division
1958-72: Football Coach, Princeton University
1955-58: Teacher - Coach, The Kent School,
Kent, Connecticut
1952-55: Teacher - Coach, St. Mark's School,
Southboro, Massachusetts

Organizations: International Foundation of Employee Benefit
Plans
Educational Conference of Health, Welfare
and Pension Plans, Inc.
Association of Private Pension & Welfare Plans,
Regional Chairman
National Association of State Retirement Admin-
istrators
National Council on Teacher Retirement
National Conference on Public Employee Retire-
ment Systems
American Pension Conference
National Football Foundation and Hall of Fame

Article 6. Agency Meetings Public.

Section

310. Agency meetings public
312. State policy regarding meetings

Sec. 44.62.310. Agency meetings public. (a) All meetings of a legislative body, of a board of regents, or of an administrative body, board, commission, committee, subcommittee, authority, council, agency, or other organization, including subordinate units of the above groups, of the state or any of its political subdivisions, including but not limited to municipalities, boroughs, school boards, and all other boards, agencies, assemblies, councils, departments, divisions, bureaus, commissions or organizations, advisory or otherwise, of the state or local government supported in whole or in part by public money or authorized to spend public money, are open to the public except as otherwise provided by this section. Except when voice votes are authorized, the vote shall be conducted in such a manner that the public may know the vote of each person entitled to vote. This section does not apply to any votes required to be taken to organize the afore-mentioned bodies.

(b) If excepted subjects are to be discussed at a meeting, the meeting must first be convened as a public meeting and the question of holding an executive session to discuss matters that come within the exceptions contained in (c) of this section shall be determined by a majority vote of the body. No subjects may be considered at the executive session except those mentioned in the motion calling for the executive session unless auxiliary to the main question. No action may be taken at the executive session.

(c) The following excepted subjects may be discussed in an executive session:

- (1) matters, the immediate knowledge of which would clearly have an adverse effect upon the finances of the government unit;
- (2) subjects that tend to prejudice the reputation and character of any person, provided the person may request a public discussion;
- (3) matters which by law, municipal charter, or ordinance are required to be confidential.

(d) This section does not apply to

- (1) judicial or quasi-judicial bodies when holding a meeting solely to make a decision in an adjudicatory proceeding;
- (2) juries;
- (3) parole or pardon boards;
- (4) meetings of a hospital medical staff; or
- (5) meetings of the governing body or any committee of a hospital when holding a meeting solely to act upon matters of professional qualifications, privileges or discipline.

(e) Reasonable public notice shall be given for all meetings required to be open under this section.

(f) Action taken contrary to this section is void. (§ 1 art VI (ch 1) ch 143 SLA 1959; am § 1 ch 48 SLA 1966; am § 1 ch 78 SLA 1968; am § 1 ch 7 SLA 1969; am §§ 1, 2 ch 98 SLA 1972; am § 2 ch 100 SLA 1972; am § 1 ch 189 SLA 1976)

Effect of amendments. — The first 1972 amendment inserted "a legislative body or" in the first sentence of subsection (a) and substituted "clearly have an adverse effect upon" for "adversely affect" in subsection (c)(1).

The second 1972 amendment inserted "a board of regents or of" near the beginning of subsection (a).

The 1976 amendment added the second and third sentences of subsection (a).

Legislative committee reports. — For legislative committee report on ch. 78, SLA 1968 (SB 395), see House Journal (1968), p. 707. For report on ch 7, SLA 1969 (HB 32), see 1969 House Journal, p. 142. For report on ch 98, SLA 1972 (SB 253), see 1972 House Journal, p. 158. For report on ch. 100, SLA 1972 (CSHB 605 am), see 1972 House Journal, p. 643.

Am. Jur. reference. — 42 Am. Jur., Public Administrative Law, § 94.

Sec. 44.62.312. State policy regarding meetings. (a) It is the policy of the state that

- (1) the governmental units mentioned in § 310(a) of this chapter exist to aid in the conduct of the people's business;
- (2) it is the intent of the law that actions of those units be taken openly and that their deliberations be conducted openly;
- (3) the people of this state do not yield their sovereignty to the agencies which serve them;
- (4) the people, in delegating authority, do not give their public servants the right to decide what is good for the people to know and what is not good for them to know;
- (5) the people's right to remain informed shall be protected so that they may retain control over the instruments they have created.

(b) Section 310(c)(1) of this chapter shall be construed narrowly in order to effectuate the policy stated in (a) of this section and avoid unnecessary executive sessions. (§ 3 ch 98 SLA 1972)

Revisor's note (1972). — AS 44.62.312(a) is based on Cal. Gov't C.A., sec. 54950.

Legislative committee report. — For report on ch. 98, SLA 1972 (SB 253), see 1972 House Journal, p. 158.

Article 7. Legislative Review of Rules.

Section

320. Legislative annulment of regulations and review

Sec. 44.62.320. Legislative annulment of regulations and review.

(a) The legislature, by a concurrent resolution adopted by a vote of both houses, may annul a regulation of an agency or department.

(b) Within 45 days after a regulation is filed by the lieutenant governor, the lieutenant governor shall submit the regulation to the

- UNIFORM RULES -

ALASKA

STATE LEGISLATURE

ADOPTED BY THE
TENTH STATE LEGISLATURE - FIRST SESSION

MAY 3, 1977

NOTE: THIS IS A TEMPORARY TYPEWRITTEN EDITION
INTENDED FOR USE DURING THE REMAINDER OF THE
CURRENT SESSION. A FORMAL PRINTING AND INDEXING
WILL BE ACCOMPLISHED BY THE PUBLISHERS OF THE
ALASKA STATUTES DURING THE INTERIM.

State Affairs (programs and activities of the Office of the Governor and the Departments of Administration, Military Affairs, Public Safety, and Transportation and Public Facilities).

(b) The committee chairmen are authorized to form such subcommittees as they determine to be necessary.

Special Committees

RULE 21. The presiding officer of each house appoints all special committees and designates their chairmen unless otherwise ordered by the house. The chairmen of like committees of each house may arrange for the committees to meet jointly to receive testimony and deal with other matters which may be expedited by joint committee action.

Open and Executive Sessions

RULE 22. (a) All meetings of a legislative body are open to all legislators, whether or not they are members of the particular legislative body that is meeting, and to the general public except as provided in (b) of this rule.

(b) A legislative body may call an executive session at which members of the general public may be excluded for the following reasons:

- (1) discussion of matters, the immediate knowledge of which would adversely affect the finances of a government unit;
- (2) discussion of subjects that tend to prejudice the reputation and character of a person;
- (3) discussion of a matter that may, by law, be required to be confidential.

(c) When a legislative body desires to call an executive session in accordance with (b) of this rule, the body shall first convene as a public meeting and the question of holding an executive session shall be determined by a majority vote.

(d) The provisions of this rule shall not be interpreted as permitting the exclusion of a legislator from an executive session, whether or not he is a member of the body that is meeting. A legislator not a member of the body holding an executive session shall, however, be subject to the same rules of confidentiality and decorum as pertain to regular members of the body.

(e) Minutes shall be kept of each meeting of a standing or special committee. Meetings may be electronically recorded at

the option of the committee. Committee minutes and other materials of research value shall be delivered to the legislature's reference library at the end of each session for appropriate disposition.

(f) To the maximum extent feasible, the time, place and subject matter of meetings of standing or special committees shall be announced by the committee chairman in advance. The announcement should be, if possible, made on the floor of the House or Senate during sessions. Posting of notices and other forms of announcement are encouraged. The presiding officer of each house shall enforce compliance with this subsection.

Committee Referral and Action

RULE 23. (a) A committee acts on all bills referred to it and reports its actions and recommendations to the house as soon as practicable. Committee reports must be in writing and the report must be signed by a majority of the members of the committee. The report will note the recommendation of each member signing the report.

(b) When a bill is reported back by a committee without at least one "Do Pass", unless the bill has a subsequent referral or referrals of record, the presiding officer shall put the question "Shall the bill be referred to the Rules Committee for placement on the calendar for second reading notwithstanding the report of the committee(s)?" If the bill has a subsequent referral or referrals of record, the question shall not be put until the last committee has reported and unless all reports are without at least one "Do Pass". The question is debatable and if a majority of the membership of the house votes in the negative, the bill is lost.

(c) If a committee has more than one bill on the same subject or if it finds it necessary to revise a bill substantially, it may report out a substitute bill and recommend that the substitute be accepted for second reading in the place of the original bill. Substitute bills are duplicated and distributed when they are reported out by the committee. Committee substitute bills carry a notation of the source or sponsor of the original bill in the manner prescribed by the drafting manual unless the sponsor objects to his or their name so appearing.

(d) All bills involving appropriations, revenues or bonding must be referred to the Finance Committee before they can be advanced to second reading.

Committee of The Whole

RULE 24. When the house forms itself into a Committee of the Whole the presiding officer vacates the chair and calls upon



MANUFACTURERS HANOVER TRUST COMPANY

600 FIFTH AVENUE, NEW YORK, N. Y. 10020

October 26, 1977

The Honorable Clark Gruening, Chairman
Special Committee on the Alaska
Permanent Fund
528 West Fifth - Suite 270
Anchorage, Alaska 99501

Dear Clark:

I send this letter to your attention as Chairman of the Special Committee, but have indicated a copy to Mike Doogan since all arrangements for our pending presentation to your Committee have been made through him.

I promised an outline of our presentation highlighting the major topics. Attached I offer that outline and indicate, in each case, who the speaker will be. For your and Mike's information, I also enclose biographies on each of the Manufacturers Hanover people who will be involved on November 18th.

During our last telephone conversation, Mike indicated that the meeting might be moved up to 9 am from 1:30 pm. We are prepared to make our presentation earlier if necessary and look forward to hearing from Mike if that change is made.

Our group will be staying at the Captain Cook Hotel the night of the 17th. We look forward to seeing you soon.

Sincerely yours,

Jake McCandless
J. L. McCandless
Vice President

Enclosures
cc: Mike Doogan

MANUFACTURERS HANOVER TRUST COMPANY

PRESENTATION - ALASKA PERMANENT FUND COMMITTEE

- I. Introduction
Speaker - J. L. McCandless - Vice President

- II. History and Development of Funds Exempt from Taxation
Speaker - Willard L. Wheeler, Jr. - Senior Vice
President

- III. Impact of ERISA on Corporate Pension Funds
Speaker - Willard L. Wheeler, Jr. - Senior Vice
President

- IV. Other Services Needed by a Public Fund
Speaker - Willard L. Wheeler, Jr. - Senior Vice
President

- V. Investment Strategy
Speaker - Victor J. Melone - Senior Vice President
 - A. Development of Economic Scenarios
Speaker - Dimitri N. Balatsos - Vice President

 - B. Debt Management
Speaker - Harald deRopp - Vice President

 - C. Equity Management
Speaker - Victor J. Melone - Senior Vice
President

- IV. Conclusion

WILLARD L. WHEELER, JR., SENIOR VICE PRESIDENT

Birth Date: October, 1932

Education: MBA, University of Chicago
BA, Cornell University
National Trust School
Investment Management Program -
Stanford University

Business Experience: Manufacturers Hanover Trust Company

1973 to date: Officer in Charge,
Employee Benefit Trust Department

1971-1973: Senior Officer, Employee
Benefit Trust Investment Department

1968-1970: Investment Officer, Personal
Trust

1957-1968: Portfolio Officer, Northern Trust
Co., Chicago

Organizations:

Investment Analysts Society of Chicago
National Foundation of Health, Welfare and
Pension Plans, Inc.
American Pension Conference
Cornell Alumni Society
Advisory Committee-Stanford University
Graduate School of Business
Past Member New York State Bankers Association
Employee Benefit Committee

MHT Co. Committees:

Senior Investment Committee
Portfolio Management Committee (Ad Hoc Member)
Trust Investment Committee

VICTOR J. MELONE, SENIOR VICE PRESIDENT

Birth Date:

November 1933

Education:

MBA, New York University Graduate
School of Business
BA St. Peter's College

Business Experience:

Manufacturers Hanover Trust Company

1977: Senior Vice President
Trust Division, Senior
Investment Officer

1974-77: Prudential Insurance
Company of America,
Vice President, Director
of Research

1972-74: Dean Witter & Company,
Incorporated,
Senior Vice President and
Director, Director of
National Research

1968-72: Blyth & Co., Vice President
and Director, Director of
Research

Organizations:

New York Society of Security Analysts
Chartered Financial Analyst

MHT co. Boards and
Committees:

Chairman, Senior Investment Committee
Chairman, Investment Officers Committee

October 4, 1977

Mr. J. L. McCandless
Vice President
Manufacturers Hanover Trust Company
600 Fifth Avenue
New York, NY 10020

Dear Jake:

I am writing at the direction of the Chairman, Clark Gruening, to firm up arrangements for a presentation by your firm at the Committee's November meeting in Anchorage. The enclosed schedule gives details of that meeting.

It is my understanding that your firm will be prepared to make presentation on how it handles trust/pension accounts and other types of financial management. In this regard, we think that any information you could give the Committee on the management of private trust accounts and the way that management contrasts with management of public trust accounts would be most useful.

At this point, it looks as if such a presentation should be made on November 18 not long after the Committee meeting commences. This, of course, may change; but I am confident in scheduling the presentation for planning purposes at that time.

Also enclosed for your information are some recent fact sheets on current investment of Alaska pension and other funds from the State Department of Revenue.

In closing, I would like to reiterate that it appears unlikely that the Committee will make specific assignments of funds for management, since its charge is to present suggestions to the full house on enabling legislation. In short, we view our position as being in the initial stages of a process.

Sincerely,

Mike Doogan
Administrative Assistant

Enclosures



MANUFACTURERS HANOVER TRUST COMPANY

600 FIFTH AVENUE, NEW YORK, N. Y. 10020

September 2, 1977

Mr. Michael Doogan
528 5th Avenue
Anchorage, Alaska 99501

Dear Mike:

It was a pleasure to meet you during my Anchorage visit last Tuesday. Thank you for your time and counsel as I endeavor to introduce Manufacturers Hanover to all of you who hold responsibility to the Permanent Fund.

It would be a privilege to arrange an investment presentation by our people to the Permanent Fund Committee at some point in the future. We are willing to come to Alaska for that purpose whenever it might be timely. In my letter to Clark I have indicated this desire, and if the Committee meetings scheduled for November 11 and 12 would be a good time, we certainly will plan to be there.

Best wishes Mike for continuing success in your efforts on behalf of Alaska. All of you face a challenging future with endless opportunities. I look forward to seeing you again in the future.

Sincerely yours,

Jake M. Candless
J. L. McCandless
Vice President



MANUFACTURERS HANOVER TRUST COMPANY

600 FIFTH AVENUE, NEW YORK, N. Y. 10020

November 25, 1977
Telephone Number
(212) 957-1893

Representative Clark Gruening
Chairman
House Permanent Fund Committee
528 West Fifth Avenue
Anchorage, Alaska 99501

Dear Clark:

On behalf of Manufacturers Hanover Trust Company, I would like to express deep appreciation and gratitude for the opportunity we had to appear before your Committee last Friday. Our effort was designed to show those members present the investment process with all its input. Perhaps it was not exactly what the Committee had expected, but it was an honest effort to educate all of you as you approach the construction of the Bill which will go before the Legislature.

We are prepared to assist your Group at any time in the future, and I will be staying in touch with you on a regular basis.

The associations I have made during my two visits are valued ones, and I look forward to further contact with you and your Committee.

I send along very best wishes to you and your family for a very pleasant Holiday Season.

Sincerely yours,

J. L. McCandless
Vice President



MANUFACTURERS HANOVER TRUST COMPANY

600 FIFTH AVENUE, NEW YORK, N. Y. 10020

October 11, 1977
Telephone Number
(212) 957-0760

Mr. Mike Doogan
Administrative Assistant
Special Committee on the Alaska
Permanent Fund
528 West Fifth, Suite 270
Anchorage, Alaska 95501

Dear Mike:

In the absence of Jake McCandless who is vacationing this week, I am responding to your letter of October 4, 1977.

Our Bank is very appreciative of this opportunity to come before your Committee on November 18 in Anchorage. Jake or I will be getting back to you shortly with an outline of the subjects we will cover in the Presentation, and we would welcome your comments to insure that our meeting will be informative.

Again, I wish to express our appreciation for this opportunity to meet with your Committee.

Very truly yours:

James S. Ward
Vice President

Quarterly Business Conditions Analysis

By IRWIN L. KELLNER
Vice President and Economist

Manufacturers Hanover Trust

Business Report

AUTUMN, 1977

The economic climate is changing—but not the way the pessimists on Wall Street and elsewhere believe. True, the economy is once again in the middle of a so-called "pause". And since this pause, unlike the ones that occurred this time last year and the year before, is taking place at a time when the economic expansion is seemingly closer to maturity, there is growing concern that it will lead to a full-fledged recession.

Rather than being on the verge of a new recession, I think we are experiencing what could very well turn out to be the longest expansion in postwar, peacetime history. I believe this will be so precisely because of the economic climate that has gotten so many people concerned. As I see it, we have entered into a new era of caution on the part of both the private and the public sectors. This has produced—and will continue to produce—an expansion that moves ahead by fits and starts. This kind of an expansion will not allow the ongoing recovery to develop into a full-fledged boom—but neither will it lead to a full-blown recession. The end result could very easily be continued economic growth through the end of this decade and beyond.

Bad News Is Good News

You can see the private sector's caution in the attitude businessmen have toward inventory building, capacity expansion, and liquidity. Still feeling the after effects of the 1973-75 recession, and aided by the use of computers, businesses seem to adjust inventory imbalances more promptly nowadays than they had in the past. They did this in the summer of 1975, following what seemed to be a premature rise in inventory-sales ratios, after the end of the recession. The same thing happened in the summers of 1976 and 1977.

Of course, this stop-start pace of inventory building has produced growth rates in real GNP that are not unlike that of a roller coaster. Following the end of the recession in the first quarter of 1975, the real GNP rose at a 6½ per cent rate in the second, and accelerated to an 11½ percent clip in the third before sliding back to a rate of three per cent in the fourth. It picked up to a nine per cent growth rate in the first quarter of last year then slowed progressively through the year, recording only a 1.2 per cent rate of rise in the fourth. Again this year the real GNP growth rate accelerated to 7½ per cent in the first, and slipped back to six per cent in the second. As the table on the back page indicates, the prognosis is for a slower rate of growth

in the third quarter, followed by a slight pick up in the fourth and then another deceleration throughout 1978.

A good part of these gyrations was caused by inventories. Real sales to final consumers progressed at a steadier pace. In 1975, they averaged growth rates of about 4½ per cent in the last three quarters. And while they slowed to a growth rate of a bit less than four per cent in the first quarter of 1976, the rate of increase in real final sales actually accelerated throughout the year, even as the rate of growth of the real GNP slowed. The same thing seems to have taken place so far this year: real final sales rose at a 3.8 per cent clip in the first quarter and jumped to a 5.1 per cent pace in the second. It is anticipated that the growth rate of real final sales is rising even faster in the third quarter, although some slowing is expected in the fourth.

In retrospect, it is clear that these minor adjustments affected the pace of overall economic activity. Rather than permitting rates of growth to change slowly, as in the past, these inventory adjustments altered the GNP's growth path frequently. That's the disadvantage; the advantage—so far at least—is that these minor adjustments have tended to forestall the need for a major adjustment. As such, the business expansion—from the standpoint of inventories, at least—seems to be more sustainable.

Part and parcel of this attempt on the part of the business sector to generate a "low pressure" recovery is businessmen's cautious attitude towards plant and equipment spending—particularly as it affects capacity. At mid-year, nonresidential fixed investment in real terms was about five per cent below the levels reached in the fourth quarter of 1973, the business cycle peak. By contrast, at this point in previous business expansions, 14 quarters after the business cycle peak, such outlays were nearly nine per cent higher.

Most of this sluggishness traces to investment in nonresidential structures. Producers' durable equipment in real terms is running about two per cent above its business cycle peak compared with an average gain of seven per cent at this time in previous expansions. The volume of bricks and mortar going up these days is nearly 16½ per cent less than it was at the business cycle peak, whereas the typical postwar recovery has seen a 10 per cent higher level at this point.

As observed in the last issue of this Business Report,

these trends in capital spending appear to reflect a split in business confidence levels. Businessmen are fairly confident of the near-term economic outlook, but extremely cautious when they look out to the longer run. The reasons for this split can be traced to the same factor: the role of government. Other than a sudden imposition of wage-price controls, there is very little that the government can do to affect the near-term outlook for business. However, when one looks out to the longer term, one encounters increased political uncertainties. There is a growing tendency on the part of governments on all levels, but particularly in Washington, to impose increasingly complex rules and regulations. Ostensibly designed with all good intentions, these regulations have tended to interfere with the orderly functioning of our economic machine, making it less efficient, while creating greater uncertainties.

Political Uncertainties Generate Caution

To be sure, businessmen have always had to deal with government intervention. Each session of government has passed many new laws and only rarely struck old ones from the books. But in recent years government intervention has been transformed from a relatively uncomplicated type of economic regulation, applied to a limited number of areas, to a staggeringly comprehensive and complex set of social engineering programs designed to affect directly the behavior of a whole society.

Not only has there been a tremendous jump in the number of major economic and social regulatory agencies and a concomitant leap in the number of rules and regulations, these laws have become increasingly unpredictable of late. Unlike economic, technological, or other uncertainties indigenous to the private free enterprise system, political uncertainties tend to be sudden, swift, and unprecedented. It is entirely possible for a multi-million dollar industrial complex to comply with all rules and regulations one day, and still be in violation somewhere down the road. Businessmen and investors can cope with uncertainties of the marketplace; they always have. However, they draw the line when it comes to political uncertainties. This could be the reason behind the growing reluctance on the part of businessmen to invest in facilities which might take a long time to come on stream, and whose profit payout point might be many years into the future.

I would hope that policymakers will realize before it is too late that by passing this multitude of laws, they are slowly but surely killing the goose that lays the golden egg: the private free enterprise system. However, such a development might be a while in coming. Thus, if businessmen are to increase their investment in bricks and mortar, they will need some other fillip to confidence. Their own caution, which I believe is prolonging the economic expansion, could very well meet the test. If it does, then the delays in capital spending that have occurred until now, could very well turn out to be a blessing in disguise. Clearly, the recovery has been able to make it to this point without the usual assistance

from capital spending. A stronger burst of plant and equipment now would go a long way toward helping prolong the life of the ongoing expansion.

For one thing, increased capital investment provides jobs. Although it might seem so to opponents of "trickle down" economic policies, new factories, office buildings, machinery and equipment neither grow on trees nor come from outer space. Rather, they must be built, and this involves labor.

Another reason why increased capital investment will prolong the recovery is that it will expand capacity. Clearly, an economic expansion depends on supplies of goods as well as the demand for them. In this era of Keynesian economics, with its emphasis on demand management, many tend to forget supplies.

Finally, increased plant and equipment invariably produces improved rates of productivity gain. And, as has been reported in these pages before, greater productivity is the only route toward increased living standards for everyone. Productivity is the balance wheel that links labor's drive for higher wages with business needs to protect profit margins by raising prices. When productivity climbs, there is room for both labor and management to improve their well-being; when productivity is stagnant or falling, only one group can benefit—and only at the expense of the other.

Getting back to the current economic scene, business caution is also evident in its attitude toward liquidity. This is perhaps the main reason why interest rates have not climbed as swiftly as they usually do at this point in a business recovery. It also suggests that there are plenty of short-term funds available for companies to use in financing their ongoing operations.

Although they have risen about 1½ percentage points since April, short-term rates of interest remain below their levels of a year ago—not to mention their peaks of 1973 and 1974. At this point in the typical postwar expansion, short-term interest rates had been on the rise for some time, and were well above their levels at the start of the recovery, reflecting generally tighter money. Today, by contrast, even after rising 150 basis points in four months, the key federal funds rate is not much higher now than it was at the end of the recession some two and a half years ago.

Economic Policy Is Right

Turning to the government, I find a similar change toward caution in attitudes. Proclamations of those who follow the weekly entrails of the Fed to the contrary, growth in the money supply over the longer run has not significantly deviated from the Fed's announced target ranges. For example, the compound annual rate of change between the average of the four weeks ending August 25, 1976, and the average of the four weeks ending August 24, 1977, was 6.9 per cent, according to the Federal Reserve Bank of St. Louis. This compares with the target range announced in the summer of 1976 of 4½ per cent to 6½ per cent. As for M2 (the money supply plus net time deposits), the compound annual

rate of change over the same time period amounted to 10.8 per cent, compared with the range of 7½ to 10 per cent announced in the summer of 1976.

Like the economy, the money supply has grown by fits and starts throughout most of this economic recovery—but whenever its growth rate threatened to get out of hand, the Fed moved promptly to restrain money growth by boosting interest rates. It happened in the summer of 1975, again in mid-1976, and, of course, in 1977 as well.

By these actions, especially its decisions taken this summer to reduce the growth rate of the money supply and to raise the discount rate a half-point, the Federal Reserve has served notice that it intends to follow a cautious monetary policy. The Fed is clearly interested in encouraging continued economic expansion, but at the same time it wants to help resist inflationary pressures. If this means higher interest rates and slower economic growth from time to time, so be it: the rewards to be reaped from a lower rate of inflation would seem to be worth it, in the long run.

But the Fed can't do the job alone. It needs help from fiscal policy—and the way things are going it looks like it's getting it. For just as the Fed is conducting monetary policy from a cautious stance, so the Administration appears to be managing fiscal policy carefully. The deficit in the Federal Government's budget for fiscal year 1977 likely amounted to less than \$50 billion. Although large compared with both past history as well as this point in the business cycle, the FY 77 deficit nonetheless came in better than \$20 billion less than feared earlier this year. No doubt this development staved off pressures on the financial markets—either in the form of short-term interest rates that would have been higher than today, or in even faster rates of money growth than have been characteristic of the past couple of months.

The prognosis for fiscal year 1978 could also be bright. Although the Administration predicts a step-up in the deficit to about \$62 billion, recent trends in government expenditures, as well as in the revenues Washington is receiving, suggest that the deficit for FY 78 may wind up no greater than that of FY 77. Again, this might result in slower economic growth, near-term, since the federal government would not be providing this much spending to the marketplace. However, it would represent a plus in the longer-term outlook, for it would permit the private sector to gain a greater share of the gross national pie, as well as move Washington firmly in the direction of the budget balance promised for the end of this decade by President Carter.

Having pointed out the benefits that the current economic scene suggests to me, it is possible to dispose quickly of the negatives that lead others to forecasts of gloom and doom. First of all, the longevity of the current recovery should not at all be disturbing. As I pointed out in June, there appears to be a relationship between the length of a recovery and the length of the previous

recession. The average recovery has tended to last three times as long as the preceding recession, and since the most recent recession was 16 months in length, this 3:1 ratio suggests that the current recovery could last at least until the spring of 1979—a total of four years. This is not mere mechanical extrapolation. Rather, it is based on the fact that the 1973-75 recession, which was not only the longest but the deepest recession of the postwar period, left a lot of economic slack. Thus there would seem to be plenty of room left for a longer-than-average comeback.

As for the negative signs in the picture today, most of them revolve around statistics that purport to predict the future, as opposed to measure of current business conditions. Take the stock market, for example. In the past year the market has declined about 12 per cent. However, in 1971 the stock market also declined 12 per cent and yet there was no recession, while in 1966 the stock market fell for about the same number of months as it has this time and yet there was no recession. Indeed, in the postwar period there have been ten major bear markets—but only six recessions. As for this summer's three-month decline in the government's index of leading economic indicators, my measurements show that since 1948 this index had declined for three months in a row on a total of 17 earlier occasions—almost three times the number of recessions that have occurred.

Business Conditions Look Good

You get a much brighter picture by looking at those statistics that depict current business conditions. Employment is at a record level, with a sizeable number of new jobs developing each month. Personal incomes are also at new highs—and are expanding at nearly twice the rate of consumer price inflation. Inflation is moderating, thanks to ample food supplies, which have pulled down grocery store prices.

Retail sales continue to grow, with gains now more widespread than earlier this year. Consumers are confident, judging by the rates at which they have been buying new houses and new automobiles. By the way, it would be unprecedented for the economy to falter while such two key industries as housing and autos are going strong. Industrial production is climbing, but generally at the rate that real retail sales are growing, since businessmen are striving to keep inventories under control. Finally, business spending on new capital goods appears to be picking up.

In light of the foregoing analysis, it seems to me that the current mini-pause will soon give way to another mini-boom, instead of a maxi-recession. In other words, we've entered into an economic climate that can be characterized as "low pressure": things may not get boomy—but they won't go bust, either. Coming after the excesses of the past dozen years, in which the temperature of the economy repeatedly reached the boiling point, such a low-pressure climate should be regarded as the harbinger of a welcome return to economic health and stability.

Autumn, 1977
MHT FORECAST OF GROSS NATIONAL PRODUCT
(Seasonally Adjusted Annual Rates)
In \$ Billions

	YEAR 76		< ACTUAL				PROJECTED >				YEAR 77		78				YEAR 78	
	LEVEL	% CH	77		77		LEVEL	% CH	78		78		LEVEL	% CH	78			
			I	II	III	IV			I	II	III	IV						
Gross National Product	1706.4	11.6	1810.8	1869.7	1912.7	1966.0	1889.8	10.7	2014.6	2064.7	2114.3	2163.6	2089.3	10.6				
GNP: \$72	1274.7	6.0	1311.0	1330.6	1344.4	1360.4	1336.6	4.9	1375.0	1388.6	1400.7	1409.7	1393.5	4.3				
% Change, annual rate	6.0		7.5	6.1	4.2	4.8	4.9		4.4	4.0	3.5	2.6	4.3					
Consumption	1093.9	11.6	1172.4	1194.0	1223.5	1250.8	1210.2	10.6	1279.9	1310.3	1341.4	1370.4	1325.5	9.5				
Durables	158.9	19.6	177.0	178.6	183.1	185.5	181.0	13.9	189.5	193.5	197.9	200.7	195.4	7.9				
Non-Durables	442.7	8.2	466.6	474.4	483.7	494.6	479.8	8.4	507.1	519.4	531.8	542.3	525.1	9.4				
Services	492.3	12.3	528.8	541.1	556.8	570.7	549.4	11.6	583.4	597.4	611.7	627.4	605.0	10.1				
Investment	243.3	28.7	271.8	294.9	295.0	308.9	292.7	20.3	319.7	327.4	333.3	337.5	329.4	12.6				
Non-Residential	161.9	8.6	177.0	182.4	188.8	194.1	185.6	14.6	199.6	205.5	212.0	218.2	208.8	12.5				
Producers Durable Equip.	106.1	10.2	119.2	121.4	125.9	129.5	124.0	16.9	133.2	136.8	141.1	145.0	139.0	12.1				
Structures	55.9	5.7	57.9	61.0	62.9	64.6	61.6	10.2	66.5	68.7	70.9	73.2	69.8	13.4				
Residential	68.0	32.3	81.0	90.8	97.0	101.4	92.5	36.0	104.4	106.6	108.9	109.8	107.4	16.1				
Inventory Changes	13.4		13.8	21.7	9.3	13.4	14.5		15.6	15.3	12.3	9.5	13.2					
Net Exports	7.8		-8.2	-9.8	-8.3	-8.1	-8.6		-10.0	-8.5	-6.1	-3.4	-7.0					
Government Purchases	361.4	6.6	374.9	390.6	402.5	414.4	395.6	9.5	424.9	435.5	445.8	459.0	441.3	11.6				
Federal Defense	86.8	3.4	89.7	93.4	95.7	98.9	94.4	8.8	100.3	102.6	104.3	107.8	103.7	9.9				
Federal Civilian	43.3	10.0	46.7	50.2	51.9	53.2	50.5	16.5	54.6	55.5	56.3	58.3	56.2	11.2				
State & Local	231.2	7.2	238.5	247.0	254.9	262.3	250.7	8.4	270.0	277.4	285.2	292.9	281.4	12.3				
Final Sales: \$72	1266.2	4.5	1301.2	1317.4	1337.8	1351.3	1326.9	4.8	1364.6	1378.7	1392.9	1403.8	1385.0	4.4				
% Change, annual rate	4.5		3.8	5.1	6.4	4.1	4.8		4.0	4.2	4.2	3.2	4.4					
GNP Price Index (1972 = 100)	133.9	5.3	138.1	140.5	142.3	144.5	141.4	5.6	146.5	148.7	150.9	153.5	149.9	6.0				
% Change, annual rate	5.3		5.3	7.1	5.1	6.5	5.6		5.6	6.1	6.2	6.9	6.0					
Consumer Price Index (1967 = 100)	170.5	5.7	177.1	180.9	183.2	185.5	181.7	6.5	188.1	190.9	193.7	196.5	192.3	5.9				
% Change, annual rate	5.7		8.4	8.8	5.2	5.2	6.5		5.8	6.1	6.0	5.9	5.9					
Total Personal Income	1382.7	10.3	1476.8	1517.2	1549.2	1595.5	1534.7	11.0	1627.2	1667.8	1707.3	1747.9	1687.6	10.0				
Disposable Personal Income	1185.8	9.4	1252.4	1292.5	1324.5	1362.5	1308.0	10.3	1394.4	1428.4	1461.1	1491.0	1443.6	10.4				
Savings Rate	5.6		4.1	5.3	5.3	5.9	5.2		5.9	6.0	5.9	5.8	5.9					
Employment Rate	56.1		56.5	57.1	57.3	57.3	57.0		57.6	57.7	57.7	57.7	57.7					
Unemployment Rate	7.7		7.4	7.0	6.9	6.9	7.0		6.5	6.4	6.6	6.6	6.5					
Indus. Production (1967 = 100)	129.8	10.1	133.5	137.3	139.7	141.7	138.0	6.4	143.6	145.4	147.3	147.8	146.0	5.8				
Housing Starts (000)	1541.3	32.7	1758.3	1909.0	2029.6	2038.8	1933.9	25.5	2012.6	1991.7	1997.1	1933.7	1983.8	2.6				
Domestic Auto Sales (000)	8633.3	21.6	9400.0	9300.0	9411.6	9073.5	9296.3	7.7	9008.4	8955.3	9058.0	8895.6	8979.3	-3.4				
Corporate Pre-Tax Profits	156.8	27.0	161.7	173.4	177.7	181.4	173.5	10.6	185.3	189.1	192.8	191.5	189.7	9.3				
- Taxes	64.7	29.0	64.4	69.3	71.9	73.4	69.7	7.7	73.2	74.8	76.2	75.6	75.0	7.5				
Net Profits	92.1	25.5	97.2	104.1	105.8	108.0	103.8	12.7	112.0	114.4	116.6	115.9	114.7	10.5				
- Dividend Payments	35.8	10.3	38.5	40.3	41.4	42.6	40.7	13.9	43.9	45.2	46.5	47.7	45.8	12.5				
Undistributed Profits	56.4	37.5	58.8	63.8	64.4	65.4	63.1	12.0	68.2	69.2	70.2	68.1	68.9	9.2				
+ Depreciation	97.1	8.5	102.0	103.5	106.2	108.5	105.1	8.2	110.9	113.3	116.0	119.3	114.9	9.4				
- Inventory Profits	14.1	17.2	20.6	17.8	13.5	16.4	17.1	20.8	16.8	19.5	20.4	17.8	18.6	9.1				
Net Cash Flow	139.3	17.7	140.2	149.5	157.1	157.5	151.1	8.4	162.3	163.0	165.8	169.7	165.2	9.3				

FINANCIAL DIGEST



MONDAY, OCTOBER 3, 1977

VOLUME XIV, NUMBER 40

OUTPUT DECLINE NOT WORRISOME

Economic activity remains in forward gear, even though two key indicators of current business conditions, industrial production and housing, declined in the latest month.

The first thing to note is that industrial output never travels upward in a straight line. In previous expansions, output had stalled six times, on average, before the recovery reached the age of 29 months. By contrast, in the current upswing, production has failed to rise on only four occasions so far—and one, January, 1977, was due to the abnormally cold winter.

Additionally, the major portion of August's drop was in two sectors—autos and electrical generation. Both had registered very high rates of output in July: autos, because of the surge in demand for 1977 model cars to beat the price increases on the 1978s, and electrical power because of the heat wave. Auto assemblies normally decline in August, as Detroit changes over to the new models, but because of July's upsurge the drop this time was greater than usual. And August's weather was cool compared with July. Finally, there is more caution than usual among businessmen these days. Businesses seem to adjust inventory imbalances more promptly nowadays than they had in the past. This is good news, since minor adjustments today tend to forestall the need for major corrections later on.

HOUSING DEMAND REMAINS STRONG . . .

As for homebuilding, the dip in August looked far worse than it really was. For one thing, while last month's

annual rate, 2.02 million housing units, was three per cent off July's pace. It remained a hefty 32 per cent above last year's figure. Additionally, the pace of single-family homebuilding remained unchanged between July and August. This is significant, since a single-family house uses more labor and materials than a one-family unit in an apartment building, and generates more after-market sales. Finally, permits to erect housing in the future rose eight per cent in August to a level 35 per cent ahead of last year.

The outlook for housing continues bright. The Manufacturers Hanover Economics Department expects the annual rate of housing starts to run in the 2 million zone through the end of next year. This would be a favorable figure under any circumstance, but it is especially impressive now because of the age of the recovery. Funds for homebuilding usually dry up when an upswing gets to be as old as the current one. This time, funds are readily available—not only from such traditional sources as the thrift institutions, whose deposit inflows remain strong, but also, from existing homes.

A little known source of purchasing power which is helping the sale of new homes is the increase in equity built up by owners of existing homes. The average house has appreciated significantly in value in recent years. According to the Commerce Department, the selling price of a typical new one-family home has doubled since 1967. Unlike installment debt, which represents a lien on future savings, this equity, when tapped through a second mortgage or a refinancing, unleashes the results of past savings. While this has always been available in the past, it is a more powerful factor nowadays because of the unusually sharp rise in prices of new and existing homes. This increase in homeowners' equity, believed to total around \$100 billion, represents potential buying power that is being used—not only to buy new homes and second homes, but to purchase home furnishings, cars, finance education, travel, and so forth.

. . . BUT MATERIALS SHORTAGES ARE DEVELOPING

If there is a cloud over housing, it may well come from a lack of supplies, rather than a dearth of demand. Shortages of many types of building materials are apparently beginning to crimp construction of new homes. What is

(continued on back page)

SELECTED FEDERAL RESERVE DATA

(Weekly Averages of Daily Figures—Millions of Dollars)

	Week Ending 9/28/77	Change Since	
		Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & PPs	110,414	+6,362	+ 7,345
Member Bank Borrowings	719	- 19	+ 632
Float	2,875	-1,422	+ 461
Total Reserve Bank Credit	117,063	+5,071	+ 7,215
Treasury Deposits with			
Federal Reserve Banks	12,089	+5,901	- 214
Currency Outside Banks	88,581	-1,367	+ 7,539
Member Bank Reserves			
Required	35,381	+ 453	+ 1,003
Excess (Deficiency)	218	+ 187	+ 19
Total Reserves Held	35,599	+ 640	+ 1,022
Net Borrowed Reserves	501	- 206r	+ 613r
Gov'ts held for Foreign Acct. by F. R. Banks (End-of-Week)	62,807	- 104	+13,588

r—Revised

9/21/77

Money Supply (\$ Bil., SA) M1	330.4	- 1.1
Money Supply (\$ Bil., SA) M2	793.0	- 0.9

BANK LOANS

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Commercial and Industrial Loans		
	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (9/21/77)	120,348	+1,065	+ 7,338
New York City (9/28/77)	33,949	- 191	+ 401
	Total Loans Gross Adjusted		
	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (9/21/77)	309,668	+2,314	+28,663
New York City (9/28/77)	69,444	-1,324	+ 2,394

Required reserves were higher in the September 28 statement week, and at the same time the member banks came under heavy pressure from a substantial increase in the Treasury's average deposits with the Federal Reserve Banks and an unusually large drop in average float. The latter development reportedly reflected in part a computer malfunction in the Chicago District. Moving vigorously to offset these tightening factors, the monetary authorities added, on average, some \$6.4 billion to the central bank's holdings of Governments and Agencies. Additional ease came in the form of a sizable decline in average currency outside banks. These and other easing influences prevailed, and the member banks' average net borrowed reserve position contracted by \$206 million.

The average Federal Funds rate jumped twenty-five basis points to 6.35%. Trading in the first four sessions was in a range of 6 $\frac{1}{8}$ % to 6 $\frac{1}{2}$ %, with the effective rate varying from a low of 6.21% to a high of 6.40%. On the settlement day, the trading band widened to 3% to 7 $\frac{1}{2}$ %, and the effective rate moved up to 6.55%. Fairly tight conditions by recent standards prevailed at the beginning of the current statement period. Trading was in a range of 6 $\frac{3}{8}$ % to 6 $\frac{5}{8}$ %, with an effective rate of 6.46%.

The major New York City banks increased the outstanding total of the large-denomination Certificates of Deposit by \$964 million in the September 28 week. The rise, which was more than four times as large as the runoff that occurred the previous week, one that included a corporate tax payment date, reduced the net decline since the beginning of the year to \$2.2 billion. In the first nine months of last year, a period of very sluggish loan demand, CD's at the New York City banks contracted by \$6.5 billion.



SECURITY MARKETS

U.S. Governments, Closing Bid Prices:

	Friday 9/30/77	Change Since Week Ago	Year Ago
90-Day Bills (Discount Basis)	5.89%	— .07	+ .85
180-Day Bills (Discount Basis)	6.19	+ .07	+ .94
Longest Bills (Discount Basis)	6.26	+ .06	+ .86
6½s 9/30/79	99.21	+ 2/32	
6¾s 9/30/81	99.4	— 3/32	
7¼s 8/15/84	100.2	— 3/32	
7¼s 8/15/92	97.31	— 4/32	
7½s 2/15/07-02	99.8	— 8/32	

Municipals:

Bond Buyer—20 Bond Index (9/29/77)	5.51%*	+ .01	— .96
Blue List Total (\$ Million)	\$1,235	+\$ 53	+\$ 354
30-Day Visible Supply (\$ Million)	\$2,515	+\$ 102	+\$1,050
Total	\$3,750	+\$ 155	+\$1,404

Corporates:

Moody's Aa Composite (9/29/77)	8.18%	+ .03	— .13
Money Mgr.—30-Day Supply (\$ Million)	\$1,801	+\$ 146	+\$ 174

Stocks:

Dow-Jones Averages			
Industrials	847.11	+ 7.97	—132.78
Transportation	215.48	+ 2.00	+ .38
Utilities	113.25	+ .75	+ 15.51
65 Stocks	290.61	+ 2.57	— 17.38
Standard and Poor's 500 Stocks	96.53	+ 1.49	— 7.64
N.Y.S.E. Composite Index	52.81	+ .74	— 2.89
N.Y.S.E. Avg. Daily Vol. for Week (000's)	19,520	+ 812	+ 1,264

*48% Taxable Equivalent 10.60%

SHORT TERM PAPER OUTSTANDING

(Millions of Dollars)

Negotiable Time CDs Weekly Reporting Banks	Latest Week	Change Since Week Ago	Year Ago
Nationwide (9/21/77)	65,237	+ 310	— 317
New York City (9/28/77)	20,497	+ 964	—1,269

	End-of-Month Total	Change Since Month Ago	Year Ago
Commercial Paper	July '77 58,760	— 612	+7,581
Bankers' Acceptances	July '77 23,499	+ 59	+3,955

The **Government** market got off to a shaky start last week. In the regular auction, bills went at their lowest levels in almost two years, and coupon issues moved moderately lower. Prices stabilized later, and the list closed unchanged to mixed on the week.

Underwriters of new **tax-exempt** bonds made price concessions of as much as ten basis points from recent levels on last week's expanded volume of \$956 million. Investor reaction improved, raising the Placement Ratio to 82.1% from the previous week's 72.6%. Trading in outstanding issues was very quiet, and price movements insignificant.

In the **corporate** sector, a new Aa-rated utility issue was offered as 8¼s at 100. Although that was moderately higher than the yield of 8.125% available on a comparable issue offered earlier in the month, the bonds sold slowly. Trading in the secondary market for older bonds continued very quiet, with prices fluctuating in a narrow range in an atmosphere of uncertainty.

Secretary Blumenthal's remarks on the nation's international trade deficit were among the factors cited for the decline on the New York **Stock Exchange** on Tuesday of last week. The Dow-Jones Industrials sank to a twenty-one month low. The market improved somewhat on Thursday and Friday, in part in response to a rise in leading economic indicators, and major indices managed modest gains on the week.

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)

Gross National Product (Current Dollars)*
 New Plant and Equipment Expenditures*
 U.S. Merchandise Trade Balance [Surpl. (s) or Def. (d)]†

Leading Indicators Composite Index (1967 = 100)†

Industrial Production Index (1967 = 100)†

Total Business Sales†

Total Business Inventories†

Civilian Employment (Thousands of Persons)†

Unemployment as % of Civilian Labor Force†

New Construction Expenditures*

Private Housing Starts (Thousands of Units)*

Personal Income*

Net Change in Consumer Instalment Credit†

Wholesale Price Index (1967 = 100)

Consumer Price Index (1967 = 100)

*Seasonally adjusted annual rate

†Seasonally adjusted.

Latest Period
or
End of Period

Previous
Period

Year Ago
Period

2nd Q'77	\$ 1,870	\$ 1,811	\$ 1,692
4th Q'77	\$ 142.02(a)	\$ 138.43(a)	\$ 125.22
Aug. '77n	\$ 2.67(d)	\$ 2.33(d)	\$ 0.74(d)
Aug. '77n	131.3	130.3	125.6
Aug. '77	138.2	138.9	131.3
July '77	\$ 213.4	\$ 214.3	\$ 193.3
July '77	\$ 317.4	\$ 315.5	\$ 290.9
Aug. '77	90,771	90,561	87,834
Aug. '77	7.1%	6.9%	7.9%
July '77	\$ 170.7	\$ 171.7	\$ 145.8
Aug. '77	2,022	2,076	1,530
Aug. '77	\$ 1,547	\$ 1,539	\$ 1,394
July '77	\$ 2.32	\$ 2.28	\$ 1.45
Aug. '77	194.6	194.9	183.8
Aug. '77	183.3	182.6	171.9

n-Newly reported figure.

a-Anticipated.

NEW YORK MONEY MARKET

Offering Rates 9/30/77	3 Months	6 Months	1 Year
† U.S. Treasury Bills	5.77%	6.10%	6.15%
* Federal Agencies	6.05	6.36	6.60
* Project Notes (48% Taxable Equivalent)	5.58	5.87	6.54
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	6.375	6.65	

† Finance Company Paper—Prime	† * Bankers' Acceptances
5- 14 days 5.875%	Oct. 6.00%
15- 29 days 6.05	Nov. 6.05
30-179 days 6.15	Dec. 6.10
180-239 days 6.25	Jan. 6.15
240-270 days 6.375	Feb. 6.20
	Mar. 6.25

† Industrial Paper—Prime	† Federal Funds Effective Rate
30- 89 days 6.125%	6.55%
90-119 days 6.25	

†Discount Basis.

*Subject to Availability.

†Estimated.

Continued

more, the cost of these supplies has begun to escalate, which is bound to boost housing prices further. Among the items in shortest supply is insulation. A combination of high-level new home activity, tightened local standards, strikes at the various insulation-producing firms, as well as increased consumer demand because of last year's cold winter and expectations of a Federal tax break would seem to be responsible for the insulation shortage.

Other items are in similar short supply—although not everywhere. Homebuilders are being delayed by spot shortages of such critical building materials as bricks, wallboard, concrete and plumbing supplies. These items, along with insulation, have risen quite sharply in price in recent months—in some cases as much as 20 per cent. And lumber, of which there is no shortage, reportedly went up 20 per cent in August alone to a level 40 per cent ahead of last year—and nearly double that of two years ago.

FINANCIAL DIGEST



MONDAY, OCTOBER 24, 1977

VOLUME XIV, NUMBER 43

WHAT'S THE FED UP TO?

Since mid-July, the Federal Reserve has been trying hard to bring excessive monetary growth under control by progressively raising the Fed funds rate. There is little argument against the objective of such policy, since continuing rapid increases in the money supply, both narrowly and more broadly defined, could refuel inflation expectations, thereby posing a serious threat to the ongoing expansion. The instrument used in implementing the policy, however, leaves a great deal to be desired.

The numbers are revealing: Between July 15, 1977 and October 12, the Fed funds rate has increased by 100 basis points from 5½% to 6½%. During the same period, the narrowly defined money stock, M1, instead of declining or stabilizing as was hoped, shot upwards \$10 billion, while the equally important M2, which includes savings deposits at commercial banks, advanced \$13.5 billion. Obviously the tactics have failed to produce the desired result.

Nor can a decline in money supply be counted on in the period ahead, as some people expect, in line with a slower-paced economy. Over short intervals, spreading from two to six quarters, there seems to be very little correlation between M1 growth and the tempo of economic activity. And there are several other factors that also tend to frustrate the Fed's ability to manage the money aggregates. Old seasonal factors, for one, appear out of line, as shown by the regular bulge in M1 during

the first month of each quarter for nearly a year now. There is also the wider use of computer banking and the proliferation of money substitutes. Money velocity, which has held unusually high thus far in this expansion, may be finally slowing down. Thereby, a given level of output now requires a greater volume of money to support it. Massive international money flows undoubtedly are playing a role, as well. And cash management by the Treasury has always posed a problem. In this regard, it is quite possible that the \$4.9 billion surge in M1 for the statement week ending October 5 traces largely to a flurry of check-writing by government agencies to meet the deadline of expenditure disbursements before FY 1977 turned over on September 30.

All in all, there is serious doubt as to whether the Fed can control the money supply. But even if it could, the relationship between "the Ms" and the national employment and price goals is equally uncertain, at least over meaningful time intervals. And since money market rates have already advanced to the level where they could begin to exert a drag on the ongoing expansion, without producing the desired results, the time appears at hand for the Fed to try out a new strategy.

WHERE HAS LOAN DEMAND GONE?

The sluggishness of business loan demand at large New York City banks has received perhaps too much attention for several months now. What has failed to make headlines is the equally important fact that corporate loan demand outside New York City is strong. This oversight implies that the New York City situation is representative of lending conditions country-wide. But the truth of the matter is that New York banks, despite their size, are only the tail which **does not** necessarily wag the dog.

Commercial and industrial loans on the books of large New York banks have typically accounted for about 25% of the total outstanding, compared with 45% for other large weekly reporting banks, and a 30% share by smaller regional banks. Since the beginning of the ongoing recovery three developments stand out. First, the

(continued on back page)

SELECTED FEDERAL RESERVE DATA

(Weekly Averages of Daily Figures—Millions of Dollars)

	Week Ending 10/19/77	Change Since Week Ago	Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	103,731	+ 40	+ 3,558
Member Bank Borrowings	1,861	+ 810	+ 1,813
Float	4,399	+ 592	+ 929
Total Reserve Bank Credit	112,321	+1,403	+ 4,740
Treasury Deposits with			
Federal Reserve Banks	4,704	- 816	- 3,695
Currency Outside Banks	90,556	+ 712	+ 7,431
Member Bank Reserves			
Required	36,278	+1,628	+ 1,691
Excess (Deficiency)	104	- 130	+ 5
Total Reserves Held	36,382	+1,498	+ 1,696
Net Borrowed Reserves	1,757	+ 940r	+ 1,808r
Gov'ts held for Foreign Acct. by F. R. Banks (End-of-Week)	67,050	+1,313	+17,054
		r—Revised	
	10/12/77		
Money Supply (\$ Bil., SA) M1	334.1	0	
Money Supply (\$ Bil., SA) M2	799.4	+ 0.5	

BANK LOANS

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Commercial and Industrial Loans		
	Latest Week	Change Since Week Ago	Year Ago
Nationwide (10/12/77)	121,251	+498	+ 7,928
New York City (10/19/77)	34,797	+485	+ 699
	Total Loans Gross Adjusted		
	Latest Week	Change Since Week Ago	Year Ago
Nationwide (10/12/77)	313,014	+992	+30,503
New York City (10/19/77)	72,315	+972	+ 3,298

Member bank borrowings increased significantly on average in the October 19 statement period to reach their highest average level in about three years, the latter a period of heavy borrowing from the Central Bank. Required reserves averaged sharply higher on the week, and the net borrowed reserve position of the member banks rose substantially over the level reported for the prior statement period.

Trading in the Federal Funds market tended to remain within a fairly narrow band during the first four sessions of the week, with the effective rate moving between 6.46% and 6.53%. Except on settlement day, when Funds changed hands between 6 $\frac{3}{8}$ % and 7 $\frac{3}{8}$ % and the effective rate rose to 6.59%, rates during the week held in a range between 6 $\frac{3}{8}$ % and 6 $\frac{5}{8}$ %. The average rate for the week increased from 6.41% to 6.50%. The current period began with trading between rates of 6 $\frac{1}{8}$ % and 6 $\frac{1}{8}$ % and an effective rate of 6.51%.

The money supply remained unchanged at \$334.1 billion in the October 12 week, bringing the average for the four weeks ended that date to \$332.1 billion. At that level, M1 is up at a seasonally adjusted annual rate of 10.4% from the average of the four weeks ended three months ago, 9.2% from the four weeks ended six months earlier, and 7.6% from the corresponding weeks of last year. The broader monetary aggregate, M2, defined as M1 plus time deposits at commercial banks other than large-denomination Certificates of Deposit, rose by \$0.5 billion in the latest reported period. Averaging \$796.1 billion in the four weeks ended October 12, M2 shows a seasonally adjusted annual increase of 9.6% from the four weeks ended three months ago, 9.4% from the four week period ended six months ago, and 10.5% from the average level prevailing in the comparable four weeks one year ago.

The latest weekly rise in large-denomination Certificates of Deposit at the leading New York City banks was the fourth gain in as many weeks. The total increase during this period, which began with CDs at the low point for the year, has now amounted to about \$2.4 billion and has cut the decline in these CDs since the close of last year from about \$3.2 billion four weeks ago to about \$0.8 billion.

SECURITY MARKETS



	Friday 10/21/77	Change Since	
		Week Ago	Year Ago
U.S. Governments, Closing Bid Prices:			
90-Day Bills (Discount Basis)	6.08%	— .22	+ 1.19
180-Day Bills (Discount Basis)	6.46	— .05	+ 1.40
Longest Bills (Discount Basis)	6.57	— .01	+ 1.39
7½s 10/31/79 (W.I.)	100.2		
7½s 11/15/82	98.27	— 1/32	
7½s 8/15/84	98.24	— 1/32	
7½s 8/15/92	96.23	— 10/32	
7½s 2/15/07-02	98.2	— 3/32	
Municipals:			
Bond Buyer—20 Bond Index (10/20/77)	5.67%*	— .03	— .63
Blue List Total (\$ Million)	\$1,094	—\$ 4	+\$ 88
30-Day Visible Supply (\$ Million)	\$1,728	+\$ 178	+\$ 76
Total	\$2,822	+\$ 174	+\$ 164
Corporates:			
Moody's Aa Composite (10/20/77)	8.30%	+ .04	+ .07
Money Mgr.—30-Day Supply (\$ Million)	\$1,728	—\$ 473	—\$ 155
Stocks:			
Dow-Jones Averages			
Industrials	808.30	—13.34	—130.45
Transportation	204.81	— 5.80	— .42
Utilities	110.52	— 1.65	+ 14.34
65 Stocks	278.26	— 5.32	— 17.70
Standard and Poor's 500 Stocks	N.A.		
N.Y.S.E. Composite Index	50.61	— .63	— 2.81
N.Y.S.E. Avg. Daily Vol. for Week (000's)	20,050	+1,016	+ 3,326

*48% Taxable Equivalent 10.90%

SHORT TERM PAPER OUTSTANDING

(Millions of Dollars)

Negotiable Time CDs Weekly Reporting Banks	Latest Week	Change Since	
		Week Ago	Year Ago
Nationwide (10/12/77)	67,741	+ 100	+3,161
New York City (10/19/77)	21,944	+ 570	+ 481
	End-of-Month Total	Change Since Month Ago	Year Ago
Commercial Paper	Aug. '77 59,397	+ 637	+9,297
Bankers' Acceptances	Aug. '77 23,091	— 407	+3,708

Rates in the **Government** bill market were generally firm last week, with the shorter bills somewhat stronger than the longer issues. Prices of coupon issues were mostly off early in the week, up somewhat in the midweek sessions, and easier toward the close. The Treasury's regular monthly auction of two-year notes produced an average yield of 7.27% compared to 6.74% last month.

Working with a fairly sizable new issue calendar, the **corporate** market put in a generally constructive week. A \$100 million Motorola, Inc. Aa-rated issue, priced to yield 8.03% in thirty years, sold well as did \$60 million Tucson Gas & Electric A-rated 8½s of 10/1/09 priced at par. Other major issues sold somewhat more slowly, but were largely distributed by the close of the week, with some issues moving initially to modest premiums. The secondary market closed unchanged to slightly lower on the week.

New issue volume in the **tax-exempt** market declined somewhat last week from the stiff pace of recent weeks. A \$150 million State of Illinois issue, carrying the highest prime grade yields of the year, sold quickly as did a Aaa-rated Fairfax County issue. Most other offerings moved reasonably well, and the Placement Ratio increased to 88.9% from the previous week's 84.7%. Prices of outstanding issues tended to improve week-to-week, and trading quickened somewhat as the week progressed.

Aside from a few feeble rally attempts, the New York **Stock Exchange** again spent most of last week on the downside. Worries over interest rates and the future of the economy evidently remained the main negative factors in market sentiment.

SELECTED BUSINESS INDICATORS

(All Dollar Figures in Billions)*

Gross National Product (Current Dollars)*
 New Plant and Equipment Expenditures*
 U.S. Merchandise Trade Balance (Surpl. (s) or Def. (d))†

Leading Indicators Composite Index (1967 = 100)†

Industrial Production Index (1967 = 100)†

Total Business Sales†

Total Business Inventories†

Civilian Employment (Thousands of Persons) -

Unemployment as % of Civilian Labor Force†

New Construction Expenditures*

Private Housing Starts (Thousands of Units)*

Personal Income*

Net Change in Consumer Installment Credit†

Wholesale Price Index (1967 = 100)

Consumer Price Index (1967 = 100)

*Seasonally adjusted annual rate

†Seasonally adjusted.

Latest Period
or
End of Period

Previous
Period

Year Ago
Period

3rd Q'77n	\$ 1,911	\$ 1,870	\$ 1,727
4th Q'77	\$ 142.02(a)	\$ 138.43(a)	\$ 125.22
Aug. '77	\$ 2.67(d)	\$ 2.33(d)	\$ 0.74(d)
Aug. '77	131.3	130.3	125.6
Sept. '77n	138.8	138.2	130.6
Aug. '77n	\$ 215.7	\$ 212.9	\$ 194.3
Aug. '77n	\$ 319.8	\$ 317.2	\$ 293.3
Sept. '77	91,095	90,771	87,794
Sept. '77	6.9%	7.1%	7.8%
Aug. '77	\$ 170.9	\$ 172.5	\$ 141.8
Sept. '77n	2,040	2,034	1,768
Sept. '77n	\$ 1,559	\$ 1,547	\$ 1,402
Aug. '77	\$ 2.51	\$ 2.32	\$ 1.53
Sept. '77	195.3	194.6	184.8
Sept. '77n	184.0	183.3	172.6

n-Newly reported figure.

a-Anticipated.

NEW YORK MONEY MARKET

Offering Rates 10/21/77	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	6.12%	6.47%	6.58%
*Federal Agencies	6.25	6.90	7.05
*Project Notes (48% Taxable Equivalent)	5.77	6.25	6.92
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
*Secondary Market—Prime	6.80	7.00	

‡Finance Company Paper—Prime	‡*Bankers' Acceptances		
5- 14 days	5.50%	Nov.	6.30%
15- 29 days	6.25	Dec.	6.40
30- 89 days	6.375	Jan.	6.45
90-270 days	6.50	Feb.	6.50
		Mar.	6.55
		Apr.	6.60

‡Industrial Paper—Prime	‡Federal Funds Effective Rate		
30- 89 days	6.45%		6.45%
90-119 days	6.60		

‡Discount Basis.

*Subject to Availability.

†Estimated.

Continued

smaller banks in the industry experienced no run-off during 1975-76, a period of corporate liquidity rebuilding and heavy funding of short-term debt. Instead, they added \$3 billion to their loan footings. Second, excluding bankers' acceptances, there has been impressive growth in C&I loans during 1977 for small and large banks outside New York City, up \$5.5 billion and \$4.4 billion, respectively. Business loan demand was up only \$1.4 billion for large New York banks. Third, loan volume for large banks outside New York flattened during the third quarter of this year, and fell off marginally for banks in New York.

If, in addition to adjusting business loans of weekly reporting banks for their holdings of bankers' acceptances, foreign C&I loans booked out of the head office are also excluded, the growth in "domestic" loan volume for New York becomes even smaller; up only \$300 million in the first nine months of 1977, compared with a strong \$7.1 billion rise for large banks outside New York.

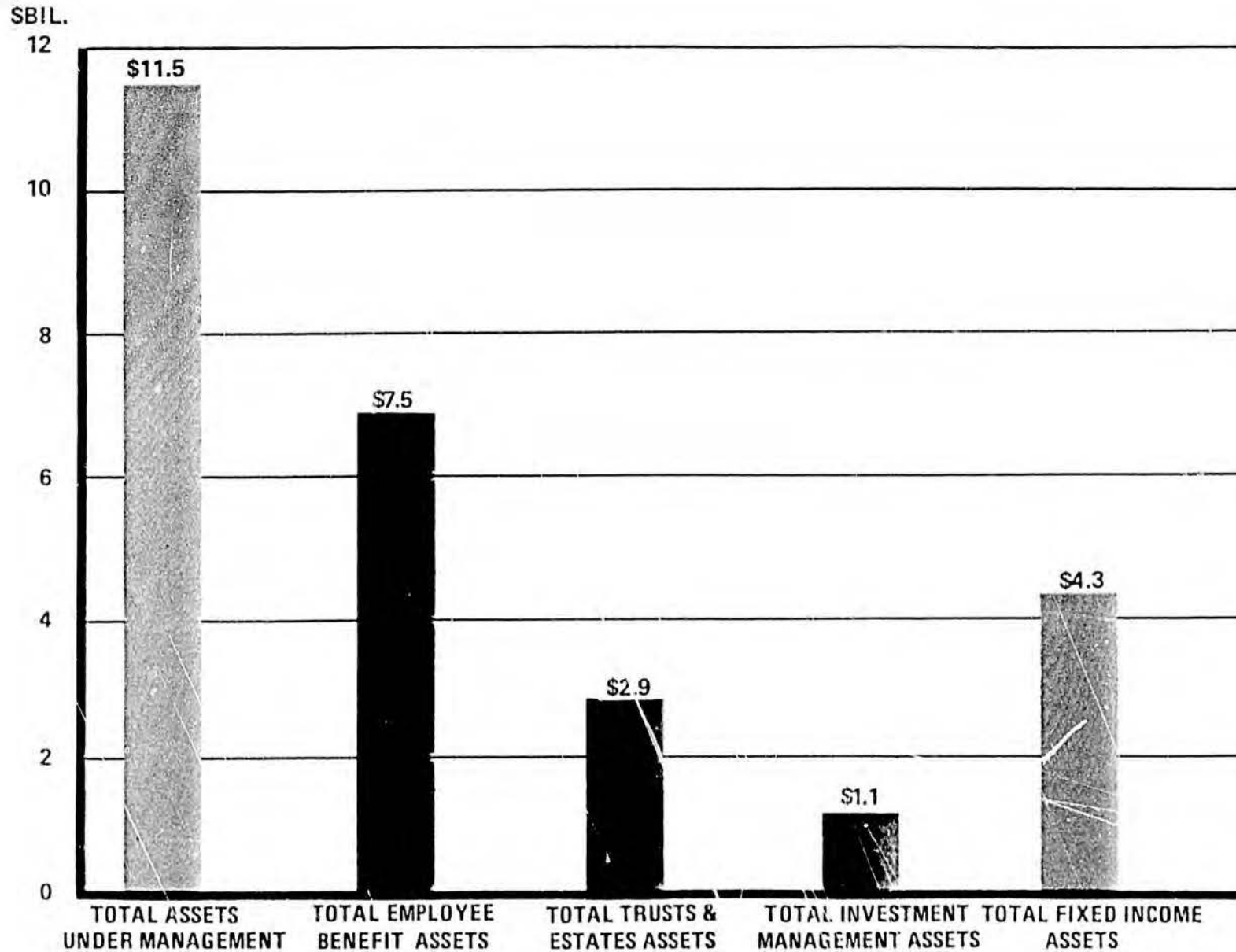
MANUFACTURERS HANOVER TRUST



SUMMARY OF ASSETS UNDER MANAGEMENT



MANUFACTURERS HANOVER TRUST

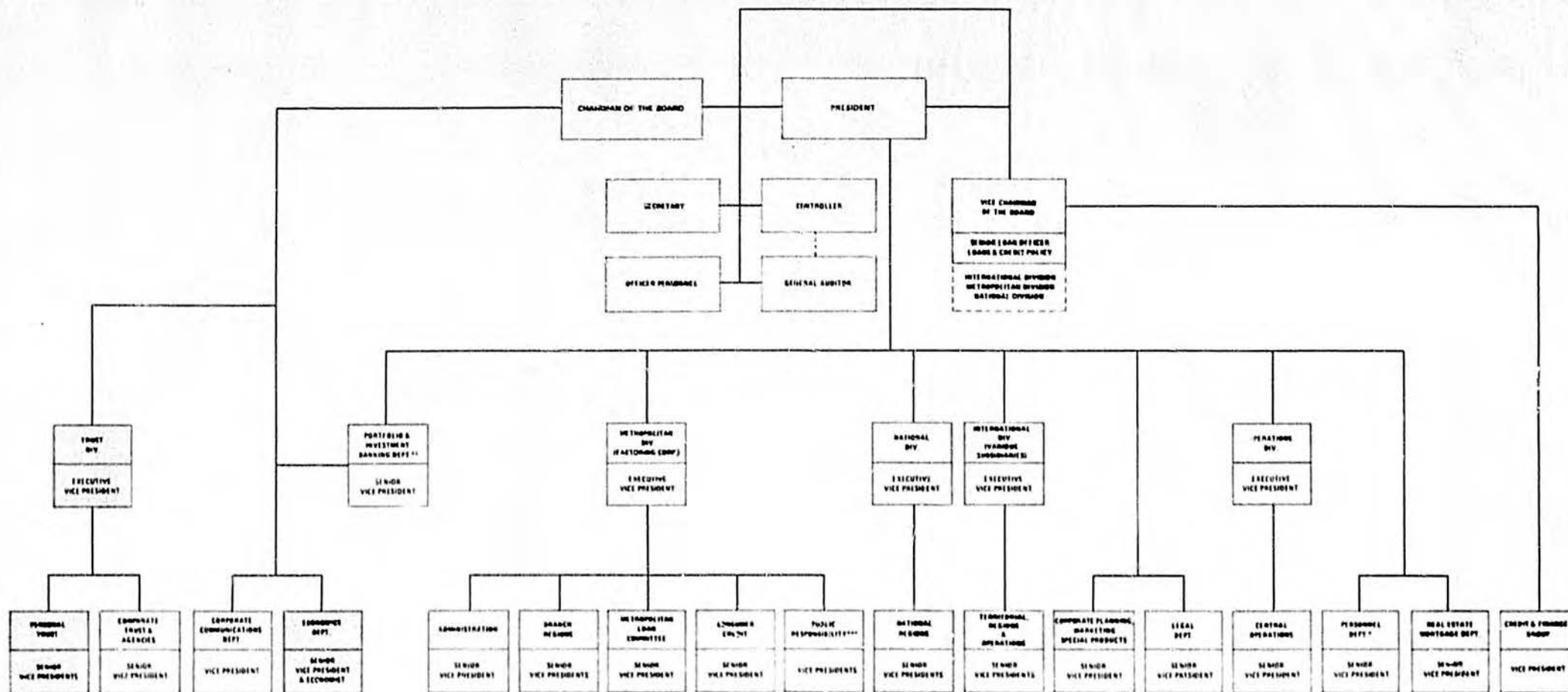


MANUFACTURERS HANOVER TRUST CO. ORGANIZATION CHART



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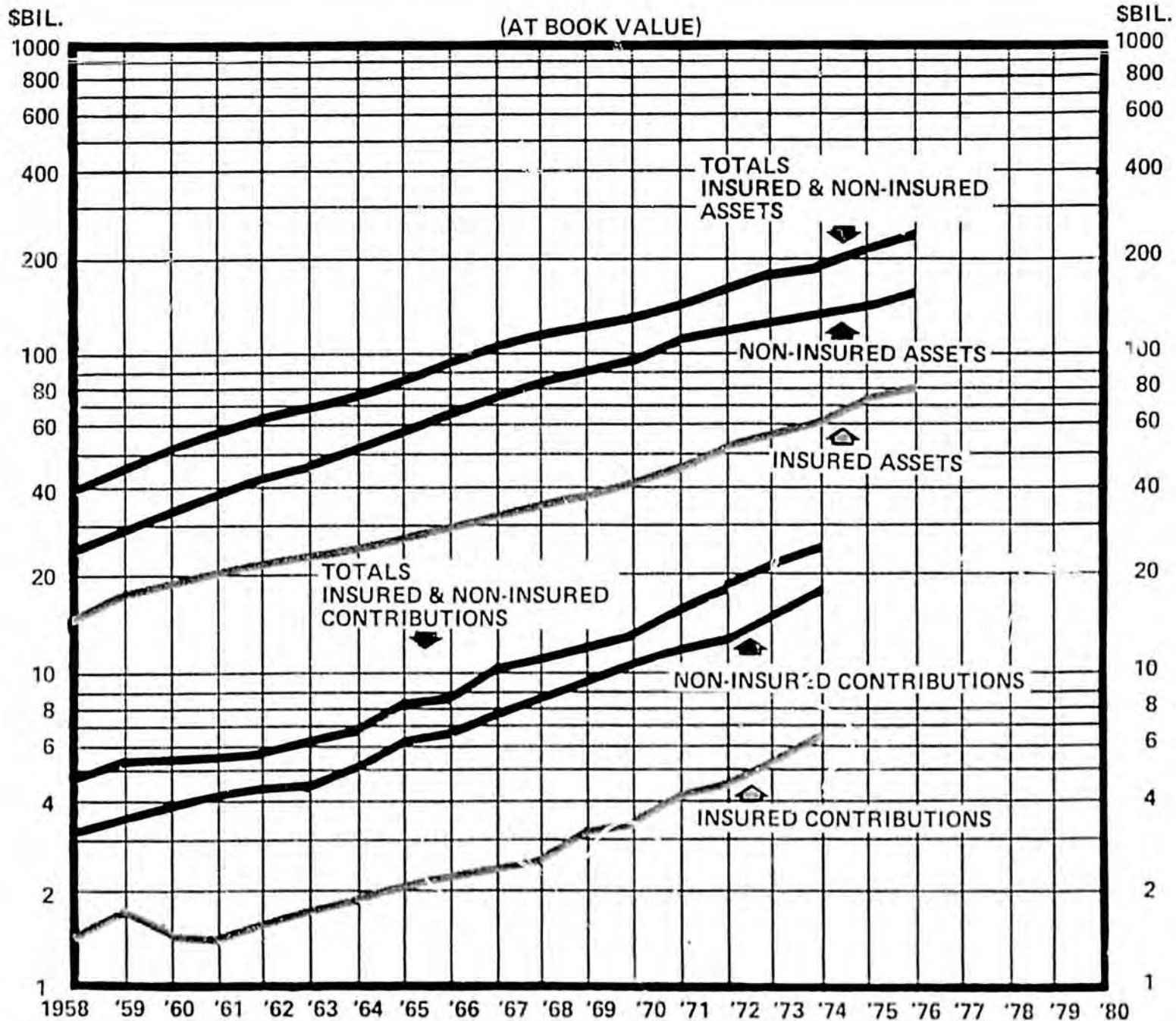
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INSURED & NON-INSURED PRIVATE PENSION PLANS CONTRIBUTIONS & ASSETS



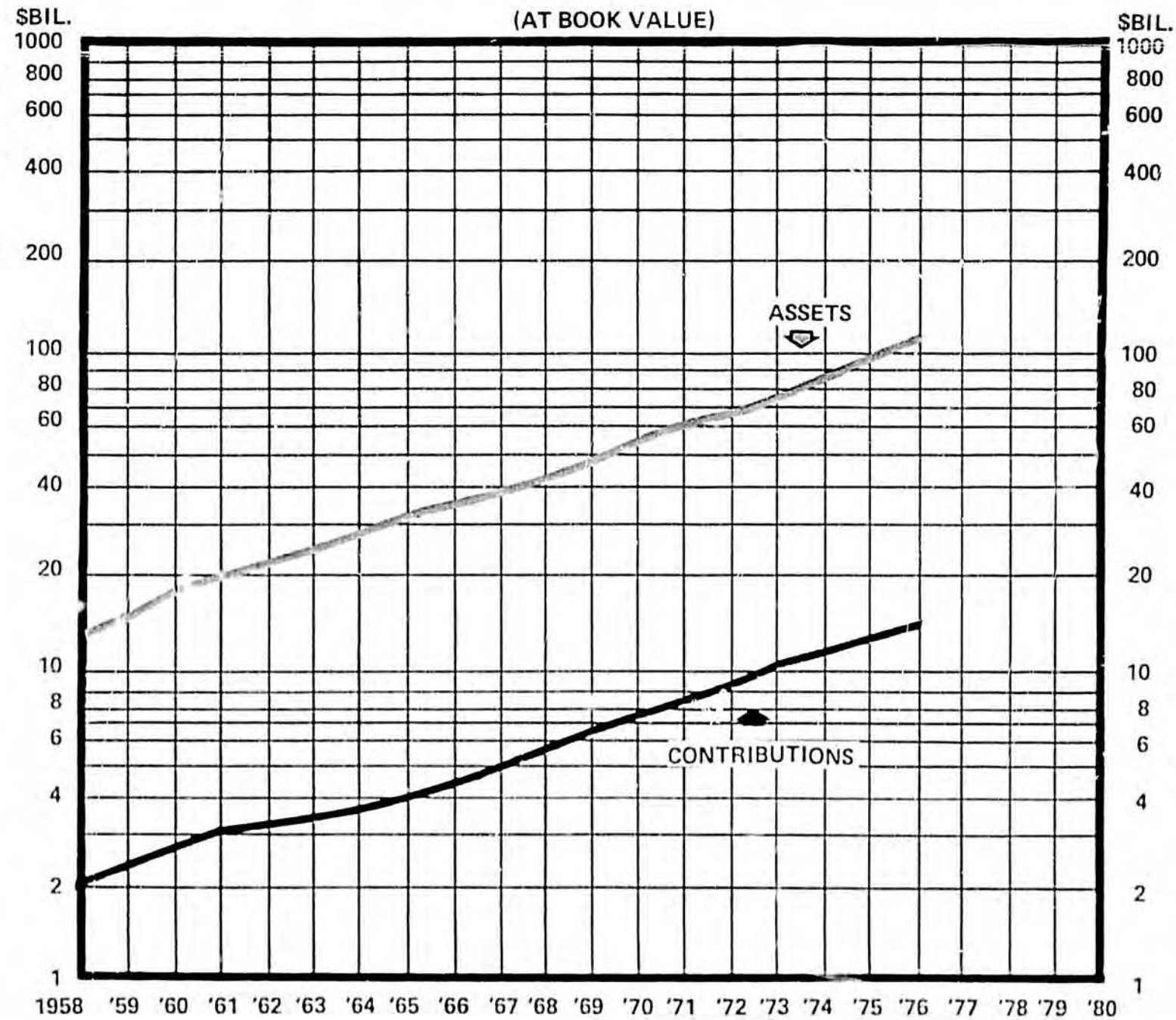
MANUFACTURERS HANOVER TRUST



STATE & LOCAL GOVT. RETIREMENT FUNDS CONTRIBUTIONS & ASSETS



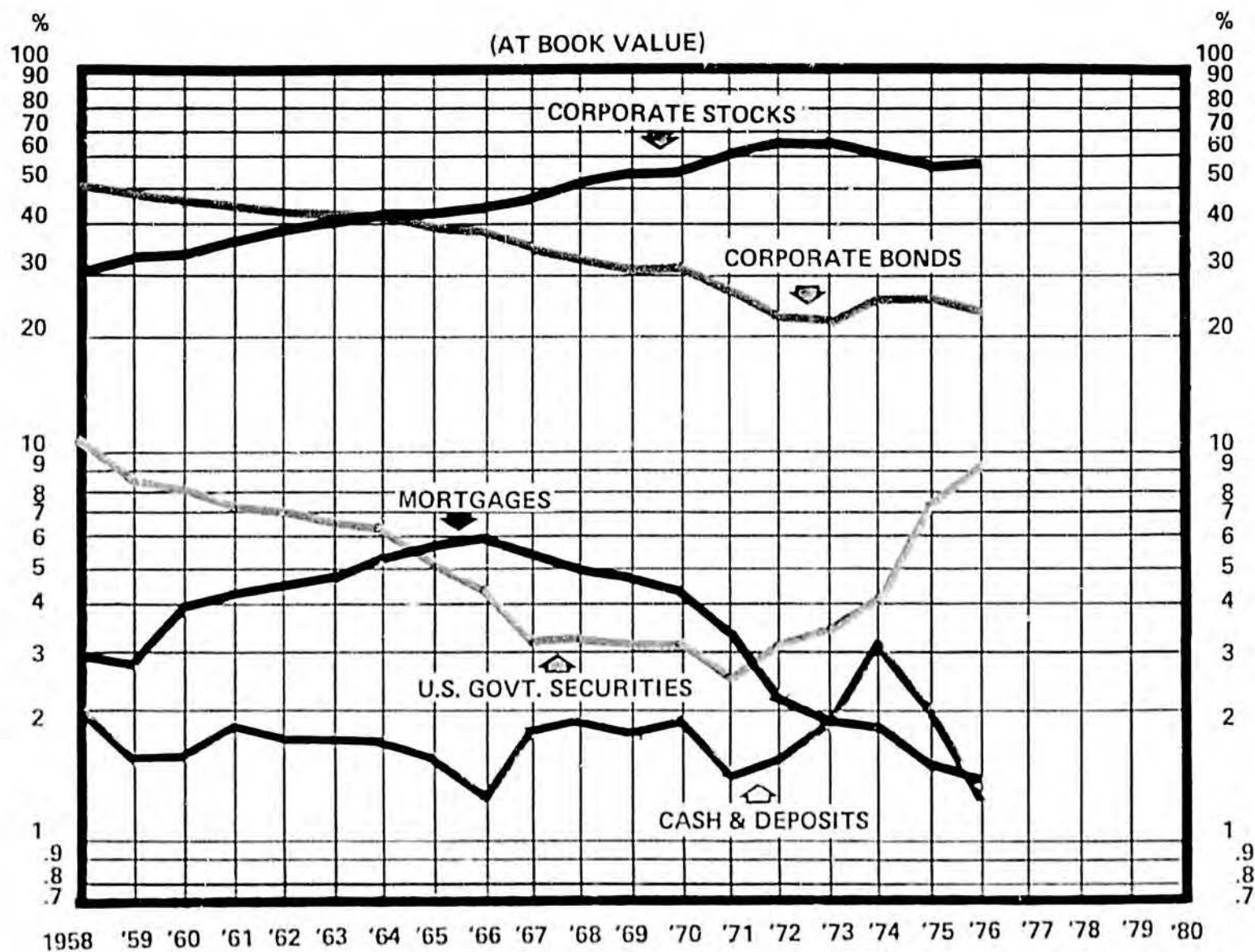
MANUFACTURERS HANOVER TRUST



NON-INSURED PENSION PLANS PERCENTAGE DISTRIBUTION OF ASSETS



MANUFACTURERS HANOVER TRUST



STATE & LOCAL GOVT. RETIREMENT FUNDS PERCENTAGE DISTRIBUTION OF ASSETS



MANUFACTURERS HANOVER TRUST

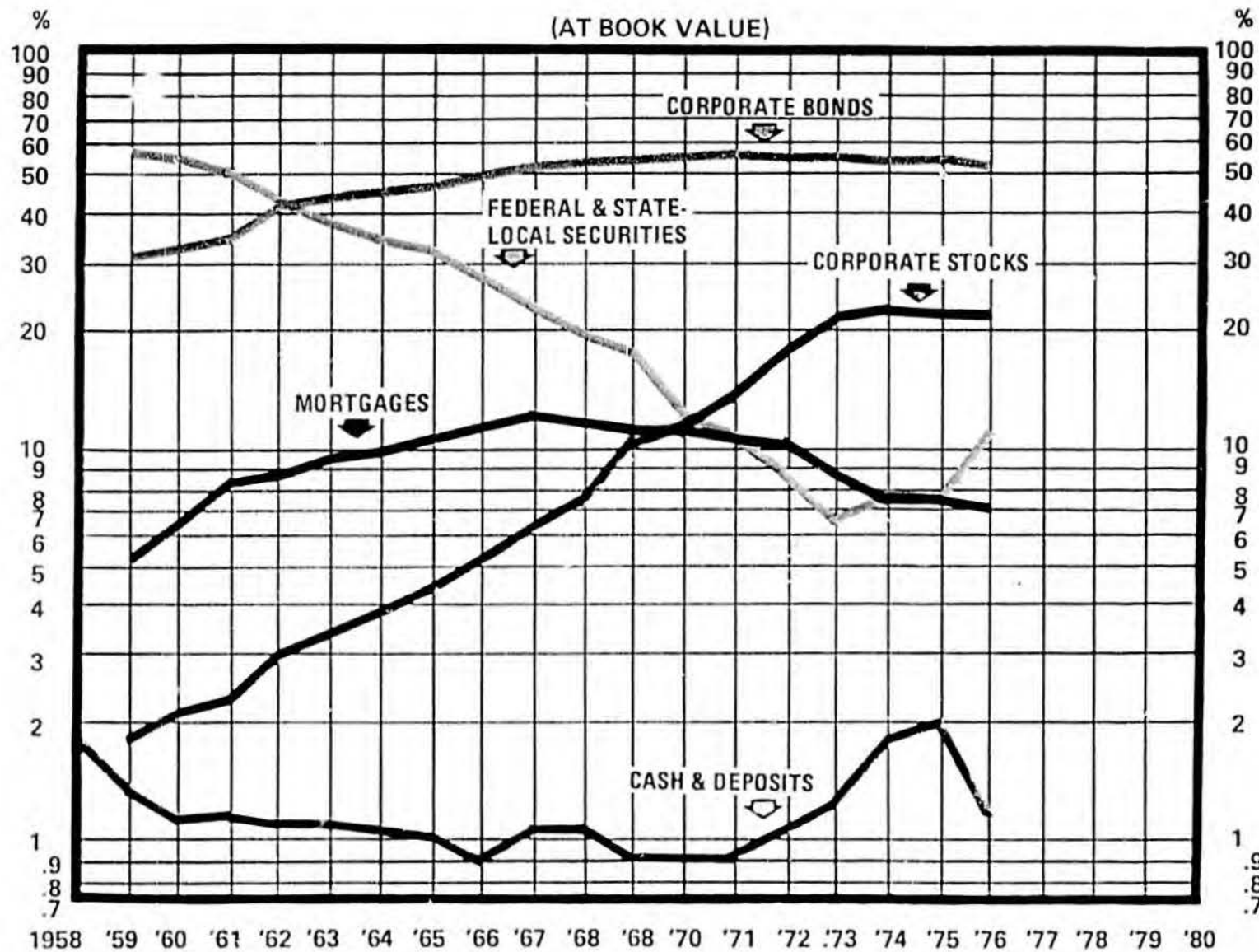


TABLE I

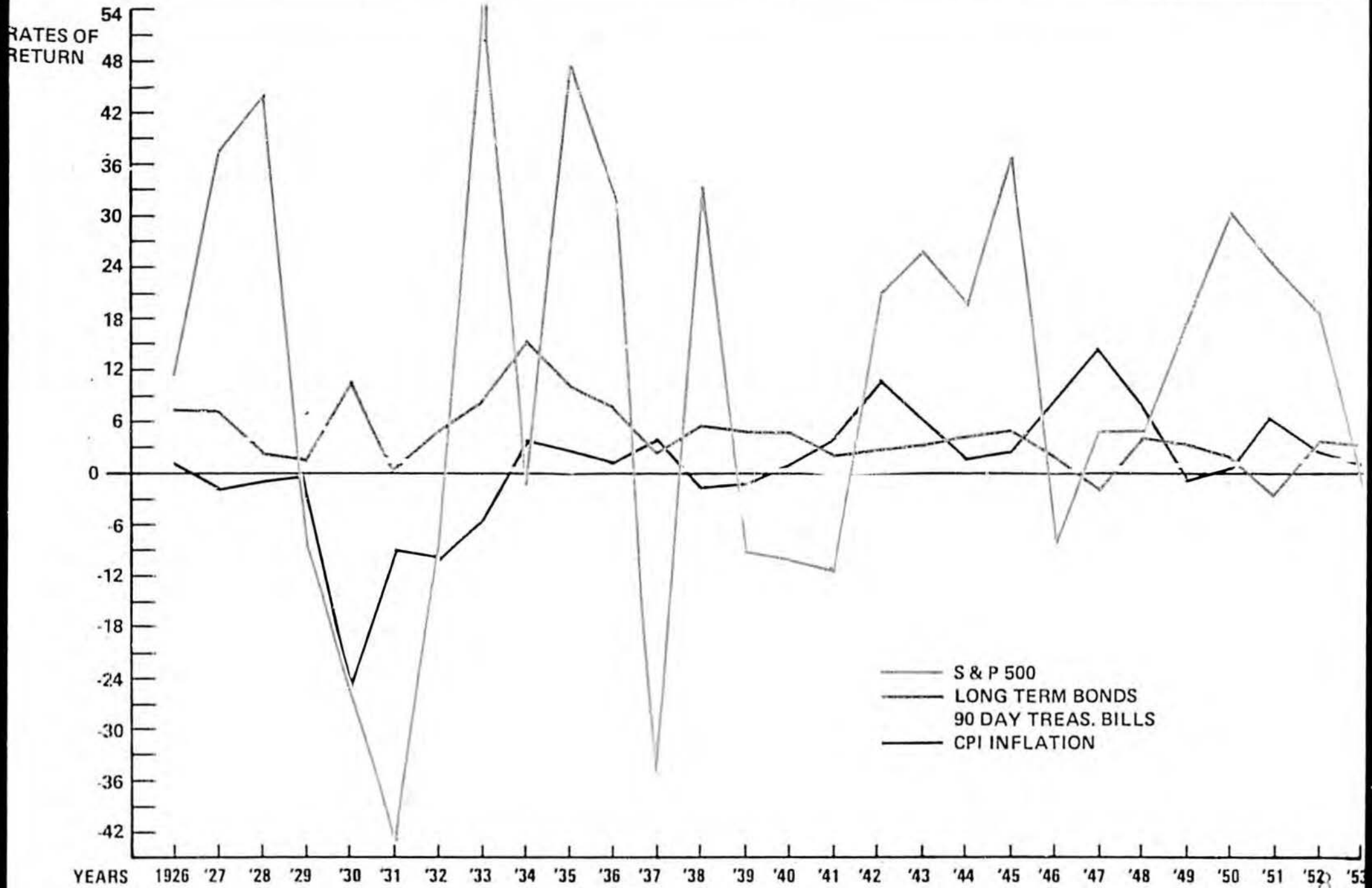
TOTAL RATE OF RETURN
(Percent Per Annum Compounded Annually)

	1926-76	Standard Deviation	1966-76
Common Stocks	9.2%	22.4%	5.0%
Long-Term Corporate Bonds	4.1	5.6	4.9
Long-Term Government Bonds	3.4	5.8	4.2
U.S. Treasury Bills	2.4	2.1	5.6
Consumer Price Index	2.3	4.7	5.6
Common Stocks, inflation adjusted	6.7	22.6	-0.7
Long-Term Corp. bonds, inflation adjusted	1.7	7.8	-0.8
Long-Term Govt. bonds, inflation adjusted	1.0	8.1	-1.3
U.S. Treas. Bills, inflation adjusted	0.0	4.6	-0.1

VARIOUS RATES OF RETURN



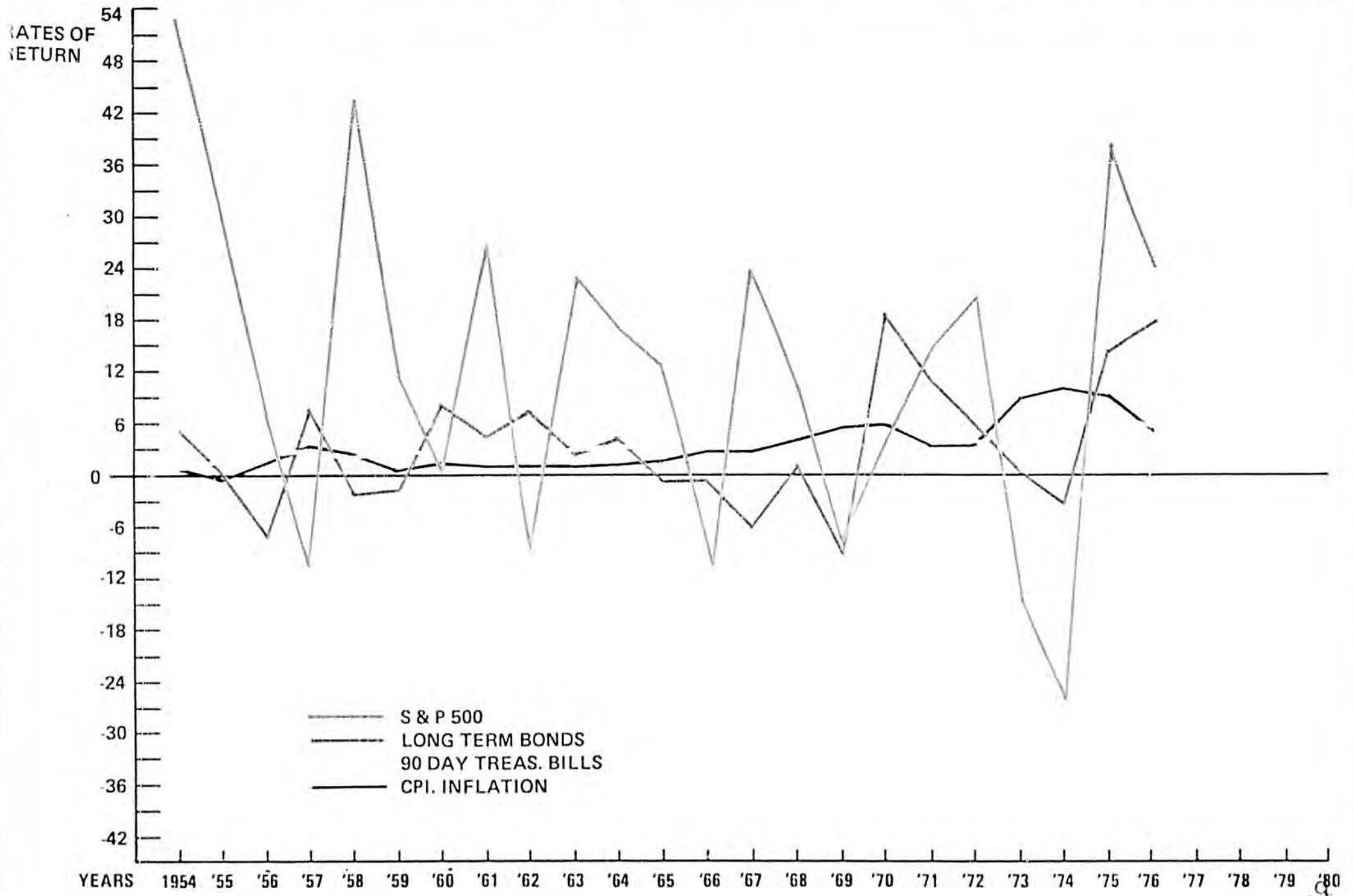
MANUFACTURERS HANOVER TRUST



VARIOUS RATES OF RETURN



MANUFACTURERS HANOVER TRUST

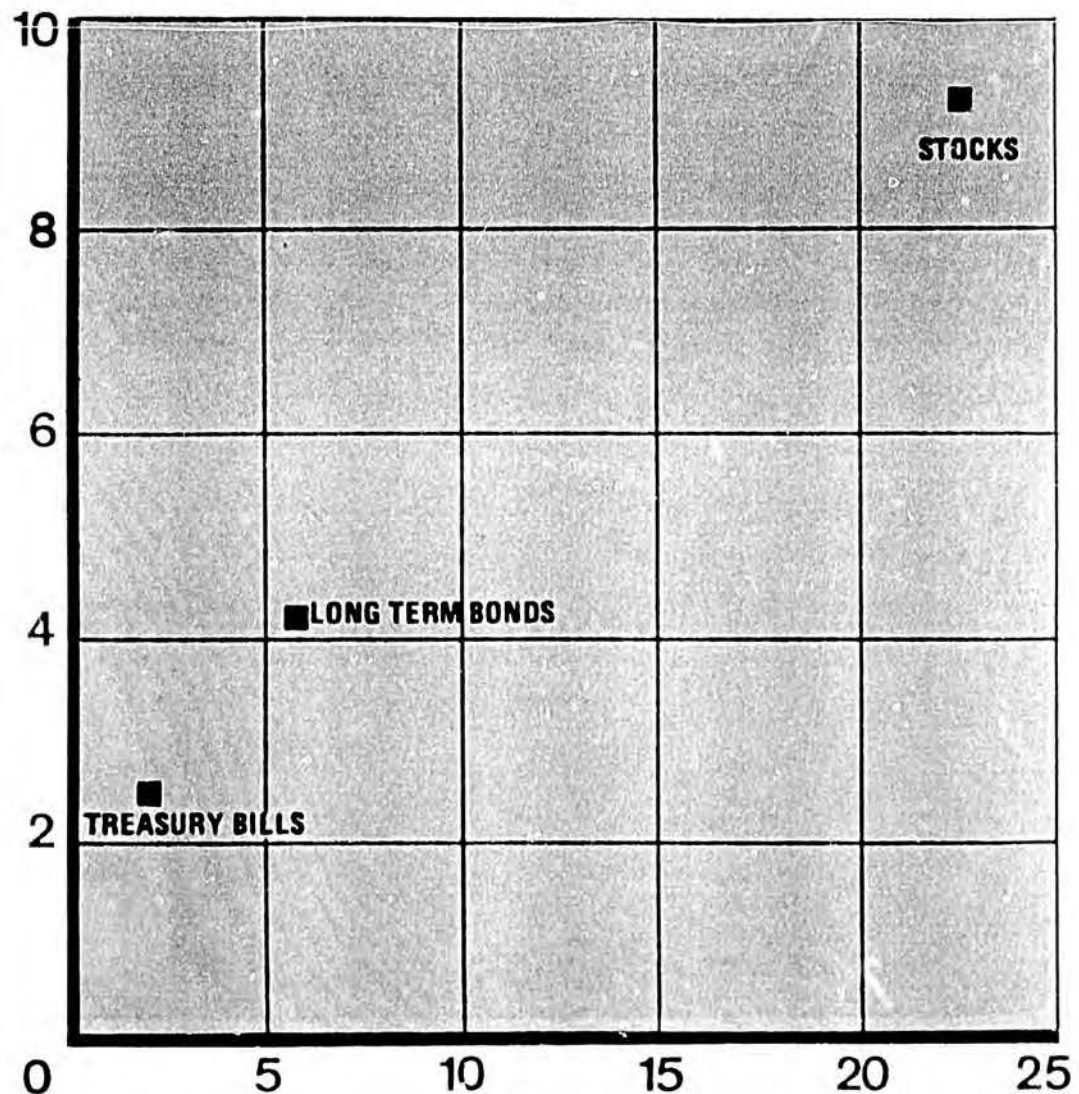


COMPOUND ANNUAL RATE OF TOTAL RETURN 1926-1976 [%]



MANUFACTURERS HANOVER TRUST

COMPOUND
ANNUAL RATE
OF TOTAL RETURN
1926-1976 (%)

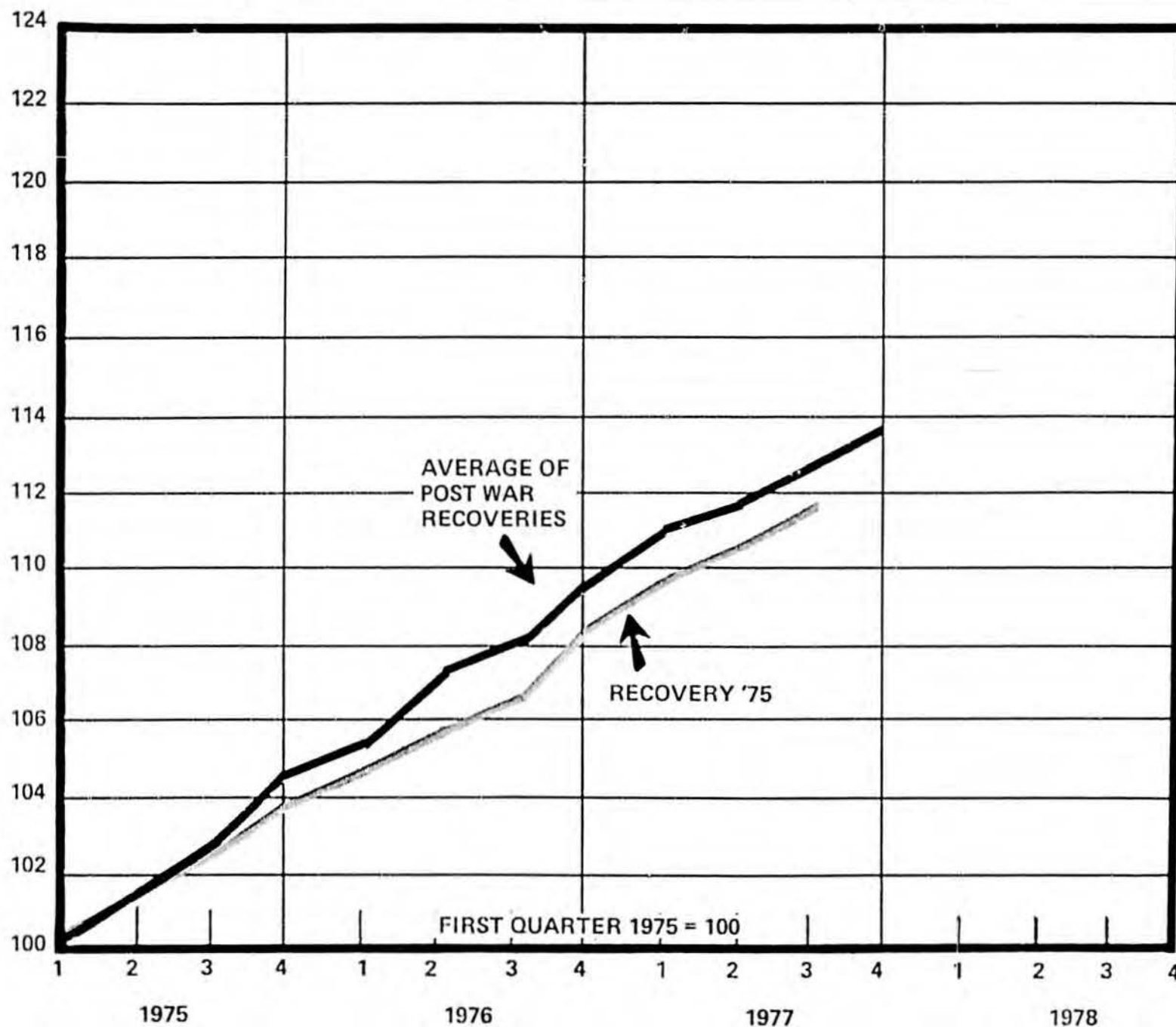


STANDARD DEVIATION IN RATE OF NOMINAL TOTAL RETURN (%)¹⁰

REAL FINAL SALES



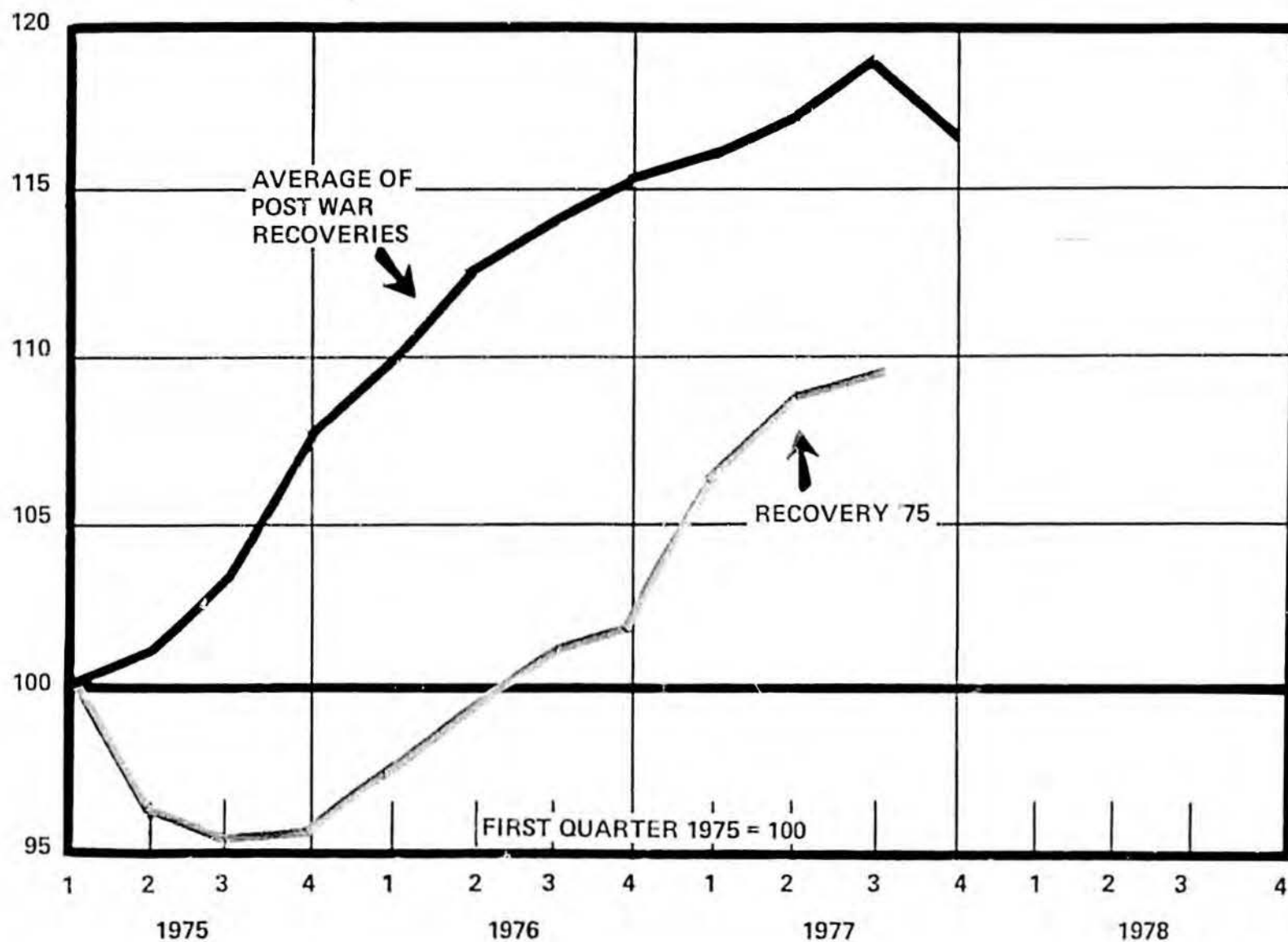
MANUFACTURERS HANOVER TRUST



"REAL" BUSINESS FIXED INVESTMENT



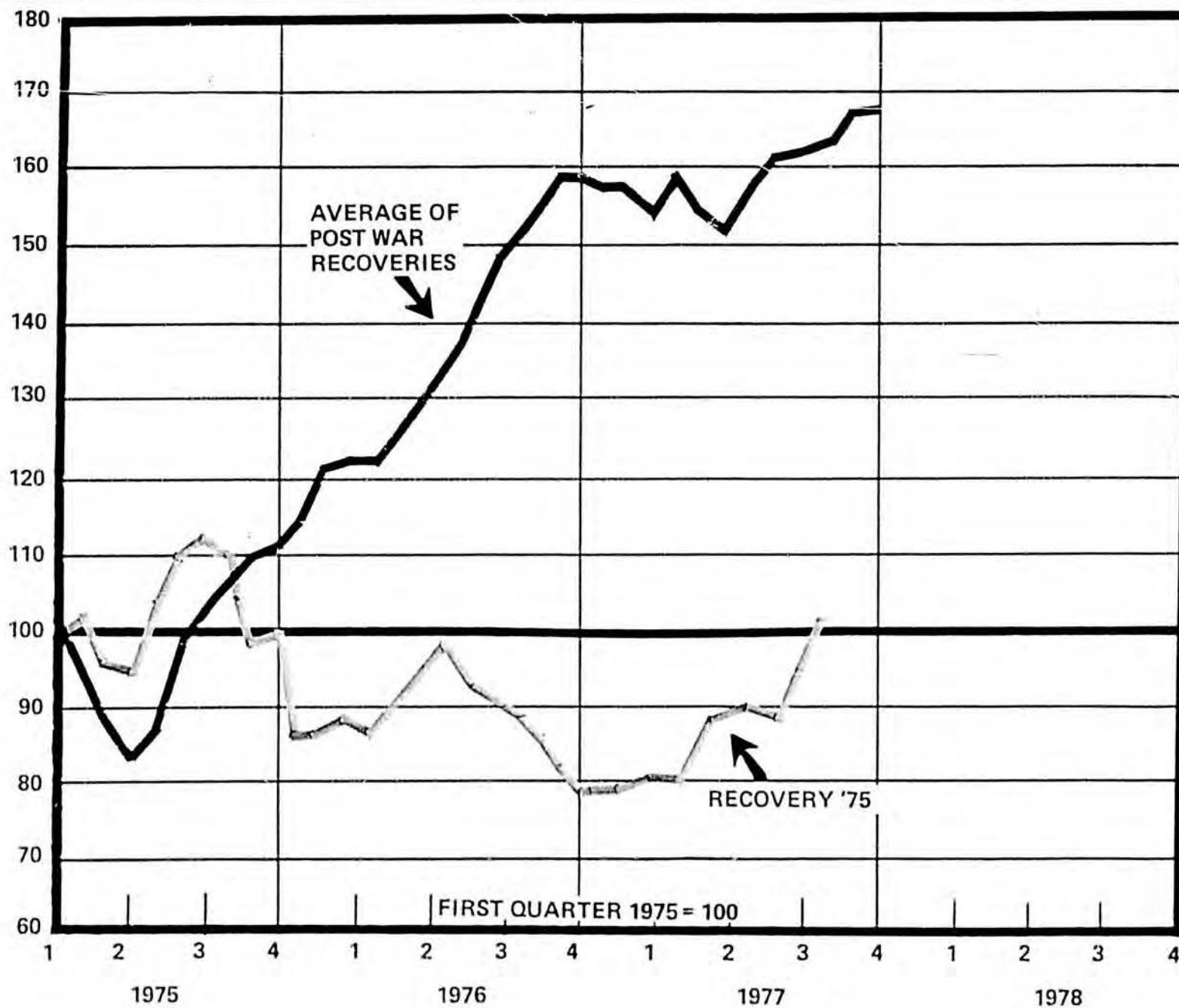
MANUFACTURERS HANOVER TRUST



SHORT TERM COMMERCIAL PAPER RATE



MANUFACTURERS HANOVER TRUST



YIELD ON AA CORP. UTILITY BONDS



MANUFACTURERS HANOVER TRUST

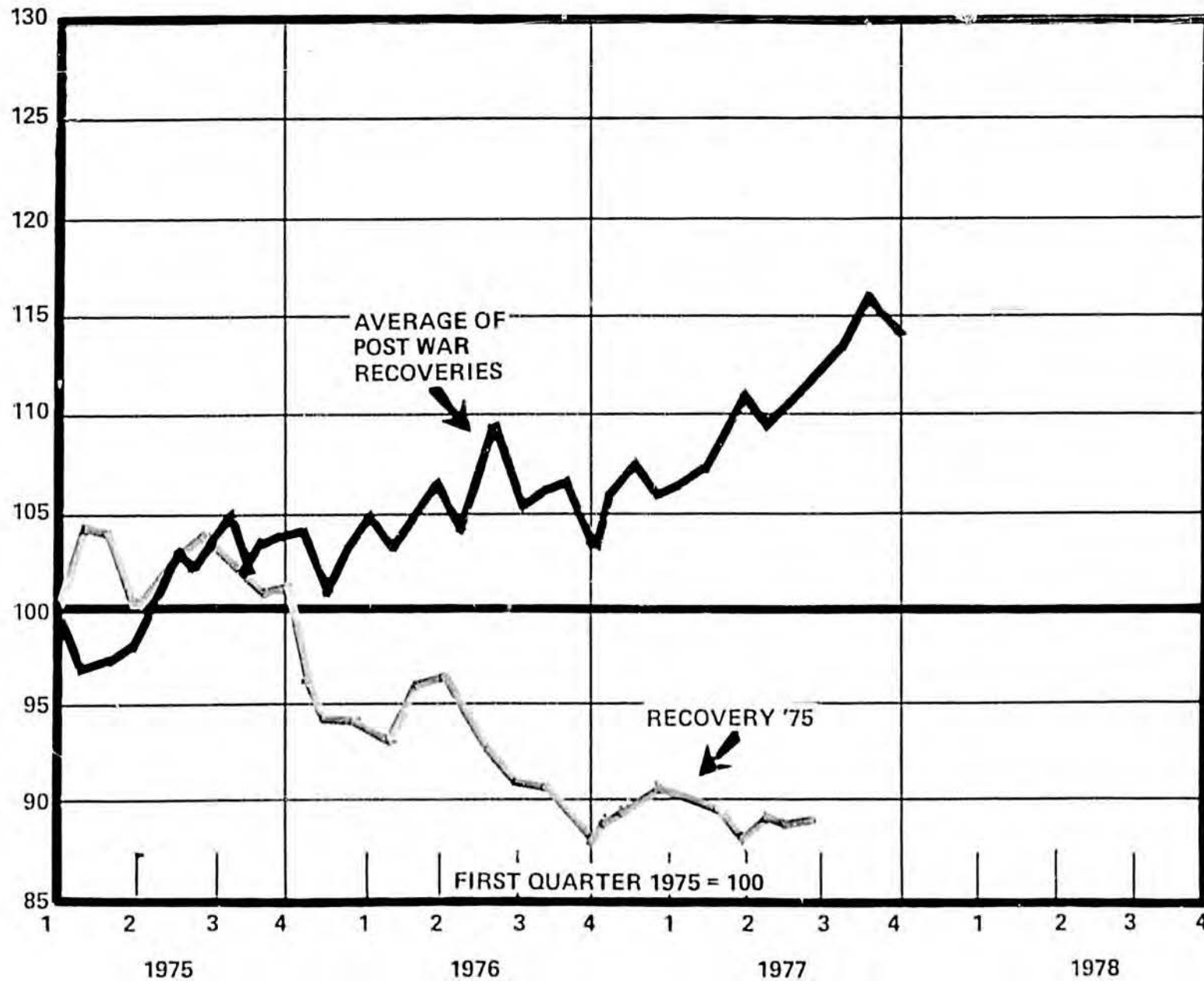
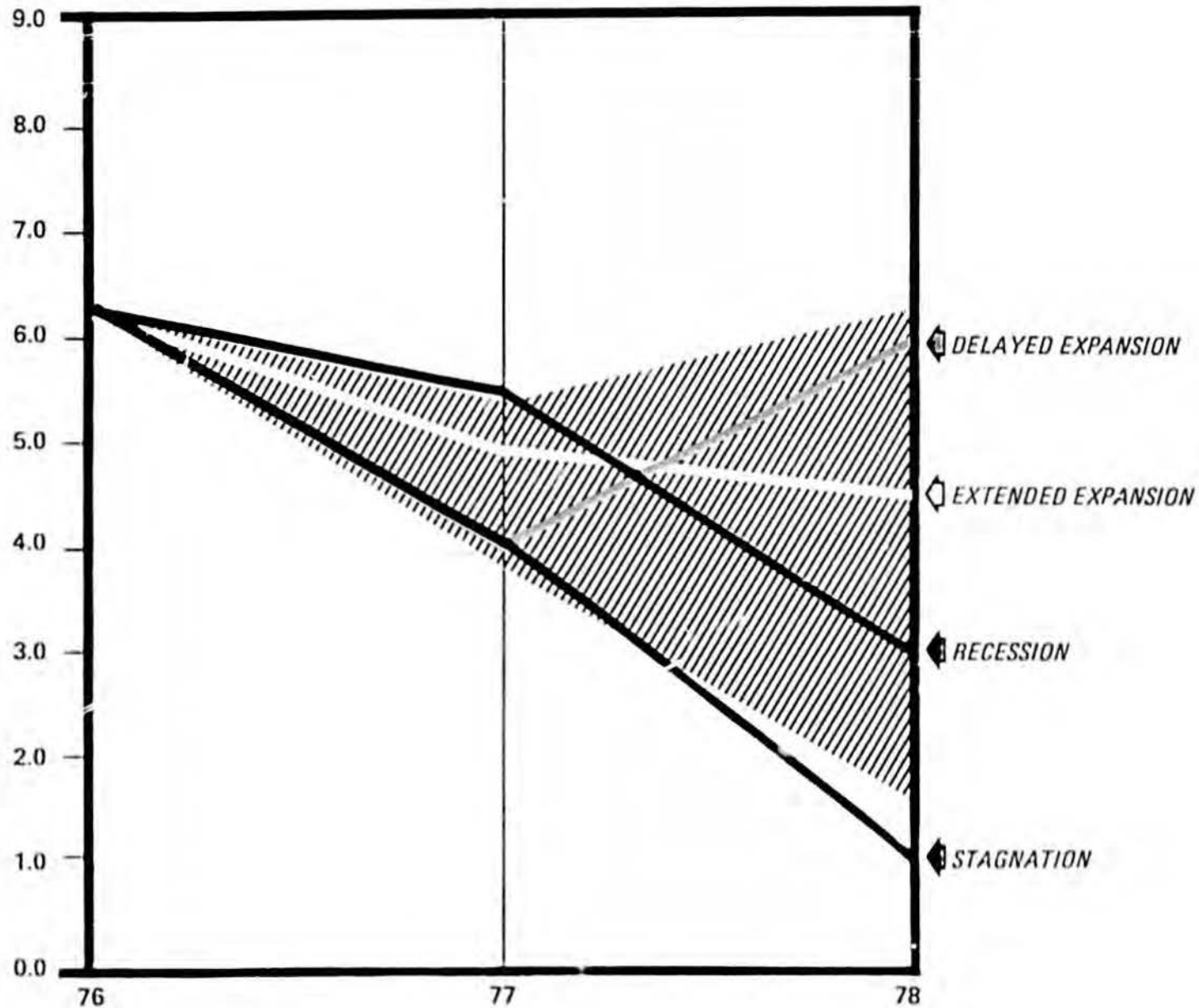


TABLE II
ECONOMIC FORECASTS

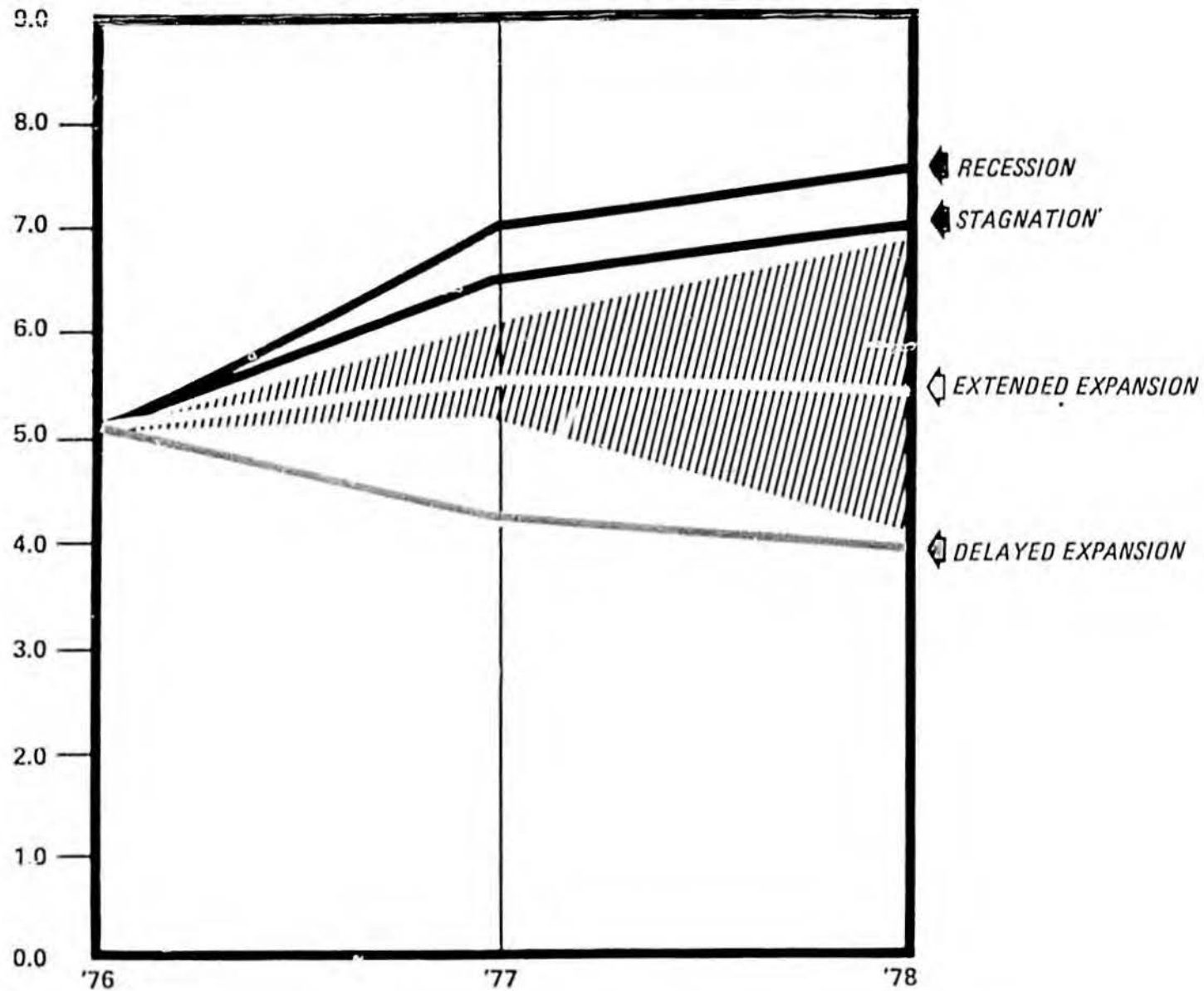
	#1 Extended Expansion				#2 Delayed Expansion				#3 Stagnation/Recession				#4 Recession			
	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979
GNP	11.3	10.5	10.0	10.0	11.3	8.5	10.0	8.5	11.3	10.5	8.0	5.5	11.3	12.5	10.5	6.0
GNP 72 Deflator	6.1 5.1	5.0 5.5	4.5 5.5	4.0 6.0	6.1 5.1	4.0 4.5	6.0 4.0	5.0 3.5	6.1 5.1	4.0 6.5	1.0 7.0	-0.5 6	6.1 5.1	5.5 7.0	3.0 7.5	-0.5 6.5
Corp. Profits	28	12.4	11.7	9	28	7.8	17.4	5.0	28	10.2	-3.4	-10.0	28	20.5	7.3	-10
Unit Labor Costs	3.6	6.2	5.5	5.5	3.6	4.5	3.0	3.5	3.6	6.0	8.5	8.0	3.6	5.0	7.5	9
Compensation	7.4	8.75	8.75	7.5	7.5	7.4	7.0	6.5	7.4	8.0	8.5	7.0	7.4	8.0	8.5	7
Productivity	3.6	2.3	2.0	2.0	3.6	2.5	3.5	3.0	3.6	2.0	0	-1.0	3.6	3.0	1.0	-2
Interest Rates																
T-Bills	5.02	5.16	5.73	5.98	5.02	4.64	4.75	4.50	5.02	5.32	6.42	6.50	5.02	5.32	6.43	6.25
Intermediate AA	7.89	7.58	7.98	7.91	7.89	7.56	7.39	6.74	7.89	7.94	8.52	8.62	7.09	7.97	8.56	8.55
Long AA	8.30	7.96	8.44	8.52	8.30	7.87	7.40	7.52	8.30	8.22	9.05	9.42	8.30	8.23	8.90	9.21
Dividends (S&P)	12.4	15	6	7	12.4	8	14	8	12.4	9	1	0	12.4	14	5	2
Return on Capital	9.2	9.8	10.4	10.6	9.2	9.4	10.5	10.5	9.2	9.5	8.6	7.3	9.2	10.4	10.4	8.9
S&P EPS	10.68	11.94	13.29	14.43	10.68	11.46	13.42	14.09	10.68	11.73	11.31	10.18	10.68	12.82	13.73	12.36
S&P DPS	4.25	4.90	5.19	5.55	4.25	4.59	5.23	5.65	4.25	4.68	4.73	4.73	4.25	4.84	5.09	5.19
S&P Index	101-121	103-133	102-132	104-134	101-121	105-135	118-152	145-187	101-121	95-123	85-106	80-100	101-121	95-119	86-110	106-125
Probability		<u>49</u>					<u>9</u>				<u>8</u>				<u>34</u>	



REAL GNP GROWTH: Forecasts vs Model



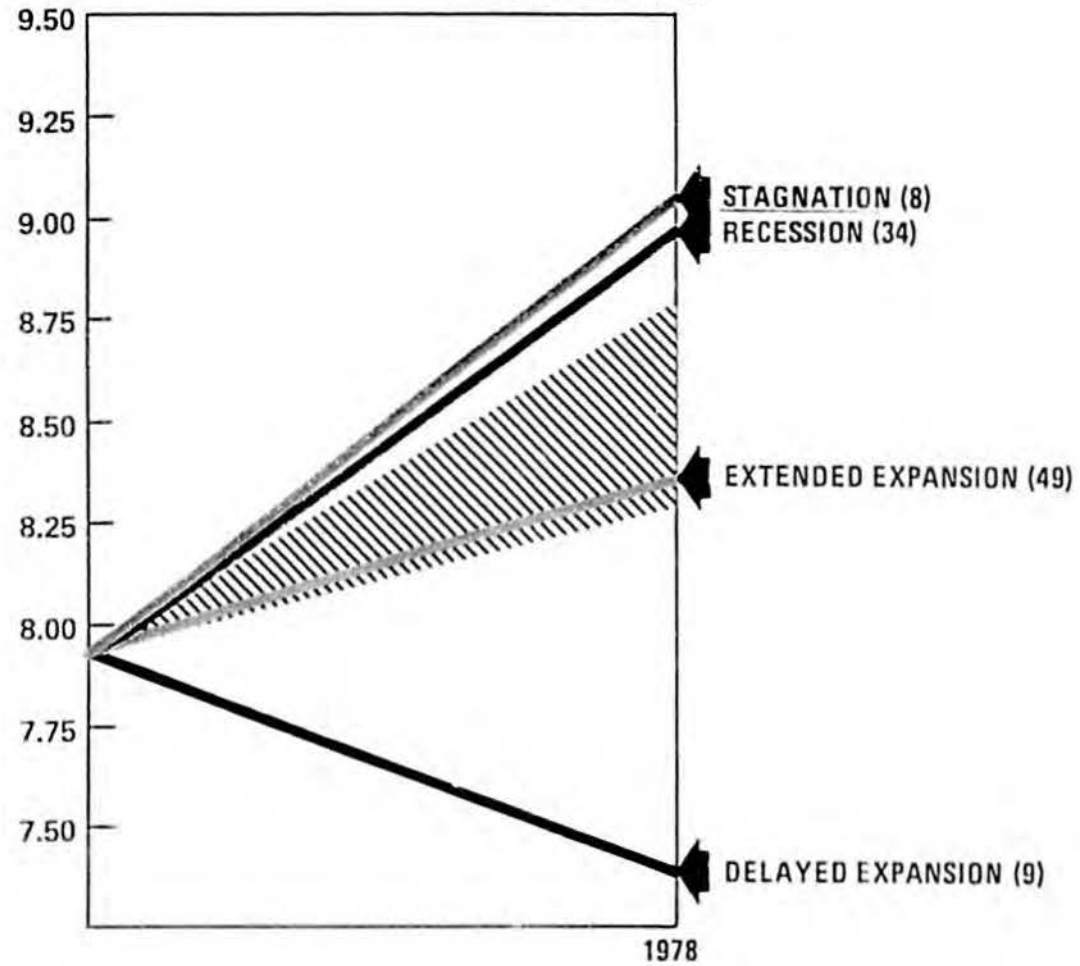
GNP DEFLATOR: Forecasts vs Model





MANUFACTURERS HANOVER TRUST

BOND MARKET FORECASTS
(LONG AA CORP.)

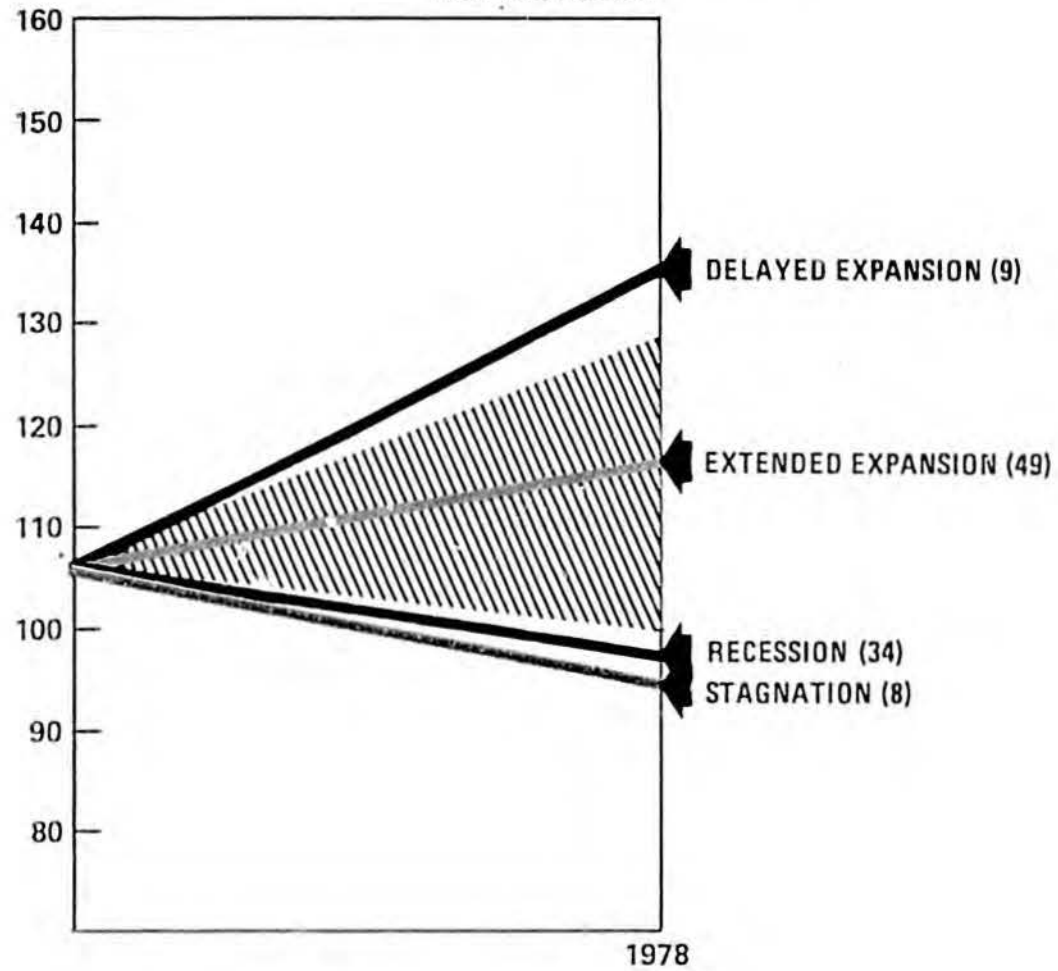




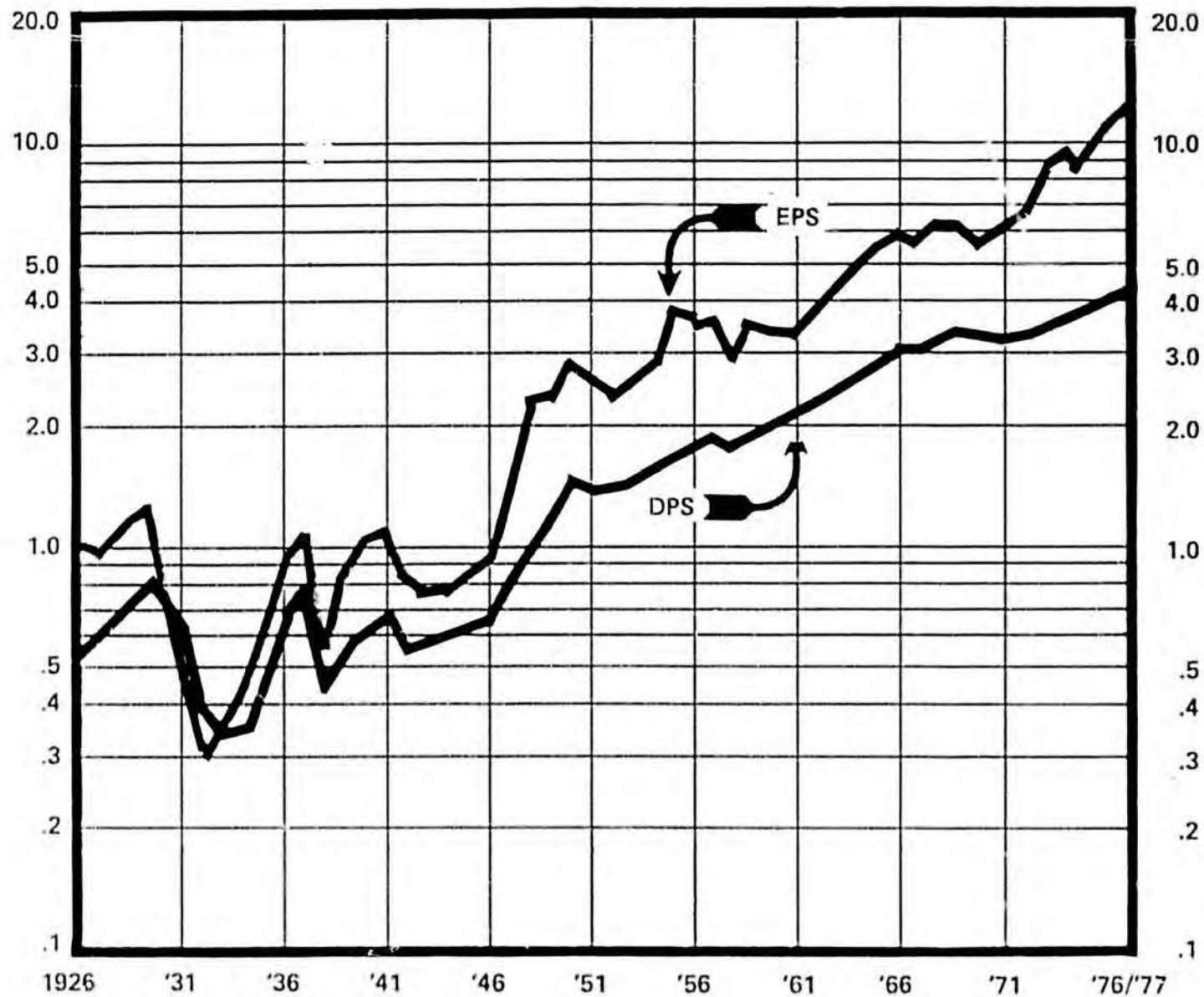
MANUFACTURERS HANOVER TRUST

STOCK MARKET FORECASTS

S&P 400 INDEX

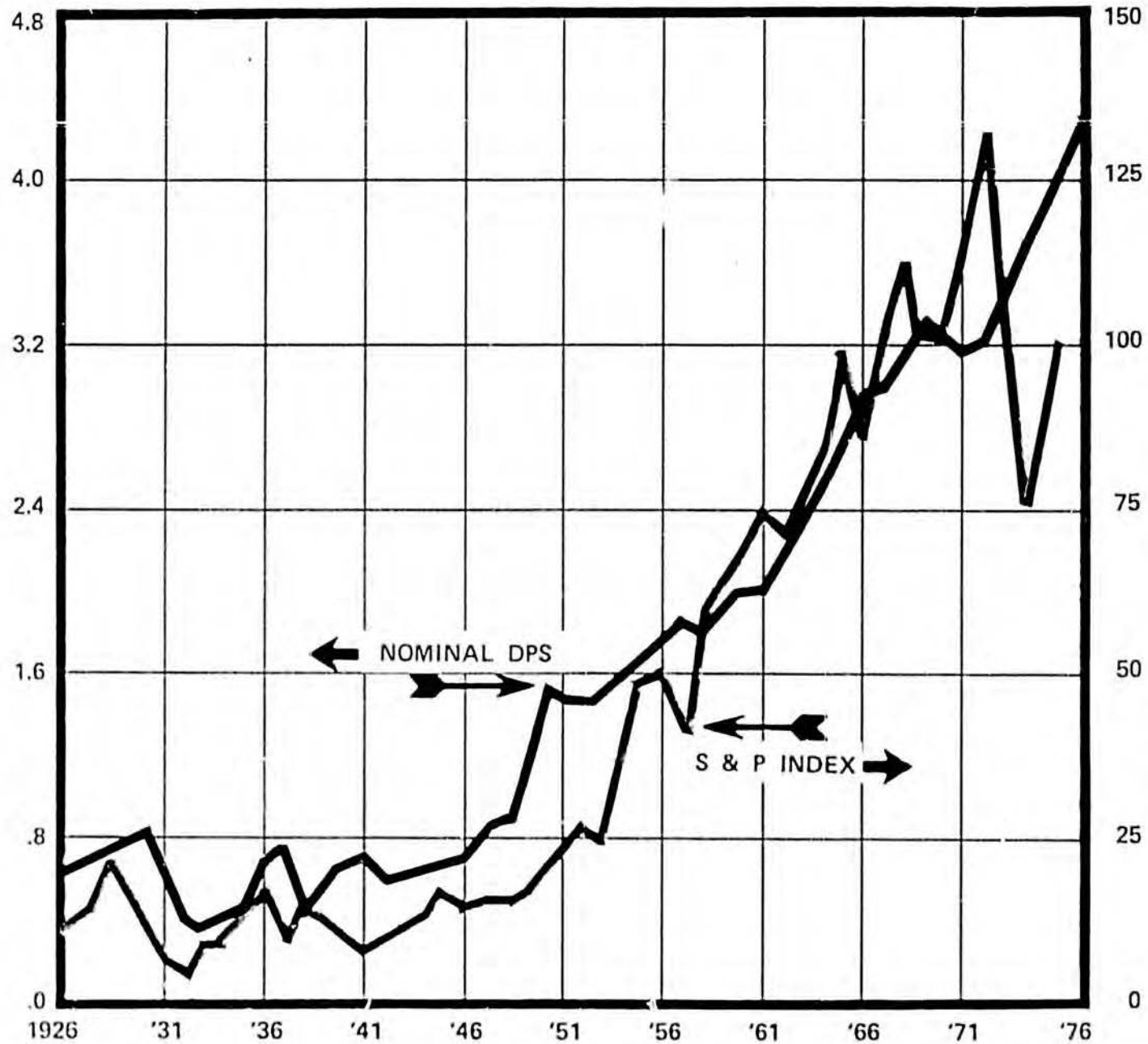


Dividends Per Share (DPS) & Earnings Per Share (EPS) 1926 - 1976



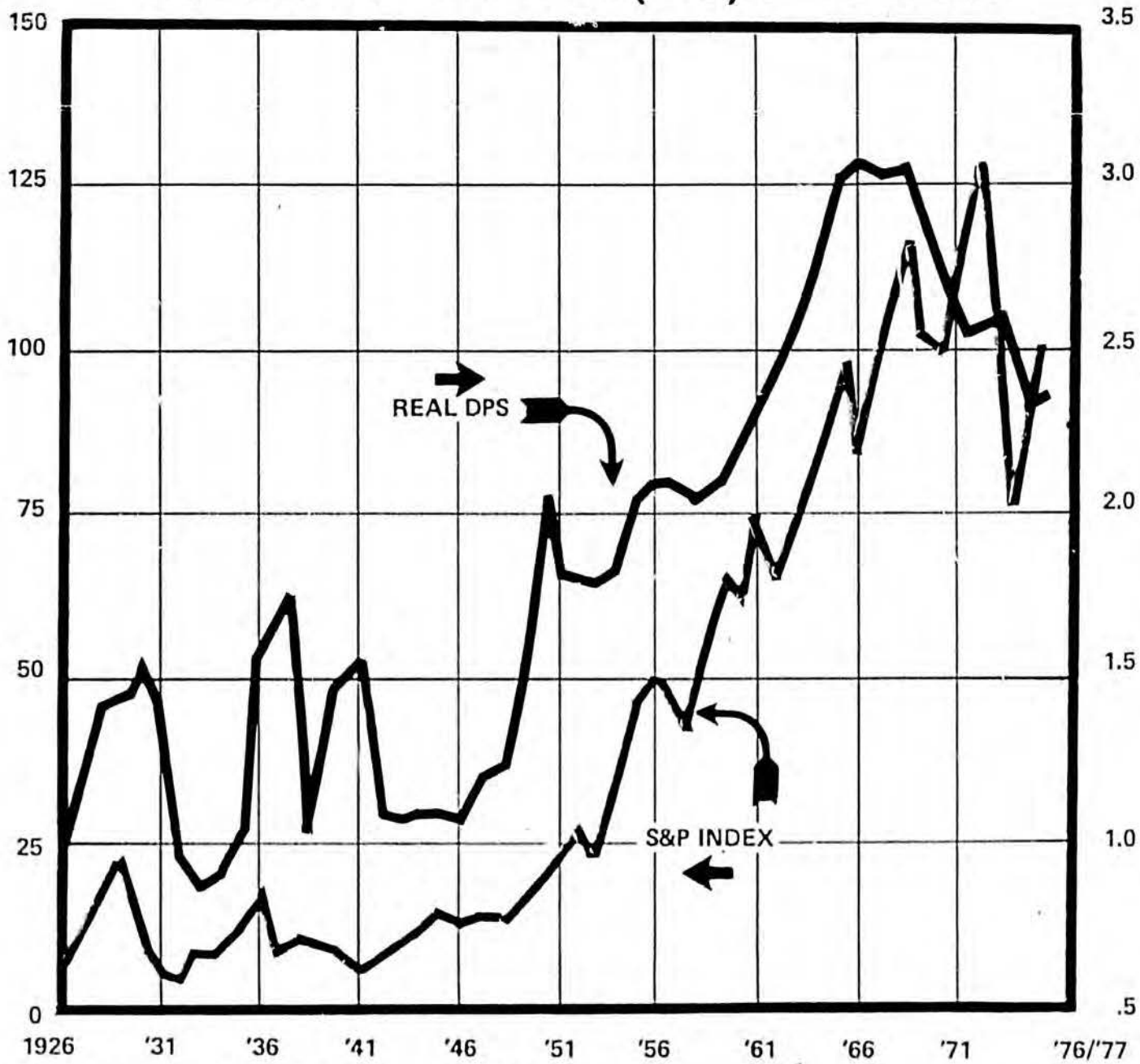
SOURCE: S & P INDEX

Relationship Between Nominal Dividends Per Share (DPS) & S&P Index



SOURCE: STANDARD & POOR'S

Relationship Between Real Dividends Per Share (DPS) & S&P Index

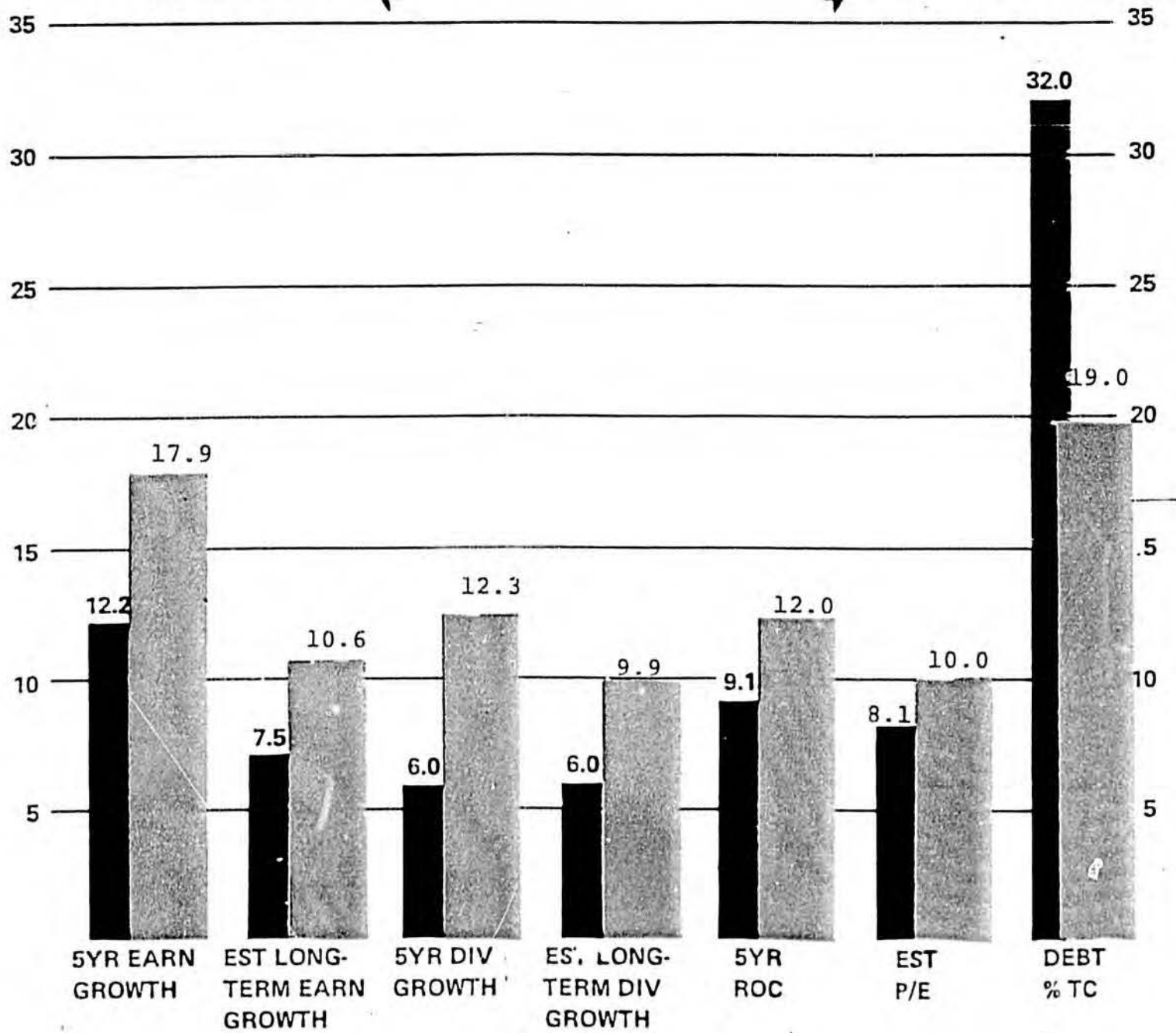


SOURCE: STANDARD & POOR'S & MHTCO

COMPARATIVE ANALYSIS

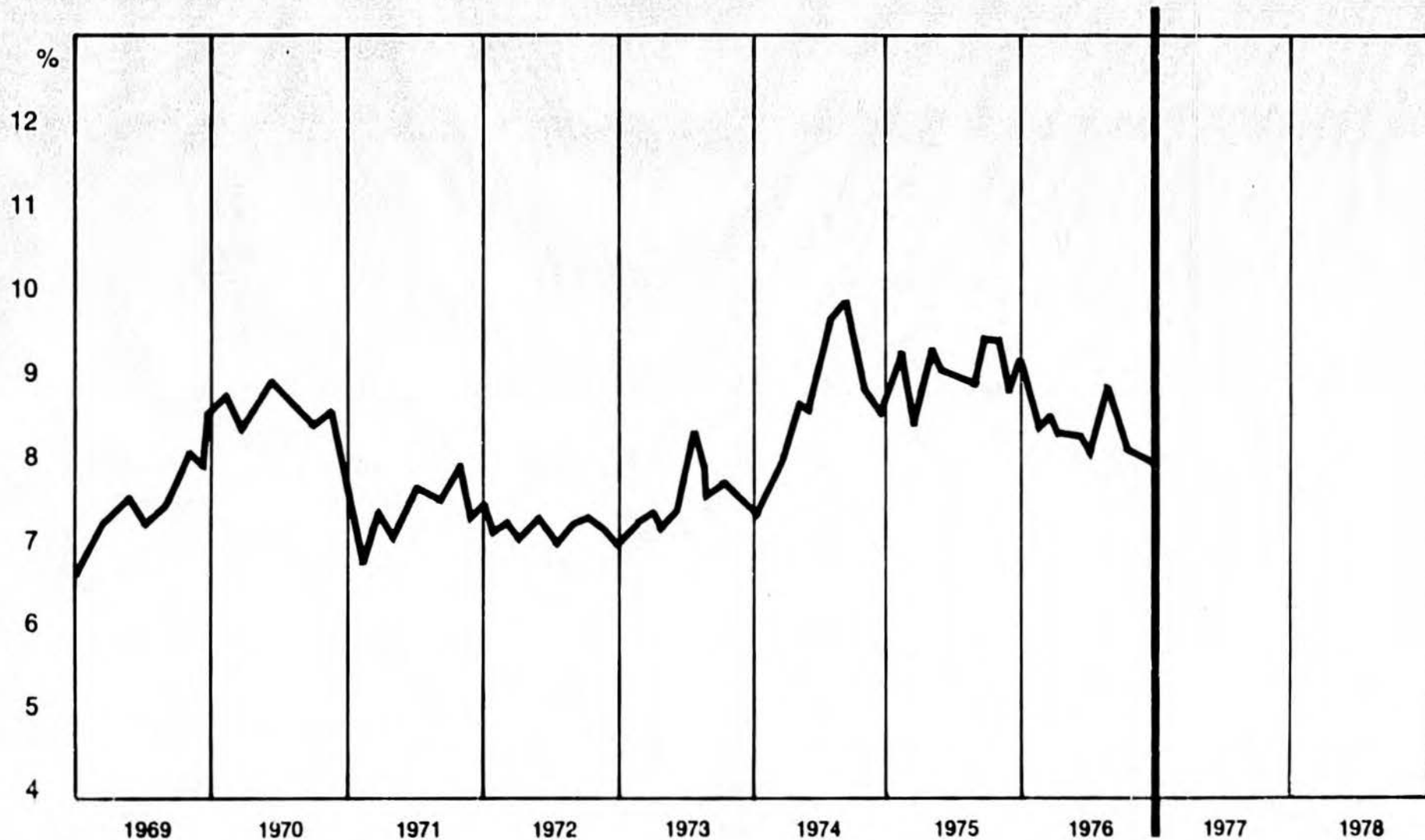
S & P 400 ◀

▶ ACC'T



YIELDS OF NEW AA INDUSTRIALS* 1969 through 1976

M MANUFACTURERS HANOVER TRUST



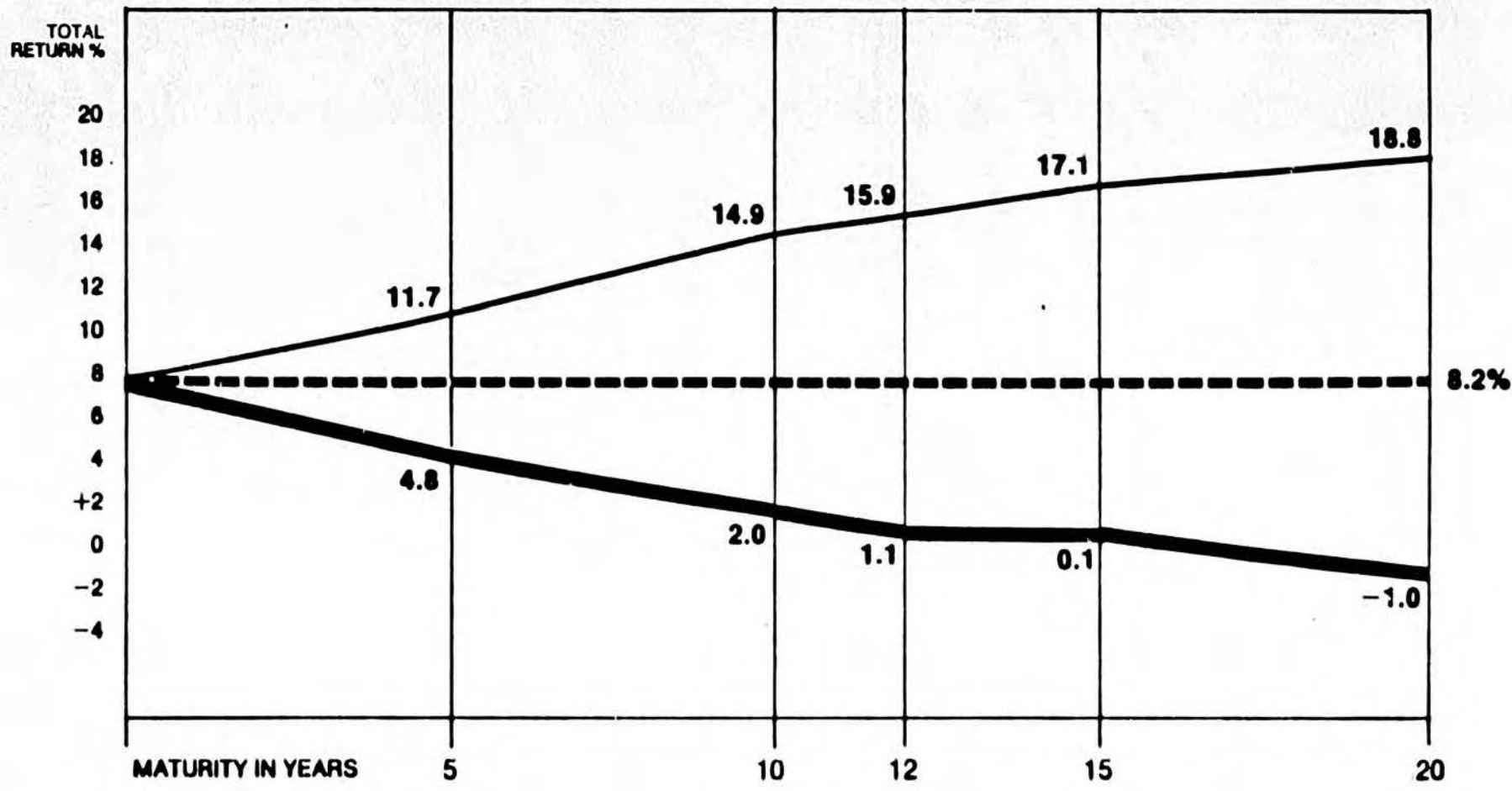
* call protected

INTEREST RATE FLUCTUATIONS AFFECT TOTAL RETURN



MANUFACTURERS HANOVER TRUST

Impact of a 100 basis point change in interest rates on total return for a one-year period.



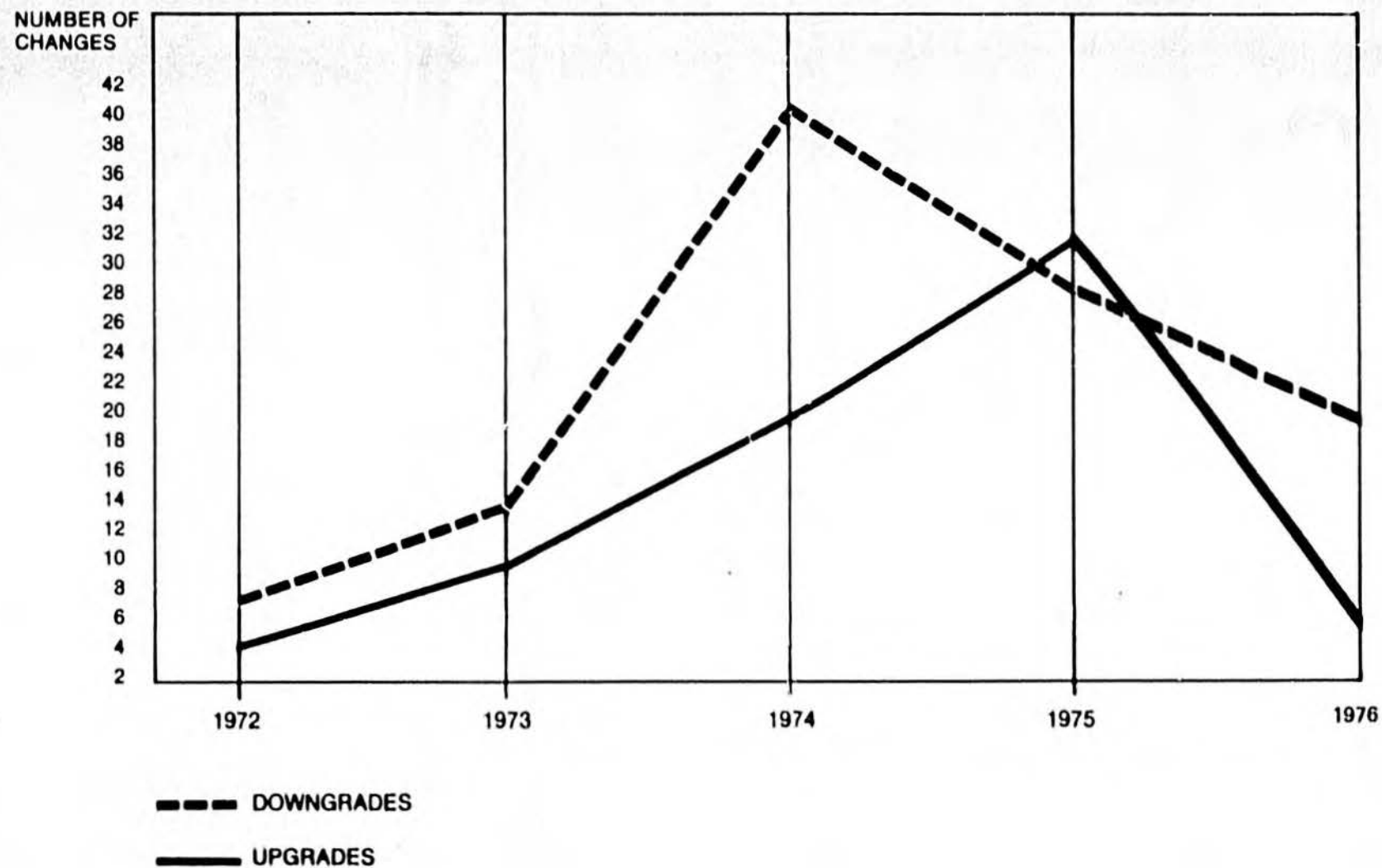
NOTE: STARTING POINT IS A BOND
WITH AN 8% YIELD TO MATURITY.

ISSUER CREDITS IMPROVE AND DETERIORATE



MANUFACTURERS HANOVER TRUST

Number of rating revisions by Moody's for industrials and utilities



ACTIVE MANAGEMENT TECHNIQUES



MANUFACTURERS HANOVER TRUST

- **Positioning in anticipation of interest rate changes**

- By Maturity**

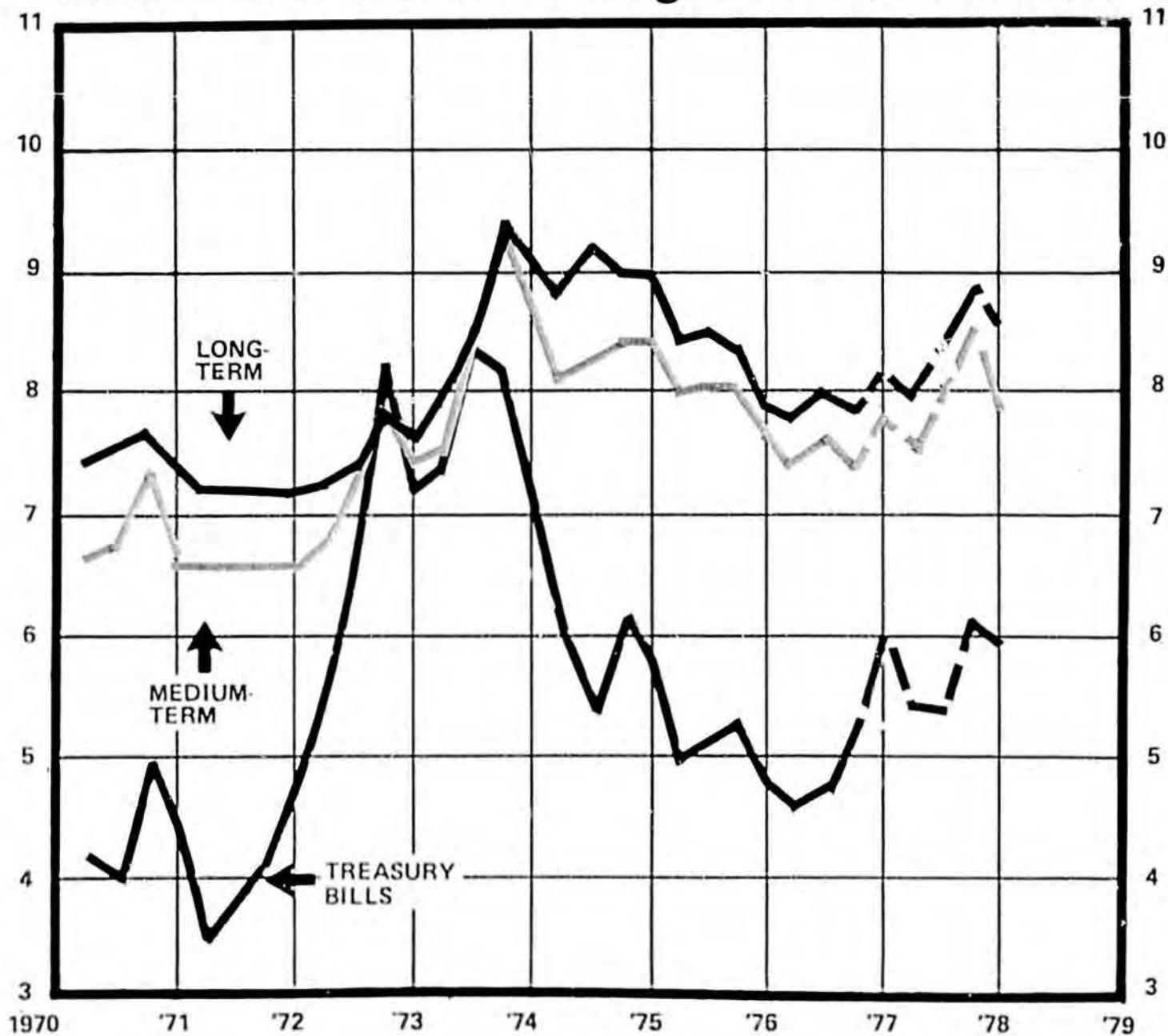
- By Quality**

- By Sector**

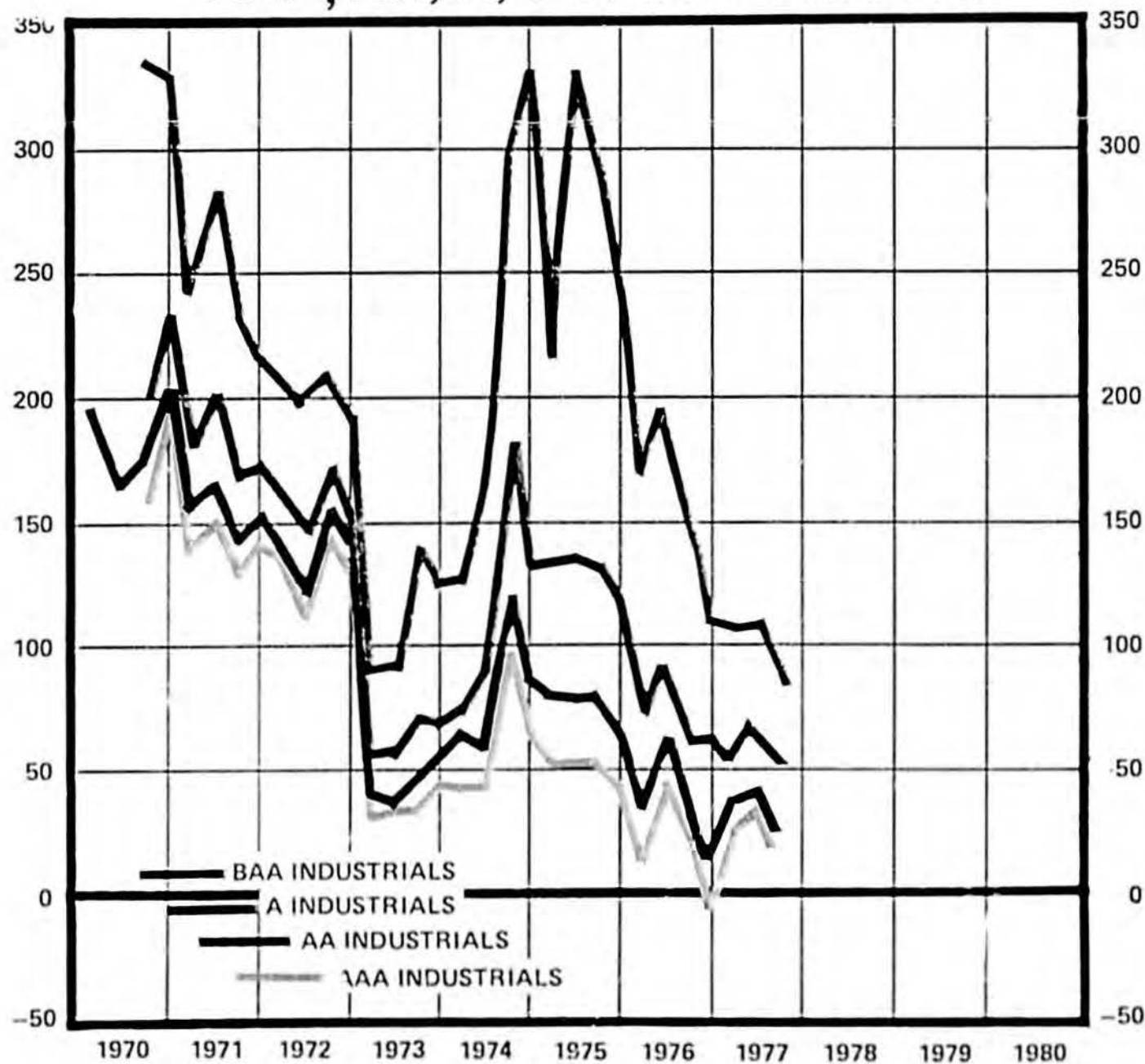
- **Swapping to improve quality or add incremental returns**

- **Avoiding losses resulting from credit deterioration**

Yield of 90 Day Treasury Bills, AA Medium-Term Industrials and AA Long-Term Industrials



Long Govts vs AAA, AA, A, & BAA Industrials



Yield Spreads - Long Govts. vs "A.A" Industrials & "AAA" Utilities

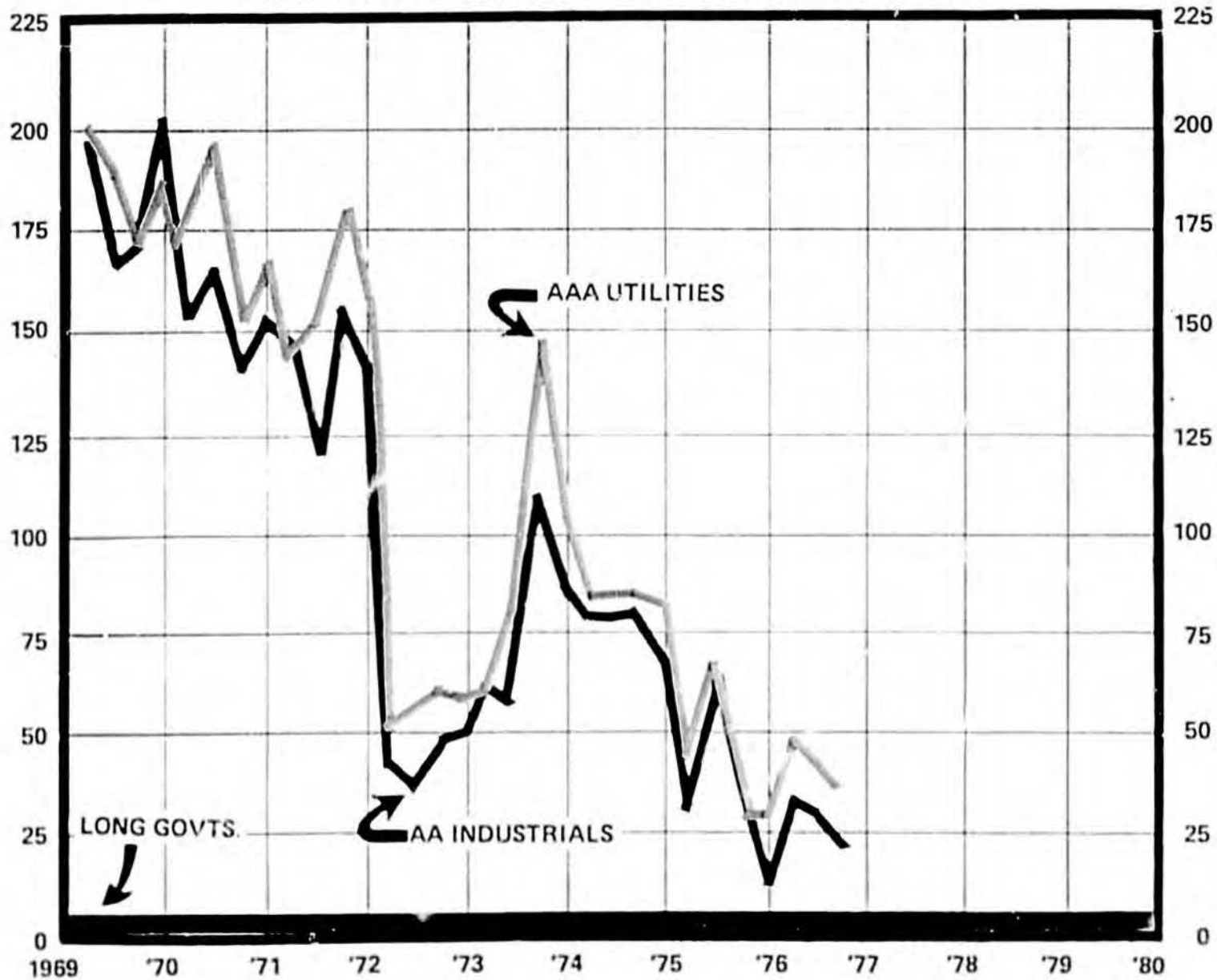


ILLUSTRATION OF REPRESENTATIVE BOND LIST ANALYSIS

M MANUFACTURERS HANOVER TRUST

ISSUE	HISTORICAL DATA									FUTURE TREND		MHT RATING ^(M)	
	FINANCIAL RATIO RANKINGS ^(M)								TOTAL RANKING	THREE-YEAR AVERAGE	PROJECTED RATIO	QUALITY	INDUSTRY
	1	2	3	4	5	6	7	8					
AUTOMOTIVE													
A	8	3	9	7	9	1	7	10	54	49	IMPROVING	-	-
B	4	2	3	2	5	2	4	7	29	29	DECLINING	+	
INDUSTRY AVERAGE									52	46			
OIL													
A	6	10	8	10	8	3	3	9	57	71	IMPROVING	-	
B	3	3	2	5	1	4	7	9	34	29	DECLINING	+	+
INDUSTRY AVERAGE									40	41			
CHEMICALS													
A	3	8	5	6	7	6	8	6	49	48	DECLINING	0	
B	3	6	3	3	3	6	8	2	34	27	DECLINING	+	+
INDUSTRY AVERAGE									45	43			

a) Financial Ratios Analyzed Are:

- 1) Cash Flow/Fixed Charges
- 2) Debt/Equity
- 3) Pretax Fixed Charge Coverage
- 4) Total Assets/Total Stockholder's Equity
- 5) Earnings Before Interest and Taxes/Total Assets
- 6) Cash Flow—Dividends/Capital Expenditures + Changes in Inventories and Receivables
- 7) Cash Flow/Capital Expenditures
- 8) Current Assets/Current Liabilities

b) Rating System

- ++ = Above Average in rating category and industry group
- + = Above Average in rating category
- 0 = Neutral relative to rating category
- = Below Average in rating category
- = Below Average in rating category and industry group

MONEY MARKET INSTRUMENTS AMOUNTS OUTSTANDING

(BILLIONS OF DOLLARS)

MANUFACTURERS HANOVER TRUST



UNITED STATES TREASURY OBLIGATIONS

Treasury Bills		154.0
Treasury Notes*		61.0
		Subtotal \$215.0

FEDERAL AGENCIES BACKED BY THE U. S. GOVERNMENT

Farmers Home Administration*		1.7
Govt. National Mortgage Assn.*		0.6
Export/Import Bank*		0.3
		Subtotal \$2.6

FEDERAL AGENCIES NOT BACKED BY THE U. S. GOVERNMENT

Federal Intermediate Credit Banks*		8.9
Federal Home Loan Banks (Bonds)*		6.4
Federal National Mortgage Assn. (Bonds)*		4.1
Federal Land Banks*		3.9
Banks for Cooperatives*		3.3
Federal National Mortgage Assn. (Discount Notes)		1.4
Farm Credit System (Discount Notes)		1.3
Federal Home Loan Banks (Discount Notes)		0.5
		Subtotal \$29.8

PRIVATE SECTOR

Bank Certificates of Deposit		67.0
Directly Placed Commercial Paper		36.0
Bank Acceptances		23.0
Dealer Placed Commercial Paper		25.0
		Subtotal \$151.0
		TOTAL \$398.4

*Maturities due within one year only included

ALASKA FUND
PROFILE OF RECOMMENDED PORTFOLIO

		<u>Market Price</u>	<u>Maturity Yield</u>
50%	Government National Mortgage Association Mortgage Backed Pass Thru Securities 8% (Average Life 12 Years)	98 3/8	8.32%*
20%	AAA American Tel. & Tel. and Subsidiary Companies 8 1/4% 40 Year Bonds	100 1/4	8.23%
10%	AAA Oil Company (Various) 8 1/2% 25 Year Bonds	103 1/4	8.20%
10%	AA Industrial Companies (Various) 8 1/2% 27 Year Bonds	103	8.22%
10%	AAA Financial Companies (Various) 8 7/8% 25 Year Bonds	105 1/4	8.35%
	Weighted Average Yield to Maturity		8.28%

*Corporate equivalent yield to average life

MANUFACTURERS HANOVER TRUST



August 1977

J. L. McCandless
Vice President
Manufacturers Hanover Trust Co.
600 Fifth Avenue
New York, New York 10020

MANUFACTURERS HANOVER TRUST COMPANY

FIXED INCOME MANAGEMENT

HISTORY AND ORGANIZATION

Manufacturers Hanover Trust, a subsidiary of the Manufacturers Hanover Corporation, is the sixth largest trust organization in the United States. At the end of 1976, the Trust Division managed more than \$11 billion. The Employee Benefit Trust Department is responsible for the management of more than \$7 billion. Of this total, \$2.9 billion are invested in fixed income securities and \$1.1 billion are managed in separate fixed income accounts. Exhibit 1 shows the distribution of total employee benefit assets under management.

The Executive Vice President and Head of the Trust Division, Joseph L. McElroy, has the ultimate responsibility for assets assigned to the Bank for management. Willard L. Wheeler, Jr., Senior Vice President, is in charge of the Employee Benefit Trust Department; Hilton M. Jervey, Vice President, is Head of the Employee Benefit Trust Investment Department and Rudolph Abel, Vice President, is in charge of the Investment Research Department. Exhibit 2 shows the organization and the reporting responsibilities of the Employee Benefit Trust Department.

COMMITMENT TO FIXED INCOME MANAGEMENT

The commitment of Manufacturers Hanover Trust to fixed income management begins with our experienced staff of professionals. The staff consists of two separate groups working in concert under the direction of the Senior Investment Committee:

A Specialized Support Group consisting of six individuals concentrates on the analytical and market monitoring functions that are required for the active management of fixed income portfolios. This Group is headed by Harald S. deRopp, Vice President.

Four credit analysts prepare detailed reports on issuer credits for the Specialized Support Group and the portfolio managers. These analysts develop the Representative Bond List which portfolio managers use to make individual security selections.

FIXED INCOME INVESTMENT PHILOSOPHY

The fixed income investment philosophy of Manufacturers Hanover Trust is to preserve capital and earn a consistent, satisfactory return by investing in high quality companies. The philosophy is our blueprint for action and encompasses both strategic and tactical goals, as described in Exhibit 3.

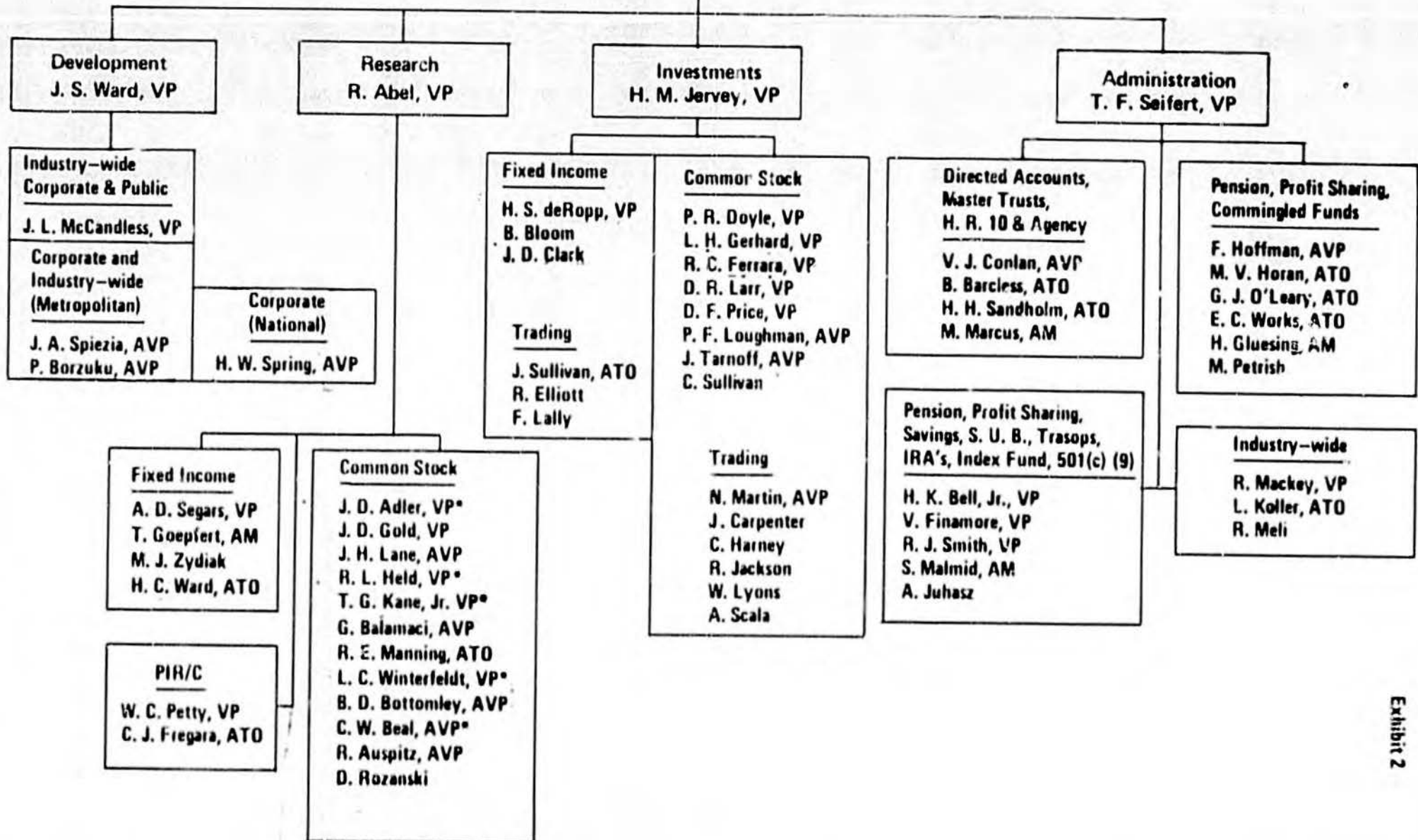
DISTRIBUTION OF EMPLOYEE BENEFIT ASSETS UNDER MANAGEMENT

December 31, 1976

	<u>Market Value</u>	<u>Percent Of Total</u>
Cash Equivalents	\$ 642,940,000	8.8%
U.S. Government Securities	1,227,709,000	16.1
Corporate and Other Bonds	1,138,526,000	15.6
Preferred Stock	37,402,000	0.5
Common Stock	4,202,948,000	57.7
Mortgages and Real Estate	<u>43,726,000</u>	<u>0.6</u>
Total Assets	\$7,293,251,000	100.0%

JOSEPH L. McELROY
EXECUTIVE VICE PRESIDENT

EMPLOYEE BENEFIT TRUST DEPARTMENT
W. L. Wheeler, Jr., SVP



*group head

GOALS OF FIXED INCOME MANAGEMENT

M MANUFACTURERS HANOVER TRUST

1

STRATEGIC

- Preserve capital
- Maximize return opportunities
- Satisfy client objectives

2

TACTICAL

- Maximize returns available from interest rate changes
 - Minimize losses associated with credit deterioration
 - Improve quality and/or current income
-

The strategic goals meet our clients' requirements for effective, long-term fixed income management and give consistency to our investment planning efforts. The tactical goals reflect the realities of the fixed income management process which the portfolio manager must consider daily in his investment decisions.

Two of these tactical goals (maximize returns available from interest rate changes and improve quality and/or current income) reflect the principal techniques we employ to actively manage fixed income accounts, namely, anticipation of interest rates and swapping. Although we often use both techniques, we recognize that in certain bond markets one tactic can be more effective than the other and the knowledge of which to emphasize is the product of our economic analysis. The third tactical goal (minimize losses associated with credit deterioration) is an essential part of our management process at all times. This goal is achieved through careful financial analysis of companies and the debt securities they issue. We also draw upon our credit analysis to give us the fundamental information we need to identify appropriate swaps.

REALITIES OF FIXED INCOME MANAGEMENT

Two of the most significant realities of fixed income management are the fluctuation of interest rates and the potential deterioration of issuer credit. Exhibit 4, Yields of New AA Industrials, shows interest rate fluctuations of 1% or more in nearly every year since 1969 and projects that they may continue to do so in 1977 and 1978. Interest rate fluctuations have a strong impact on the total return of a bond portfolio, depending upon its average maturity structure. To combat a potentially adverse impact on total return, a portfolio manager varies the maturity structure of his portfolio according to his forecast of the level and direction of interest rates.

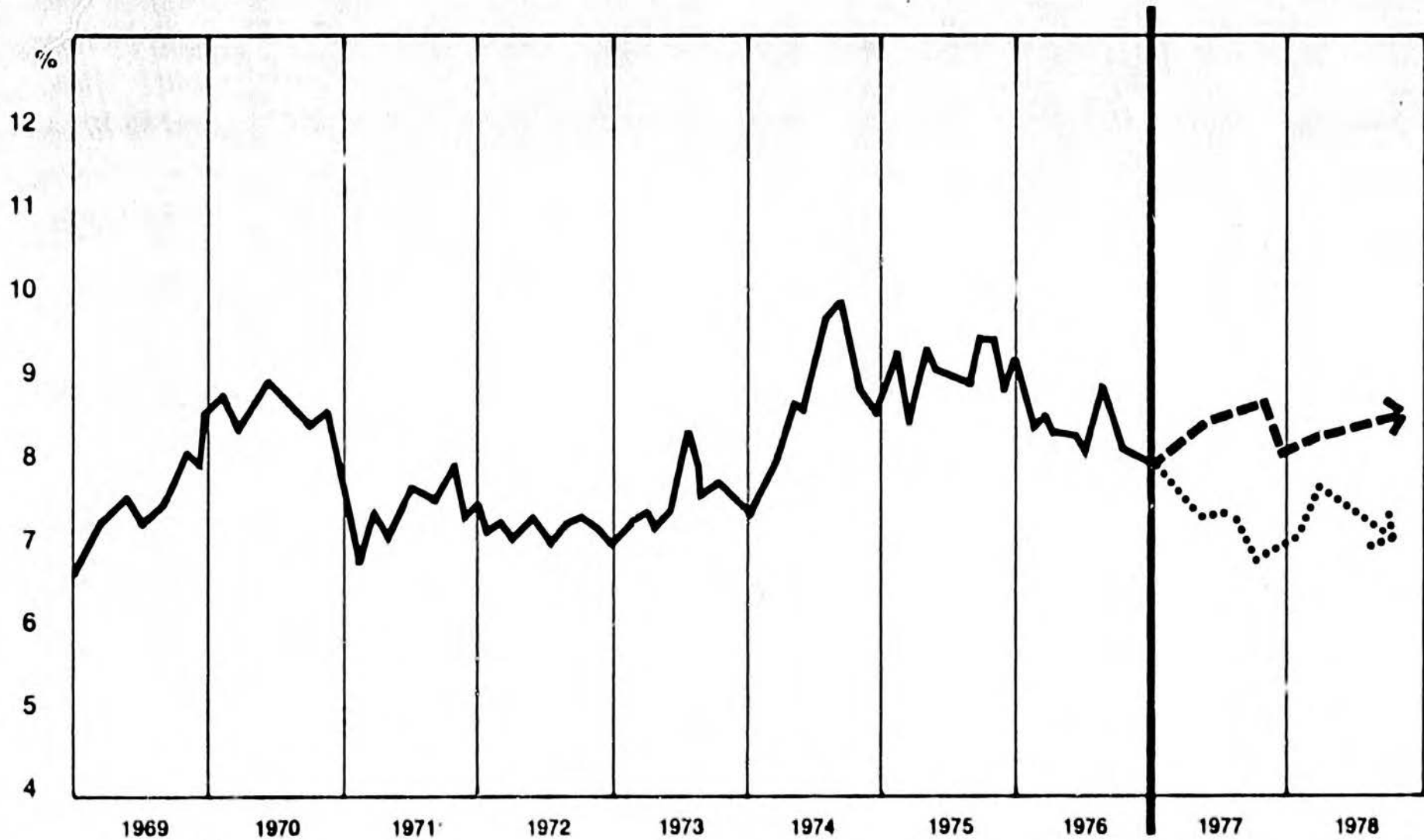
Exhibit 5, The Importance of Maturity Decisions, shows the impact of a 100 basis point (1%) change in interest rates, in either direction, on the total return of bonds with maturities of 5, 10, 12, 15 and 20 years. The starting point has interest rates at eight percent and indicates changes in one-year total return for a one percent increase and decrease. The longer the maturity of a bond, the greater the impact one can expect on total return from a change in interest rates. For example, in this exhibit a one percent decline in interest rates would produce an 18.8 percent one-year total return for a bond with a maturity of 20 years. Conversely, a one percent increase in interest rates would produce a minus one percent total return for the same bond. As a result of this and other analyses, we recognize the importance of interest rate changes on total return in our efforts to maximize total return.

The second major reality of fixed income management is the marked increase in the upgrading and downgrading of issuer credits by the rating agencies. Exhibit 6, The Importance of Credit Research, indicates the number of rating changes that occurred in the past four years. Between 1972 and 1974 there was a dramatic increase in the number of downgrades. At Manufacturers Hanover our credit research analysts use a proprietary system to anticipate changes in issuer quality ratings.

YIELDS OF NEW AA INDUSTRIALS*

1969 through 1976

M MANUFACTURERS HANOVER TRUST



* call protected

ILLUSTRATION OF REPRESENTATIVE BOND LIST ANALYSIS

M MANUFACTURERS HANOVER TRUST

ISSUE	HISTORICAL DATA									TOTAL RANKING	THREE-YEAR AVERAGE	FUTURE TREND PROJECTED RATIO	MHT RATING (b)	
	FINANCIAL RATIO RANKINGS (a)								QUALITY				INDUSTRY	
	1	2	3	4	5	6	7	8						
AUTOMOTIVE														
FORD	8	3	9	7	9	1	7	10		54	49	IMPROVING	-	--
GENERAL MOTORS	4	2	3	2	5	2	4	7		29	29	DECLINING	+	
INDUSTRY AVERAGE										52	46			
OIL														
COASTAL STATES GAS	6	10	8	10	8	3	3	9		57	71	IMPROVING	-	
EXXON	3	3	2	5	1	4	7	9		34	29	DECLINING	+	+
INDUSTRY AVERAGE										40	41			
CHEMICALS														
ALLIED CHEMICAL	3	8	5	6	7	6	8	6		49	48	DECLINING	0	
MONSANTO	3	6	3	3	3	6	8	2		34	25	DECLINING	+	+
INDUSTRY AVERAGE										45	43			

a) Financial Ratios Analyzed Are:

- 1) Cash Flow/Fixed Charges
- 2) Debt/Equity
- 3) Pretax Fixed Charge Coverage
- 4) Total Assets/Total Stockholder's Equity
- 5) Earnings Before Interest and Taxes/Total Assets
- 6) Cash Flow—Dividends/Capital Expenditures + Changes in Inventories and Receivables
- 7) Cash Flow/Capital Expenditures
- 8) Current Assets/Current Liabilities

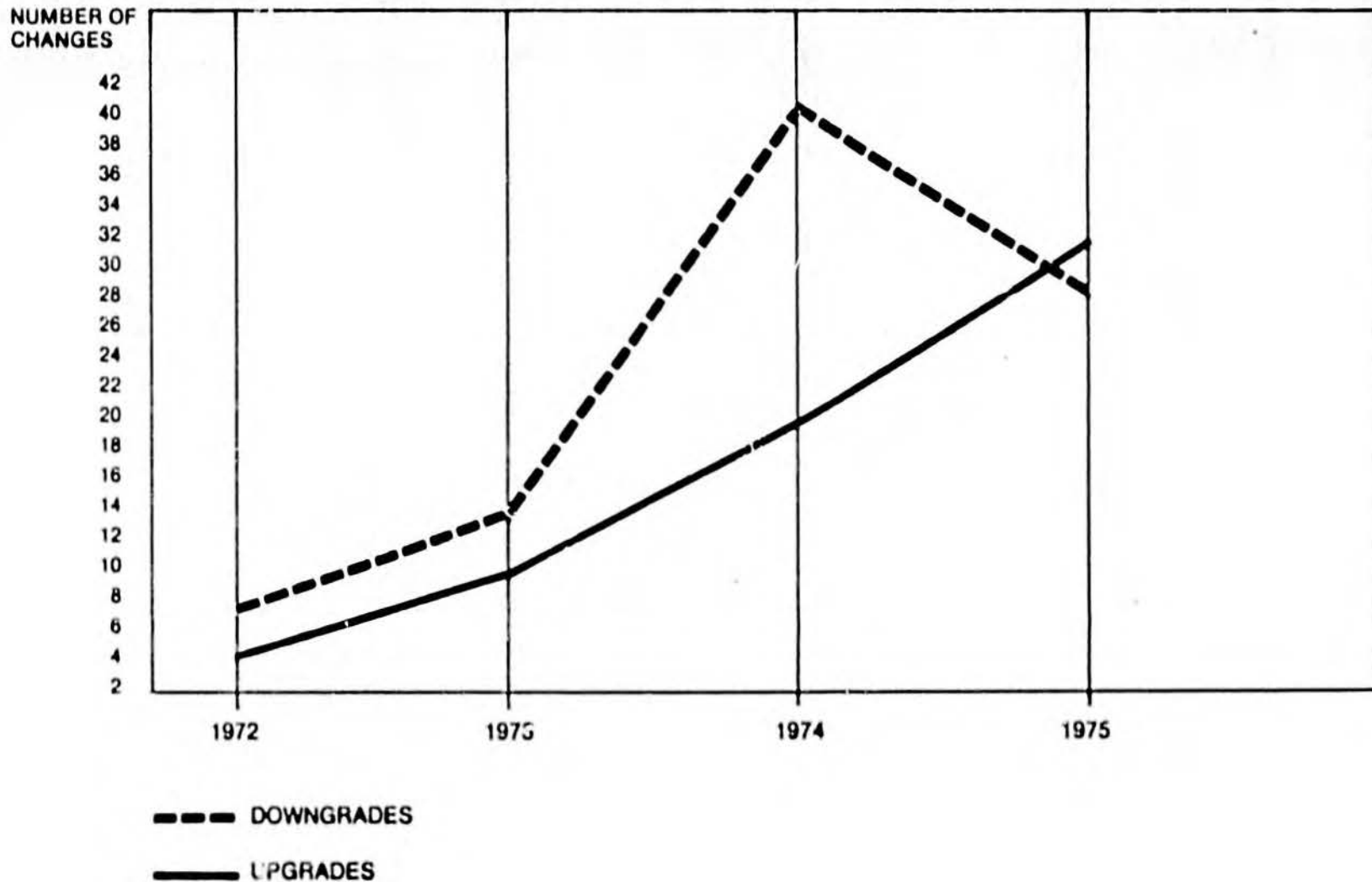
b) Rating System

- ++ = Above Average in rating category and industry group
- + = Above Average in rating category
- 0 = Neutral relative to rating category
- = Below Average in rating category
- = Below Average in rating category and industry group

THE IMPORTANCE OF CREDIT RESEARCH

M MANUFACTURERS HANOVER TRUST

Number of rating revisions by Moody's for industrials and utilities



PRINCIPLES OF FIXED INCOME MANAGEMENT

The successful management of fixed income accounts at Manufacturers Hanover Trust is based upon four principles or building blocks. It is our experience that each of the factors listed in Exhibit 7 is an integral part of the fixed income management process. The paragraphs below describe each of these building blocks in greater detail.

Economic Analysis

We use thorough economic analysis to identify and categorize the economic relationships that influence the market prices of bonds. In recent years the outlook for interest rates has been an extremely important derivative of our economic analysis. We have developed a methodology for weighting our forecasts at any point in time according to how certain we believe they are. This approach enables us to measure the impact of several possible economic scenarios on the expected results of our bond portfolios.

Economic analysis also assists our investment planning effort by identifying the segments of the economy that can be expected to show unusual strength or weakness. Examples of our economic work are attached in Appendix A.

Credit Research

Fundamental research has always been considered an important part of common stock management. Recently, bond managers have recognized its importance for their own portfolios. The deterioration of the financial condition of American industry in 1973 and 1974 (see Exhibit 6) has intensified the need to verify the quality rating of a company through independent analysis.

At Manufacturers Hanover Trust we have long used credit research to anticipate difficulties in a company's financial condition. Through our proprietary Ratio Ranking System we regularly monitor eight different financial ratios that describe the credit worthiness of a company and industry. Exhibit 8 shows how our Ratio Ranking System works by excerpting a page from our Representative Bond List Analysis. The exhibit is divided into three sections: Historical Data, Future Trend and MHT Rating.

The Historical Data section is an analysis of eight key financial ratios which we believe best identify the quality of an issuer's financial condition. These ratios give us a picture of the liquidity and profitability of the issuer, the protection to the bondholder and the extent to which a company has already utilized its borrowing capacity. Each factor is given a rank of 1 to 10, then totaled. The final two columns under Historical Data indicate the current total ranking and the average for the past three years. The lower the number, the better the ranking. We also develop a ranking for each industry so that we can compare a company to its industry and one industry with another.

BUILDING BLOCKS OF FIXED INCOME MANAGEMENT

M MANUFACTURERS HANOVER TRUST

1 **ECONOMIC ANALYSIS**

2 **CREDIT RESEARCH**

3 **ACTIVE MANAGEMENT**

4 **CONTROL**

ILLUSTRATION OF REPRESENTATIVE BOND LIST ANALYSIS

M MANUFACTURERS HANOVER TRUST

ISSUE	HISTORICAL DATA										FUTURE TREND	MHT RATING ^(b)		
	FINANCIAL RATIO RANKINGS ^(a)								TOTAL RANKING	THREE-YEAR AVERAGE		PROJECTED RATIO	QUALITY	INDUSTRY
	1	2	3	4	5	6	7	8						
AUTOMOTIVE														
FORD	8	3	9	7	9	1	7	10	54	49	IMPROVING DECLINING	-	-	
GENERAL MOTORS	4	2	3	2	5	2	4	7	29	29		+		
INDUSTRY AVERAGE									52	46				
OIL														
COASTAL STATES GAS	6	10	8	10	8	3	3	9	57	71	IMPROVING DECLINING	-		
EXXON	3	3	2	5	1	4	7	9	34	29		+	+	
INDUSTRY AVERAGE									40	41				
CHEMICALS														
ALLIED CHEMICAL	3	8	5	6	7	6	8	6	49	48	DECLINING DECLINING	()		
MONSANTO	3	6	3	3	3	6	8	2	34	25		+	+	
INDUSTRY AVERAGE									45	43				

a) Financial Ratios Analyzed Are:

- 1) Cash Flow/Fixed Charges
- 2) Debt/Equity
- 3) Pretax Fixed Charge Coverage
- 4) Total Assets/Total Stockholder's Equity
- 5) Earnings Before Interest and Taxes/Total Assets
- 6) Cash Flow—Dividends/Capital Expenditures + Changes in Inventories and Receivables
- 7) Cash Flow/Capital Expenditures
- 8) Current Assets/Current Liabilities

b) Rating System

- ++ = Above Average in rating category and industry group
- + = Above Average in rating category
- O = Neutral relative to rating category
- = Below Average in rating category
- = Below Average in rating category and industry group

The second section, Future Trend, projects the credit standing of each issue in our bond universe. Using the resources of the Bank's Stock Research Department, our credit analysts determine the trend of a company's financial condition based upon its estimated earning power. Finally, in the last section of the analysis, we assign our own quality rating to each issue in order to be more certain of the financial strength and credit worthiness of every company we consider for the portfolios of our clients.

Active Management

Active bond management at Manufacturers Hanover Trust enables our portfolio managers to take advantage of opportunities to maximize returns without exposing their portfolios to higher levels of risk. These opportunities appear frequently as a result of the open market operations of the Federal Reserve or through the covering of short positions by large bond dealers. Since we maintain portfolios of highly marketable securities, our managers are always in a position to take advantage of these opportunities.

Active management as an opportunistic technique can also be used to take advantage of aberrations in historical yield spreads that result from sinking fund operations, supply-demand imbalances, and temporary emotional outbursts. Used in these instances with the guidance of the Specialized Support Group, we believe our active bond management can improve total return of a portfolio without changing its overall risk level.

A final aspect of our active management capability is our willingness to use other high quality debt instruments when appropriate. Among these vehicles are Eurodollar obligations unconditionally guaranteed by AAA and AA U.S. companies and payable in dollars, convertible bonds purchased on a yield basis and secondary private placements with mandatory pro rata sinking fund provisions.

Control

The last principle of fixed income management at Manufacturers Hanover Trust is our reliance on controls to maintain and improve upon product quality. Product quality is as important in our business as it is in any other. Our control procedures serve as a built-in auditing mechanism which continuously reviews the progress of all investment actions. The controls we apply on a weekly, monthly and quarterly basis are indicated below:

Weekly

- Portfolio Management Committee reviews market developments and expectations.
- Portfolio commitment levels are examined.
- Historical yield relationships are compared with the current situation.
- Senior Fixed Income Manager reviews the volume and type of transactions.

Monthly

- Senior Investment Committee reviews strategy in light of recent market developments.
- Senior Investment Committee examines performance and progress toward investment goals.
- Portfolio Management Committee reviews actions taken and their success or opportunity for improvement.

Quarterly

- Portfolio composition is examined in an exception report that identifies all variations from stated policy.
- A comprehensive, internal performance measurement system measures the results of each account and compares these results with other portfolios in the bank.
- Senior investment officers review the progress of accounts.
- Clients receive reports of all transactions showing the gain or loss.
- Portfolio managers meet with clients quarterly or semi-annually to discuss past actions and future prospects.

These strong management controls enable us to evaluate actions and make mid-course corrections in a timely manner. Control, moreover, integrates the principles of economic analysis, credit research and active management so that each factor adds value to the quality of the final product.

FIXED INCOME DECISION-MAKING PROCESS

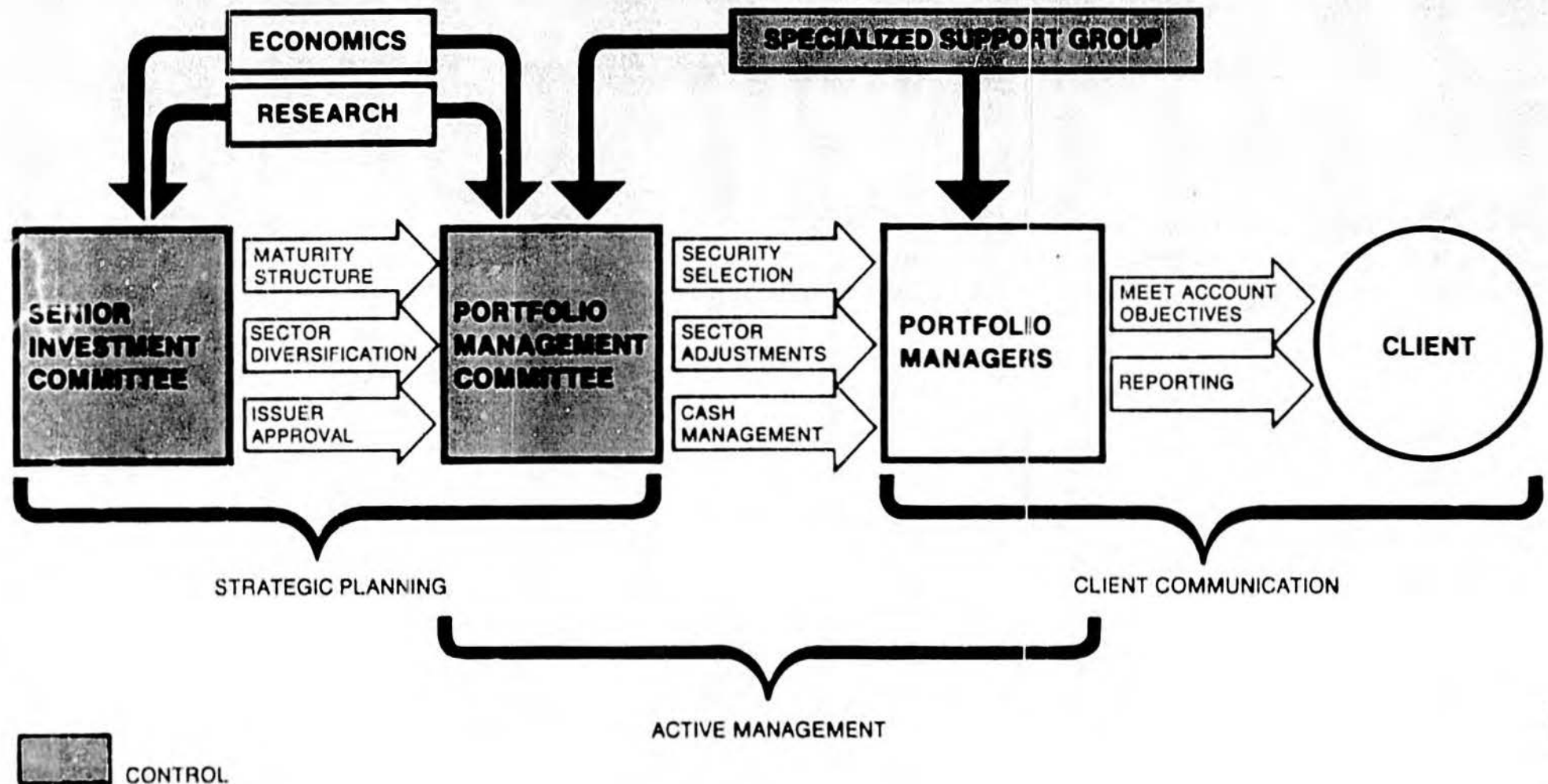
Once a client understands our investment philosophy and principles of fixed income management, the next factor to consider is the decision-making process. The structure of our investment organization is oriented to decision-making so that each segment contributes to the planning, implementation or control of our investment decisions. Our decision-making process for fixed income management is presented in Exhibit 9 and the functions of each segment are described below.

Senior Investment Committee (SIC)

The Senior Investment Committee is the source of all investment policy decisions. The committee meets monthly or as the situation requires and is chaired by the head of the Trust Division. Its permanent members include the officers in charge of Employee Benefit Trust, Research and Portfolio Management. In addition, the head of the Specialized Support Group and our financial economist attend committee meetings on a regular basis.

FIXED INCOME DECISION-MAKING PROCESS

M MANUFACTURERS HANOVER TRUST



The major information flows to the Senior Investment Committee come from the Economics and Research Departments. The SIC uses this information to develop all fixed income strategic planning and policy decisions. The three principal decisions of the SIC are maturity structure, sector diversification and issuer approval.

The maturity structure decision is derived from our forecast of interest rates. The sector diversification decision is derived from our analysis of the economy and the relative strength of the various sectors. The issuer approval decision is based upon information supplied by the Research Department and determines the recommended list of securities.

The Senior Investment Committee has ultimate responsibility for all investment decisions.

PORTFOLIO MANAGEMENT COMMITTEE (PMC)

The Portfolio Management Committee is chaired by Hilton M. Jervey and includes all portfolio managers. The committee meets weekly, or as the situation requires, to review the findings of the Senior Investment Committee and to adapt investment policy to account objectives. The major decisions of the Portfolio Management Committee are: security selection, sector adjustments and cash management.

To make these decisions the PMC relies on our financial economist, the Credit Research Department and the Specialized Support Group. The economist interprets current economic data and reviews monetary policy as it bears on the management of our fixed income accounts. A member of the Credit Research Department assists in the screening of new issues and the selection of existing issues through the use of the Ratio Ranking System. The head of the Specialized Support Group recommends sector adjustments, swapping opportunities and the availability of quality debt instruments in the secondary market.

The Portfolio Management Committee serves as a review mechanism for the Senior Investment Committee and a forum for the ideas of the individual portfolio managers.

SPECIALIZED SUPPORT GROUP

The Specialized Support Group acts as a catalyst in the translation of investment policy into portfolio management actions. The Group is headed by Harald S. deRopp and is organized according to function. One member is responsible for developing swap opportunities and evaluating arbitrage possibilities. Another is solely responsible for cash management and short-term investments. A third specialist investigates and recommends the use of specialized fixed income securities in client accounts. The three remaining members of the Group concentrate on trading -- one specializes in treasury issues and the other two trade agency and corporate issues.

The work of the Specialized Support Group makes a significant contribution to our fixed income management success by providing strong analytical and trading capabilities.

PORTFOLIO MANAGERS

The primary function of the portfolio manager in the decision-making process is to construct a portfolio that lies within the policy guidelines established by the Senior Investment Committee and meets the objectives of his client. Each portfolio manager is responsible to his client and the Senior Investment Committee for the investment results of his portfolio.

The portfolio manager is also responsible for communicating directly with the client about investment policy and actions. Portfolio managers meet with clients quarterly and are always available for meetings whenever the situation requires. Every account has a back-up manager to ensure continuity of action and communication should the primary manager be away from the Bank.

In order to be responsive to the specific needs of each client, portfolio managers call upon the Specialized Support Group for assistance with new issues, special types of swaps and special investment studies. With the manager's prior approval, the Group acts in his behalf in carrying out swaps and other transactions that require immediate action.

KEY PERSONNEL IN FIXED INCOME MANAGEMENT

Willard L. Wheeler, Jr.
Senior Vice President

Willard L. Wheeler, Jr. is Senior Vice President in charge of the Employee Benefit Trust Department and a member of the Senior Investment Committee.

He joined the Bank in 1968, was elected Senior Portfolio Manager in 1970 and became the officer in charge of the Employee Benefit Trust Investment Department in 1971. Mr. Wheeler has held his present position since 1973. Prior to joining Manufacturers Hanover Trust, he spent eleven years with Northern Trust Company.

Mr. Wheeler is active in a number of professional organizations, including the Investment Analysts Society of Chicago, the National Foundation of Health, Welfare and Pension Plans, the Employee Benefit Committee of the New York State Bankers Association and the Advisory Committee of the Stanford University Graduate School of Business. He holds a B.A. from Cornell University and an MBA degree from the University of Chicago.

Hilton M. Jervey
Vice President

Hilton M. Jervey is the officer in charge of the Employee Benefit Trust Investment Department, the head of the Portfolio Management Committee and a member of the Senior Investment Committee.

He joined Manufacturers Hanover Trust in 1963 as a Senior Research Analyst, was later promoted to Group Head, and in 1969, was appointed Director of Research. Prior to being elected to his present position in 1977, he served as a Portfolio Manager in the Employee Benefit Trust Investment Department for seven years.

He holds an AB degree from Princeton University, and MBA from the Wharton Graduate School of Business and is a Chartered Financial Analyst. Mr. Jervey is an active member of the New York Society of Security Analysts, the Financial Analysts Federation and the Institute of Financial Analysts.

Harald S. deRopp
Vice President

Harald S. deRopp is an investment officer specializing in fixed income investments, and heads the Specialized Support Group. In these two roles he regularly attends the meetings of the Senior Investment Committee and the Portfolio Management Committee.

Mr. deRopp began his investment career at Manufacturers Hanover Trust in 1961 as a member of the Investment Research Department. He is an active member of the Bond Portfolio Managers Association.

Mr. deRopp holds an undergraduate degree in economics from the University of Delaware and an MBA from the Wharton School of Business at the University of Pennsylvania.

Rudolph Abel, Jr.
Vice President

Rudolph Abel is the Director of Investment Research at Manufacturers Hanover Trust. In this position he is a permanent member of the Senior Investment Committee.

Mr. Abel began at Manufacturers Hanover Trust as a Security Analyst in 1970. In the ensuing years he rose to Group Head before his election to Director of Research in 1974.

He holds a B.A. from the University of Connecticut and an MBA from the Wharton School of Business at the University of Pennsylvania. He is an active member of the Financial Analysts Federation and the New York Society of Security Analysts.

FIXED INCOME
PERFORMANCE

The success of our approach to fixed income management is evidenced by our investment results over the last seven years. Exhibit 10 shows the compound annual rates of return achieved by our Group Trust Fixed Income Fund. This fund has approximately \$100 million in assets and is fully discretionary.

FIXED INCOME INVESTMENT PERFORMANCE



MANUFACTURERS HANOVER TRUST

GROUP TRUST FOR PENSION & PROFIT SHARING PLANS

COMPOUND ANNUAL RATES OF RETURN FOR PERIODS ENDING 12/31/76

7 YEARS 1970-1976	6 YEARS 1971-1976	5 YEARS 1972-1976	4 YEARS 1973-1976	3 YEARS 1974-1976	2 YEARS 1975-1976	1976
9.4%	9.6%	8.5%	8.2%	9.7%	15.2%	17.7%

In achieving these rates of return, the Group Trust Fixed Income Fund has maintained an average weighted quality rating of better than AA and has primarily owned only the most marketable Treasury, agency and corporate issues. Exhibit 11 shows the distribution of this fund's assets by maturity and sector.

ACCOUNTING AND REPORTING

Manufacturers Hanover Trust provides detailed statements monthly for all portfolios under our management. These statements report chronologically all income and principal transactions, including non-cash transactions such as stock dividends, splits and exchanges.

Similarly, we provide quarterly a complete list of investments in the portfolio with each item fully described, including the amount of each asset, its cost and market value, the estimated annual income it is expected to produce and the current yields on cost and market price. A summary statement is produced showing the composition of the portfolio by major asset category, such as reserves, industry classifications, etc. We also include a comprehensive report containing detailed analyses of the investment results. Investment results are expressed as a rate of return on the assets in the portfolio and are computed using generally accepted principles.

The Bank provides an annual accounting which includes the following:

1. Summary of transactions
2. Summary of assets
3. Analysis of investment return during the period
4. Statement of receipts and disbursements
5. Contributions to the fund
6. Payments from the fund
7. Expenses
8. Investments acquired during the period
9. Investments disposed of during the period
10. Investments held at the close of the period
11. Income accrued and/or receivable
12. Summary of brokers commissions.

As a basic part of our service, the Bank will also be responsible for the safekeeping of the physical assets of the fund. This function includes the following:

- We will receive and deliver either against payment or against receipt as the client requests
- We will provide daily advices describing the security transactions in each manager's account.
- Except for those securities eligible for inclusion at Depository Trust Company, we will store all securities in our underground vaults.
- We will process subscription rights, exchange of securities and calls for redemptions.

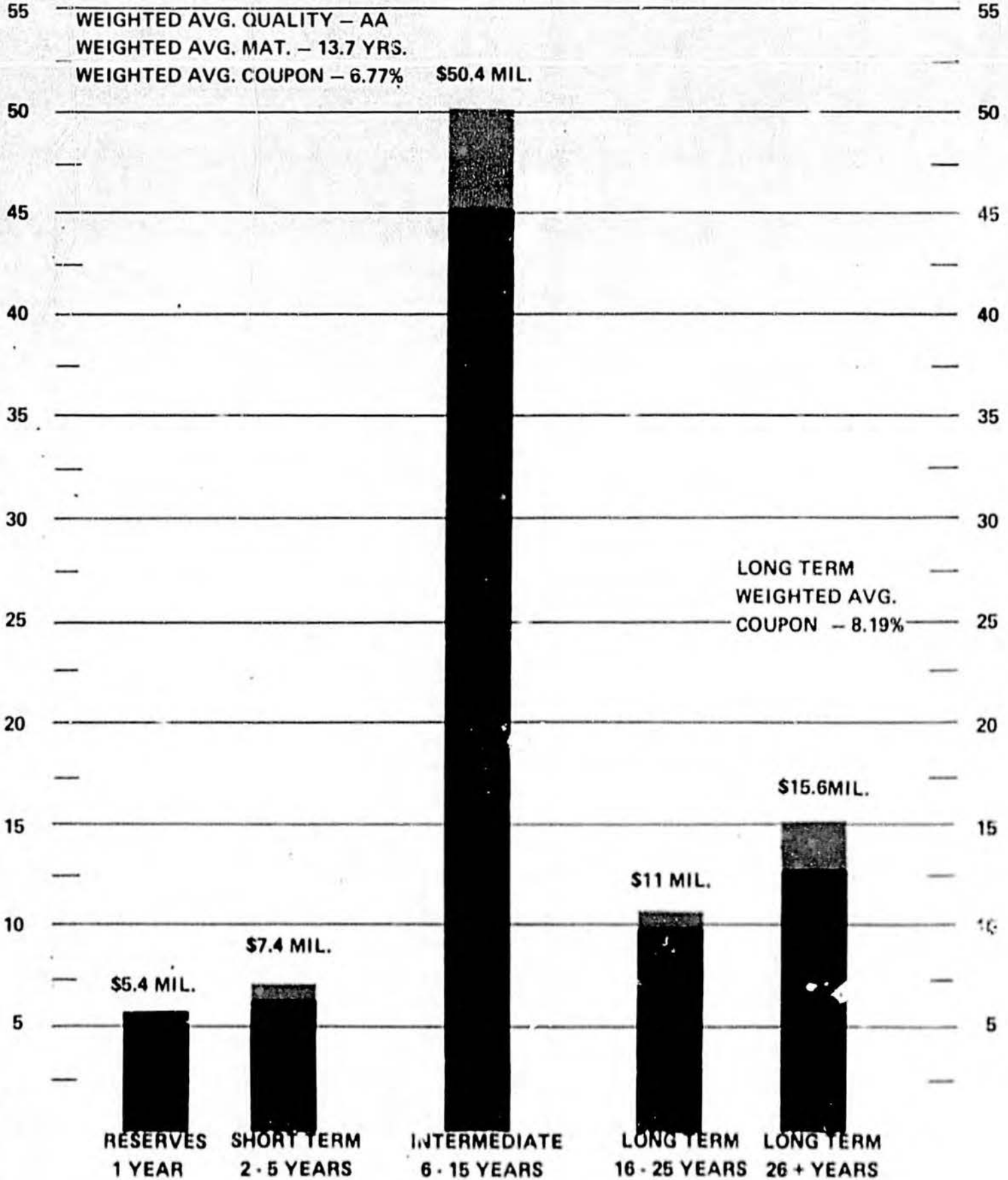
Group Trust Fixed Income Fund

DISTRIBUTION OF ASSETS BY MATURITY AND SECTOR

MARCH 31, 1977

\$ MIL.

\$ MIL.



U.S. GOVT. TREASURIES ■ CORPORATES
 U.S. GOVT. AGENCIES ■ OTHERS

- We will collect income and principal when due and credit the account on the payable date whether or not in fact we have received the payment.

CONCLUSION

The information in this booklet is designed to serve as a reference on the fixed income management capabilities of Manufacturers Hanover Trust. In summary, we would like to cite seven factors which contribute to the success of our program:

- 1) A history of commitment to fixed income management
- 2) An investment philosophy that seeks to preserve capital and earn a consistent, satisfactory return by investing in high quality companies
- 3) Our ability to cope with the realities of interest rate fluctuations and issuer credit deterioration
- 4) The four building blocks of fixed income management
- 5) The investment decision-making process
- 6) Our Specialized Support Group
- 7) The experience of our people.

We have attached a fee schedule for your review.

FEE SCHEDULE

Annual Fee Schedule

1/2 % on first \$ 1,000,000

1/5 % on next \$ 4,000,000

1/8 % on next \$495,000,000

1/10% on excess
over \$500,000,000

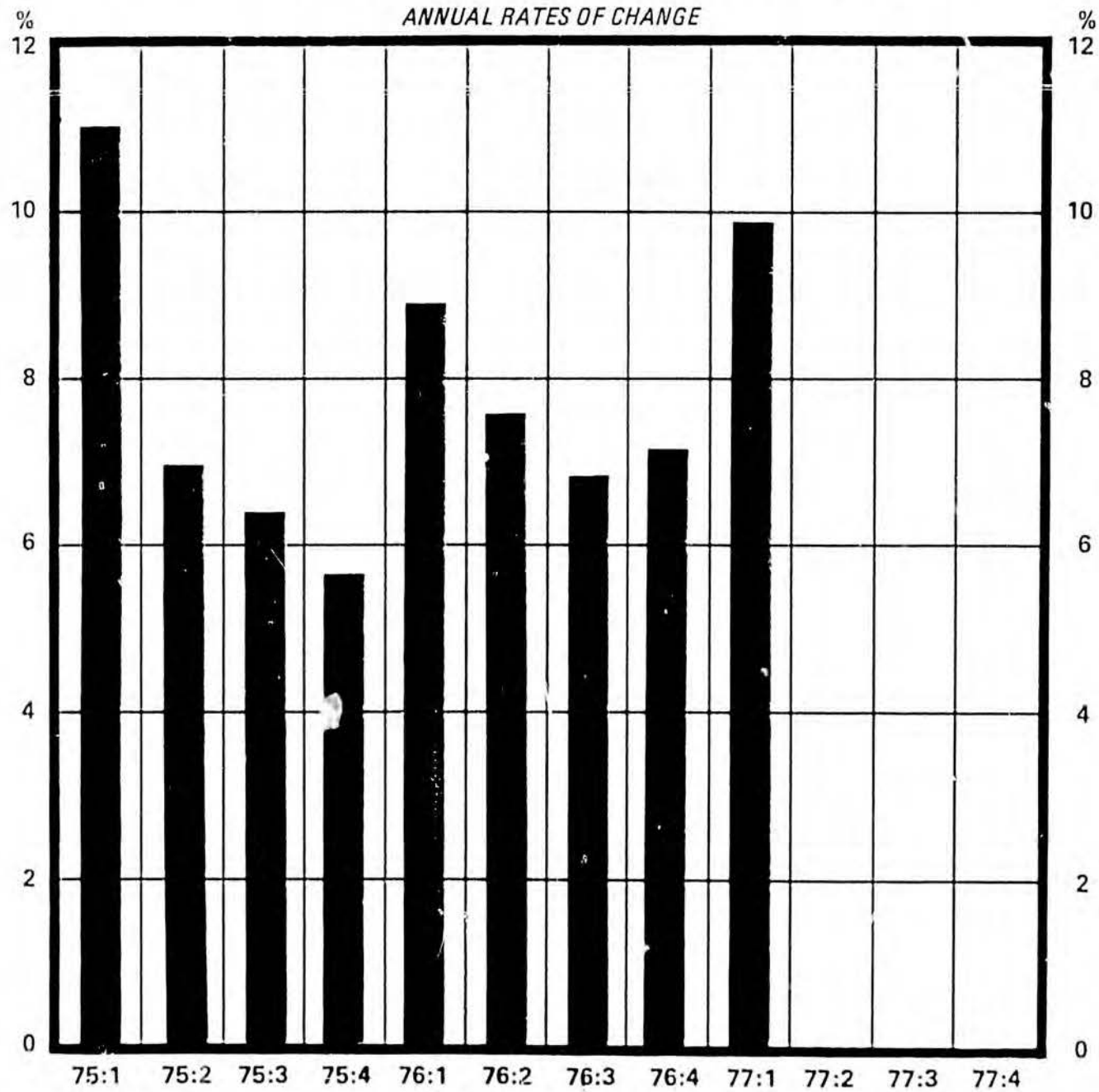
Minimum: \$5,000 per year

Benefit Payments:

For recurring payments: 60¢ plus postage per check
For lump sum payments: \$3.00 per check

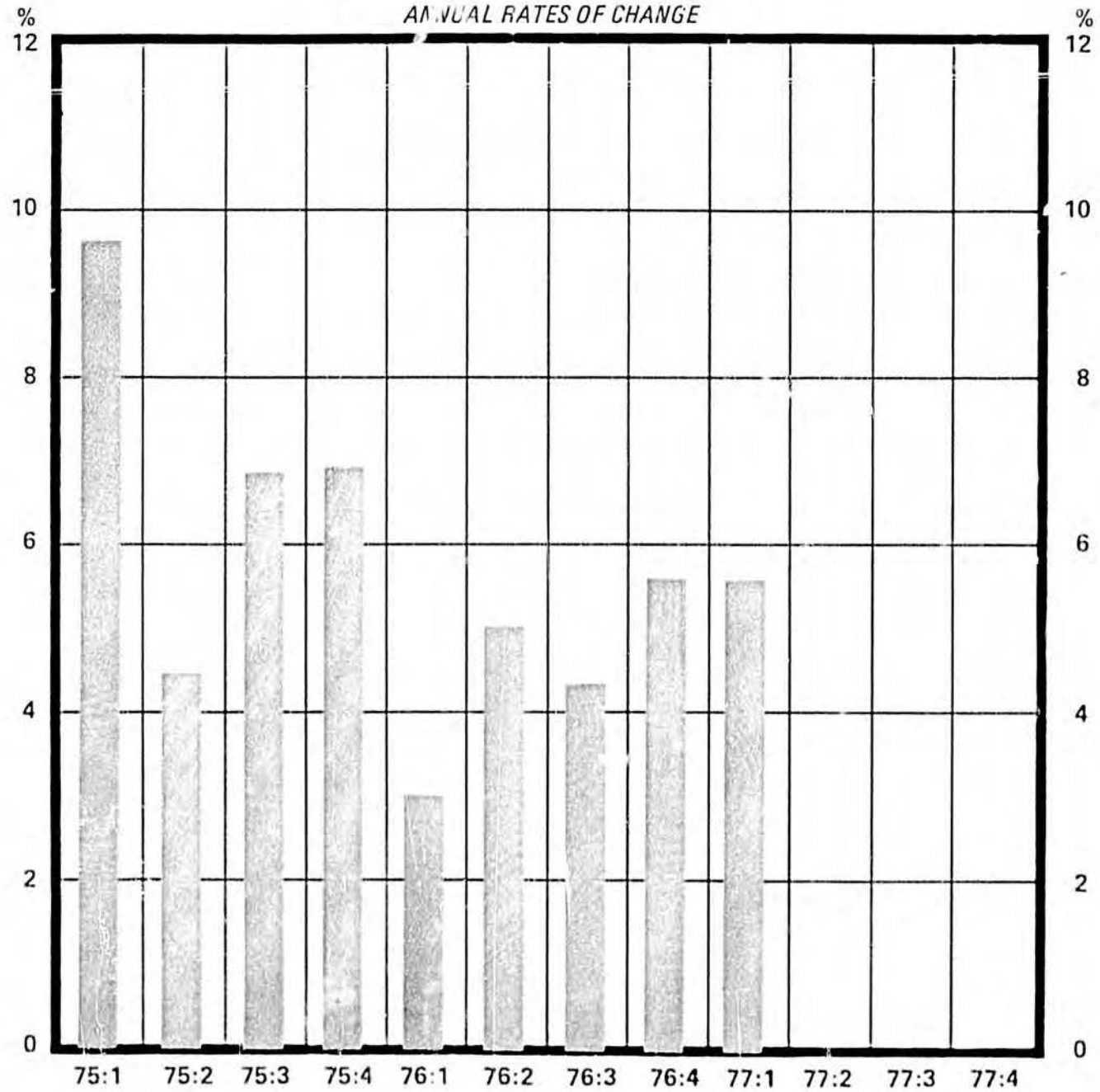
APPENDIX A

COMPENSATION PER MANHOUR

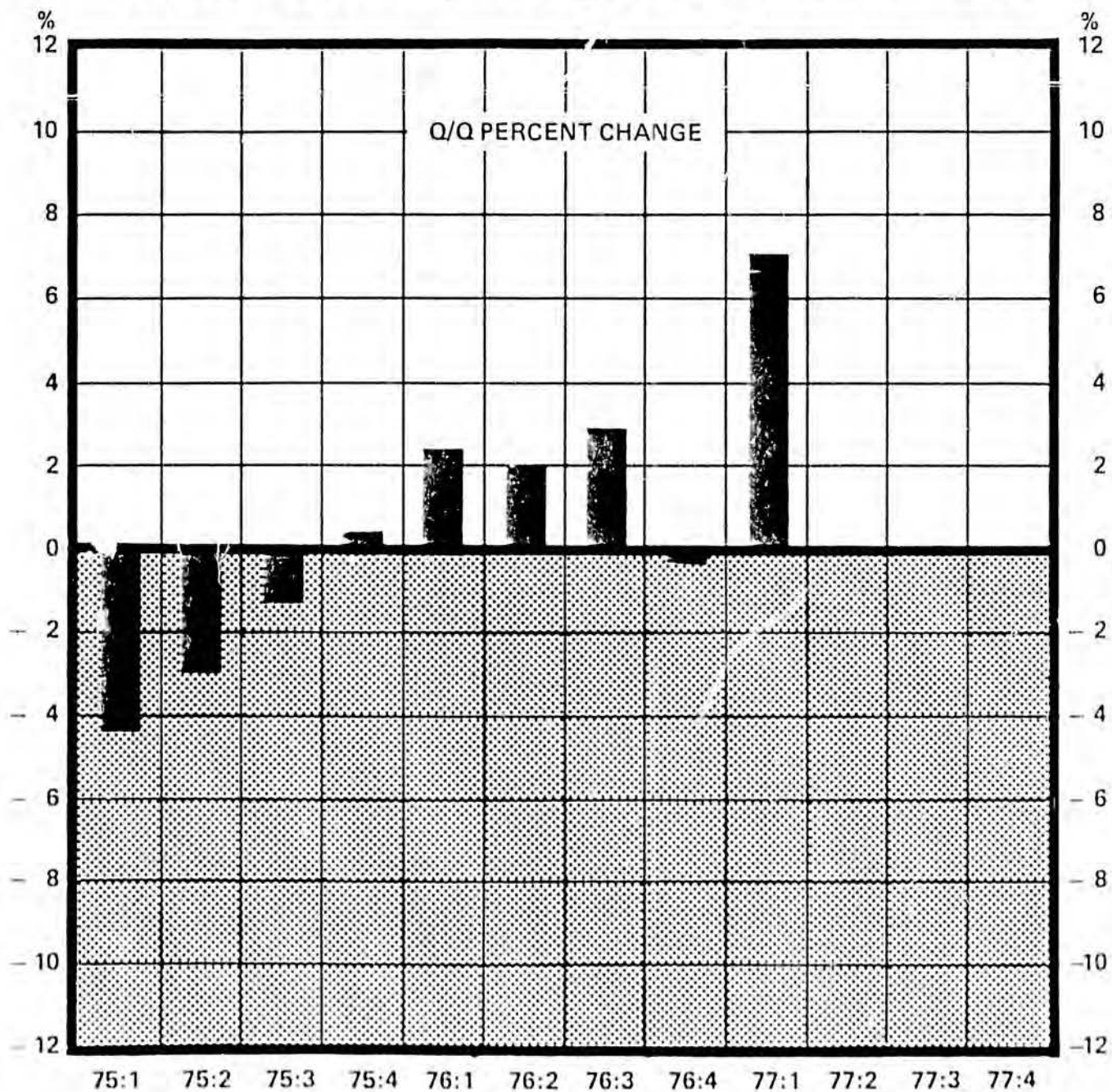


GNP DEFLATOR

ANNUAL RATES OF CHANGE

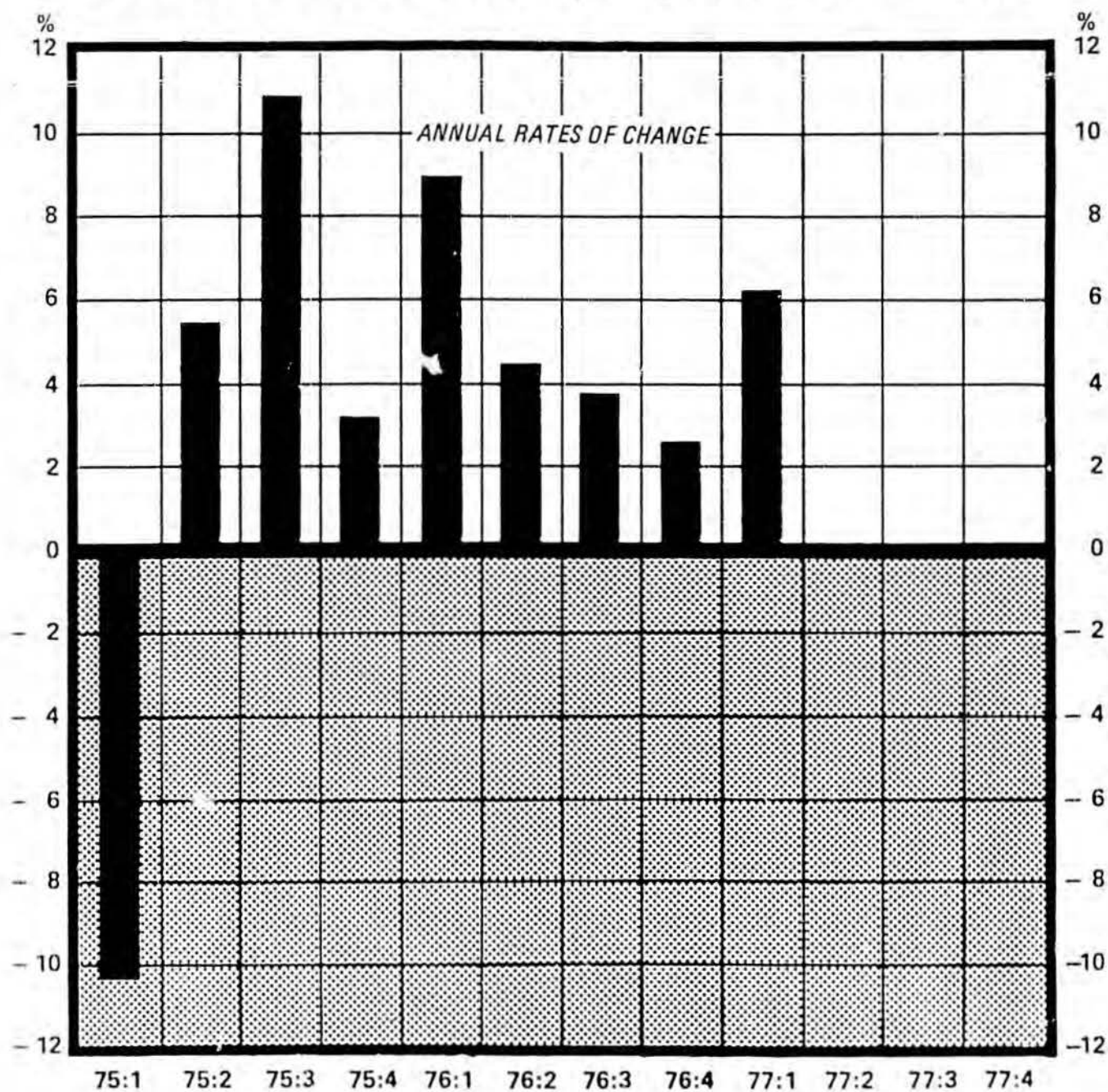


PRODUCERS' DURABLE EQUIPMENT CONSTANT (1972) DOLLAR BASIS



GNP

CONSTANT (1972) DOLLAR BASIS



Manufacturers Hanover Trust Company
Presentation To
The Special Legislative Committee
of
The Alaska Permanent Fund

Anchorage, Alaska

November 18, 1977

Participants:

Victor J. Melone, Jr., Senior Vice President
Willard L. Wheeler, Jr. Senior Vice President
Dimitri N. Balatsos, Vice President
Harald S. deRopp, Vice President
Joey L. McCandless, Vice President

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I. INTRODUCTION

Manufacturers Hanover Trust, a subsidiary of the Manufacturers Hanover Corporation, a publicly-held company traded on the New York Stock Exchange, is one of the world's largest banking groups with assets of more than \$30 billion. With over 700 employees at its Rockefeller Center location in New York City, the Trust Division, the nation's sixth largest trust entity, manages a total of \$11.5 billion of assets. Of this total \$7.5 billion represent accounts managed in the Pension Department and over \$4 billion represent endowment, foundation, personal trust, and insurance company accounts in the Personal Trust Department.

A more detailed accounting of the assets under management as of December 31, 1976 is outlined below and appears on page 2.

	<u>Number of Accounts</u>	<u>Market Value</u>
Tax Exempt Funds		
Employee Benefit - Separate Accounts	373	\$ 7.3 billion
Employee Benefit - Commingled Accounts	475	201.4 million
Total Employee Benefit	<u>848</u>	<u>\$ 7.5 billion</u>
Other	471	\$ 1.1 billion
Total Tax Exempt	<u>1319</u>	<u>\$ 8.6 billion</u>
Taxable Accounts (Personal Trust & Estate)	<u>7134</u>	<u>\$ 2.9 billion</u>
Total Accounts & Assets	8453	\$ 11.5 billion

The distribution of separately managed Employee Benefit (Pension Funds) is as follows:

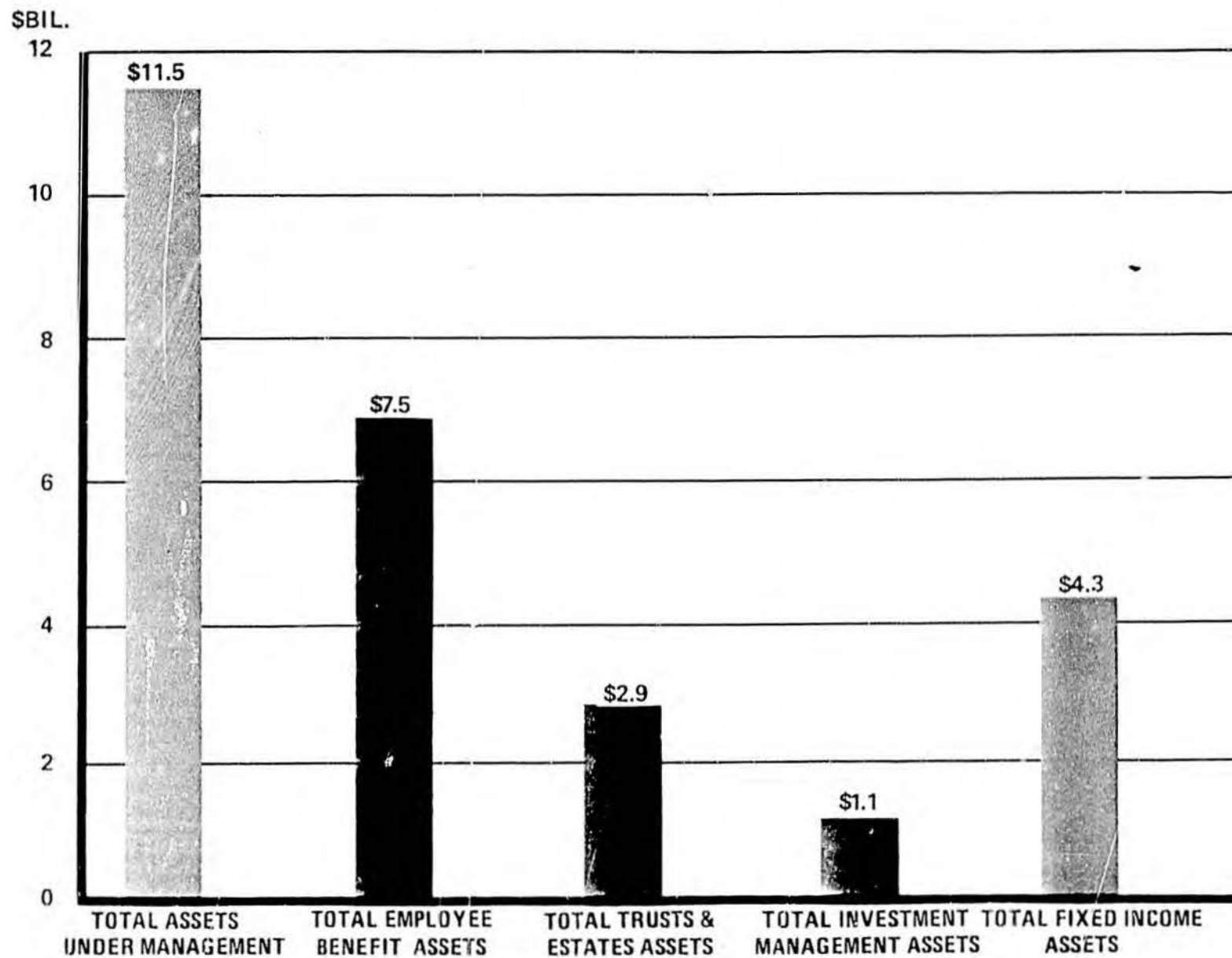
<u>Portfolio size</u>	<u>Number of accounts</u>
Under \$1 million	104
\$ 1- 5 million	117
\$ 5- 10 million	41
\$10- 25 million	50
\$25- 50 million	24
\$50- 100 million	22
Over \$100 million	15

Joseph L. McElroy, Executive Vice President and head of the Trust Division has the ultimate responsibility for all assets assigned to the Bank for management. Victor J. Melone, Senior Vice President and Senior Investment Officer directs basic investment strategy for the Division. The administration and supervision of Alaska Permanent Fund assets that could be assigned in the future would be managed in the Employee Benefit Trust Department which is under the direction of Willard L. Wheeler, Jr.,

SUMMARY OF ASSETS UNDER MANAGEMENT



MANUFACTURERS HANOVER TRUST



Senior Vice President. Mr. Wheeler's staff of ten portfolio managers includes Harald deRopp Vice President, who heads the Fixed Income Management Team at Manufacturers Hanover. Detailed organization charts appear on pages 4 and 5.

There are currently twenty-three analysts in the Research Department including three who devote full-time to the analysis of fixed-income investments. By virtue of the substantial value of assets under our management, we have access to major investment banking, bond and brokerage research firms which provide the Bank with a constant flow of information on world economic conditions and interest rates, as well as on specific issues and companies.

The Alaska Permanent Fund represents a unique investment challenge since the assets are public monies held in trust. Although public monies have different objectives than private pension funds, their fiduciary character as well as their size and tax-exempt feature make them comparable. Therefore, we will outline our investment alternatives for the Permanent Fund based on our long and detailed experience with public and private pension trusts. Before discussing the investment alternatives available to the State of Alaska, we will summarize the history of funds exempt from taxation.

II. HISTORY AND DEVELOPMENT OF FUNDS EXEMPT FROM TAXATION

The earliest pension plans in the United States were established almost a century ago on a pay-as-you-go basis with or without reserves which appeared as liabilities on the balance sheet. At that time, employers had the attitude that pensions were completely discretionary on their part, and therefore, they should have the ability to reduce benefits or discontinue plans at their will.

In the mid-1920's, insurance companies started issuing deferred group annuity contracts which involved the annual purchase of guaranteed benefits for employees covered by the plan. Subsequent variations of this are the deposit administration (DA) contract and the immediate participation guarantee (IPG) contract where amounts are deposited periodically into a single fund which is not allocated among the employees until they retire and annuities are purchased out of the fund on their behalf. IPG plans permit participation in gains or losses as they occur rather than being spread over the life of the contract as in DA plans.

In the 1920's, there were several trustee funds in existence, and there was minimal interest in common stocks. In fact, it was common for trustee plans to be restricted, by provision in the trust agreement or in practice, to investments permitted for life insurance companies. Insurance company guarantees were more acceptable mainly because supervision by the state insurance departments offered a feeling of security. In addition, insurance companies already had an accessible product and experienced personnel. Moreover, guaranteed rates of return available from these companies were more attractive as compared to market rates of return.

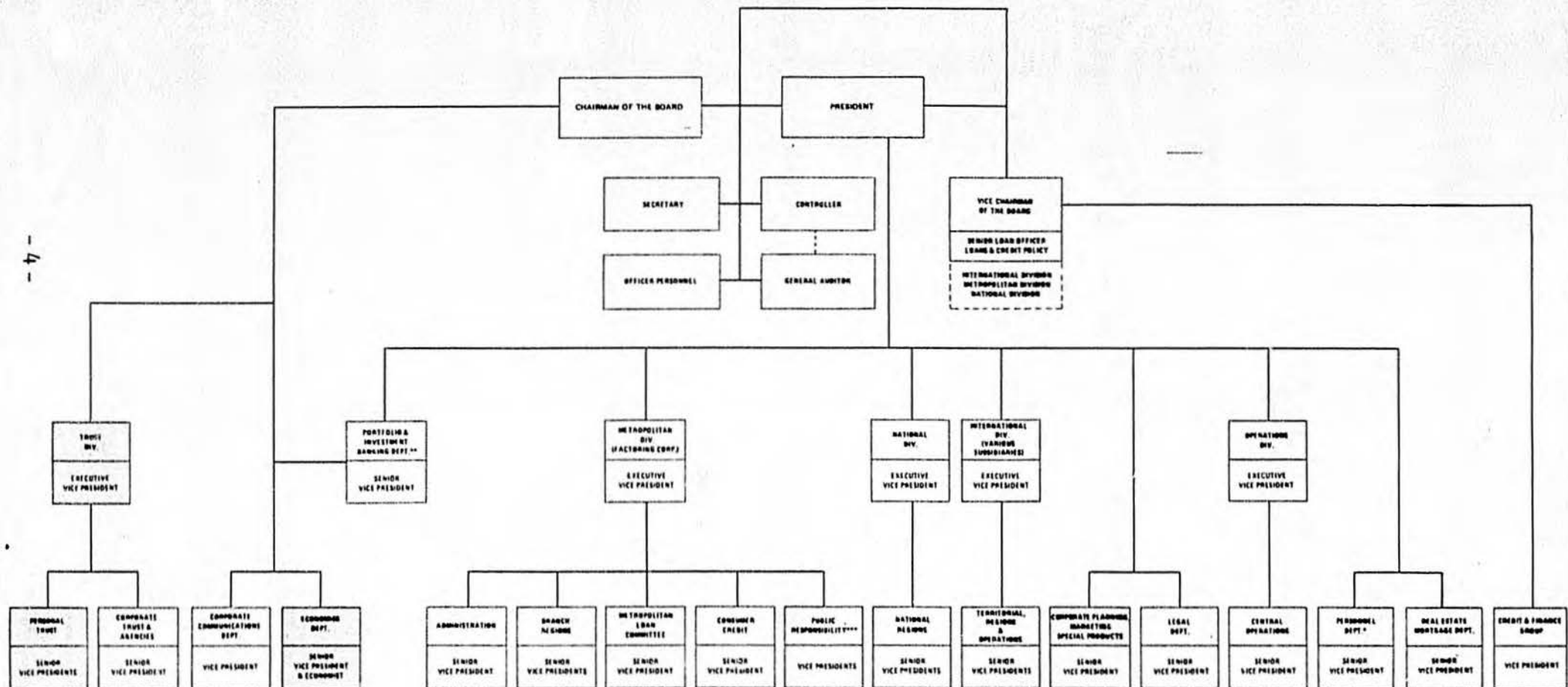
The chart on page 6 demonstrates the tremendous growth in private pension assets from \$40.8 billion in 1958 to \$240.5 billion in 1976 or a 489% increase in 18 years. The chart also shows a more rapid growth in non-insured pension funds (537%) as compared to insured pension funds (413%). As the terms imply, insured pension funds are those underwritten by insurance companies while non-insured funds are those

MANUFACTURERS HANOVER TRUST CO. ORGANIZATION CHART



MANUFACTURERS HANOVER TRUST

MANUFACTURERS HANOVER TRUST COMPANY BOARD OF DIRECTORS



JOSEPH L. McELROY
EXECUTIVE VICE PRESIDENT

TRUST DIVISION—INVESTMENTS
V. J. Melone, SVP

EMPLOYEE BENEFIT TRUST DEPARTMENT
W. L. Wheeler, Jr., SVP

Development
J. S. Ward, VP

Research
R. Abel, VP

Investments
H. M. Jervey, VP

Administration
T. F. Seifert, VP

**Industry-wide
& Public**

J. L. McCandless, VP

**Corporate
(Metropolitan)**

J. A. Spiezia, AVP
P. Borzuku, AVP

**Corporate
(National)**

H. W. Spring, AVP

Fixed Income

H. S. deRopp, VP
B. Bloom
J. D. Clark

Trading

J. Sullivan, ATD
F. Lally, ATO
R. Elliott

Common Stock

P. R. Doyle, VP
R. C. Ferrara, VP
L. H. Gerhard, VP
D. R. Larr, VP
D. F. Price, VP
J. Tarnoff, VP
R. H. Dent, AVP
P. F. Loughman, AVP
C. Sullivan

Trading

N. Martin, AVP
J. Carpenter, ATO
C. Harney
R. Jackson
W. Lyons
A. Scala

**Directed Accounts,
Master Trusts,
H. R. 10 & Agency**

V. J. Conlan, VP
B. Barless, ATO
H. H. Sandholm, ATO
M. Marcus, AM

**Pension, Profit Sharing,
Savings, S. U. B., Trasops,
IRA's, Index Fund, 501(c) (9)**

H. K. Bell, Jr., VP
V. Finamore, VP
R. J. Smith, VP
S. Malmid, AM
A. Juhasz

**Pension, Profit Sharing,
Commingled Funds**

F. Hoffman, AVP
M. V. Horan, ATO
G. J. O'Leary, ATO
E. C. Works, ATO
H. Gluesing, AM
M. Petrish

Industry-wide

R. Mackey, VP
L. Koller, ATO
R. Mell

Technical

E. V. Bader, AVP

Fixed Income

A. D. Segars, VP
T. Goepfert, AM
M. J. Tuttle

PIR/C

W. C. Petty, VP
C. Stevenson

Common Stock

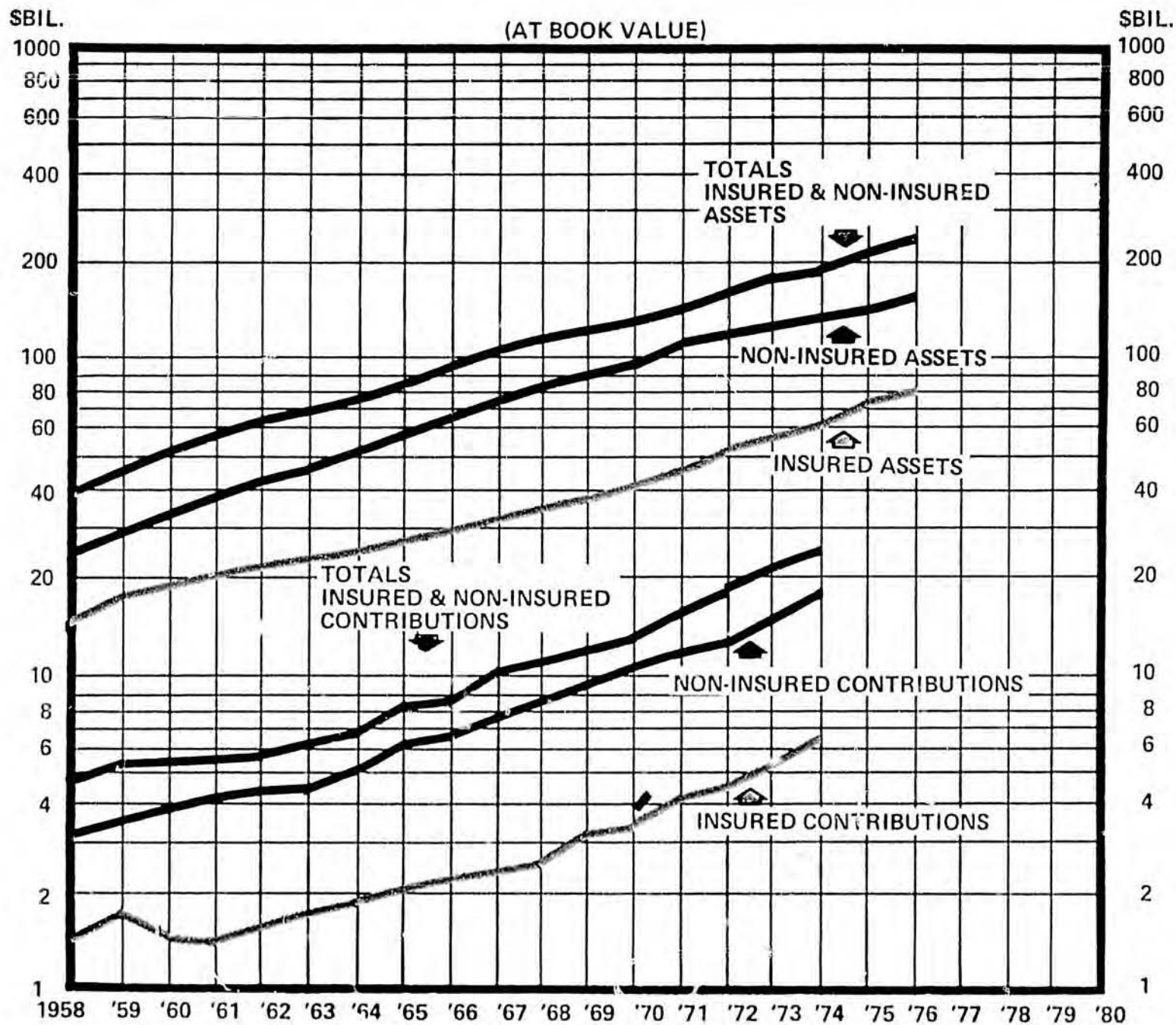
J. D. Adler, VP*
J. D. Gold, VP
J. Klein, AVP
C. W. Beal, VP*
R. L. Held, VP*
L. C. Winterfeldt, VP*
B. D. Bottomley, AVP
J. H. Lane, VP*
D. Rozanski, AVP
S. Farnham
K. Gamble
A. Schager
G. Balamaci, AVP
R. E. Manning, ATO
A. J. Stainman

*group head

INSURED & NON-INSURED PRIVATE PENSION PLANS CONTRIBUTIONS & ASSETS



MANUFACTURERS HANOVER TRUST



invested and administered without the use of insurance companies. Contributions to both insured and non-insured pension funds also increased rapidly during the same period.

The assets of state and local government retirement funds and annual contributions to those funds have also grown dramatically between 1958 and 1976. As the chart on page 8 shows, these assets grew from \$14.6 billion to \$111.5 billion or a 664% increase during the period.

The faster growth of non-insured pension plans could be attributed to several factors. One factor is the Federal income tax on the investment income of insurance companies which reduced such income by 1/4% or more. In contrast, non-insured funds had tax-exempt investment returns. Another factor is the inability of insurance companies to invest pension fund assets in equities, therefore crediting these assets with lower total portfolio returns. Banks also started strengthening their staff of trained sales, investment and administrative personnel. And most importantly, banks modified their investment practices of the pre-World War II period and wrote trust agreements with more flexible investment provisions.

By the middle 1960's, a sizable number of non-insured trust funds were invested 50% or more in common stocks. As shown by the chart on page 9 the investment by non-insured pension funds in common stocks reached an average of about 65% of total assets in 1972 and 1973 from 31% in 1959. The chart on page 10 also shows a marked increase in corporate stock and bond investments of state and local government retirement funds. A very distinct line is that of investments in Federal and state-local securities which showed a steep decline from 59% in 1959 to 6.4% in 1963, moving up to 11% in 1976.

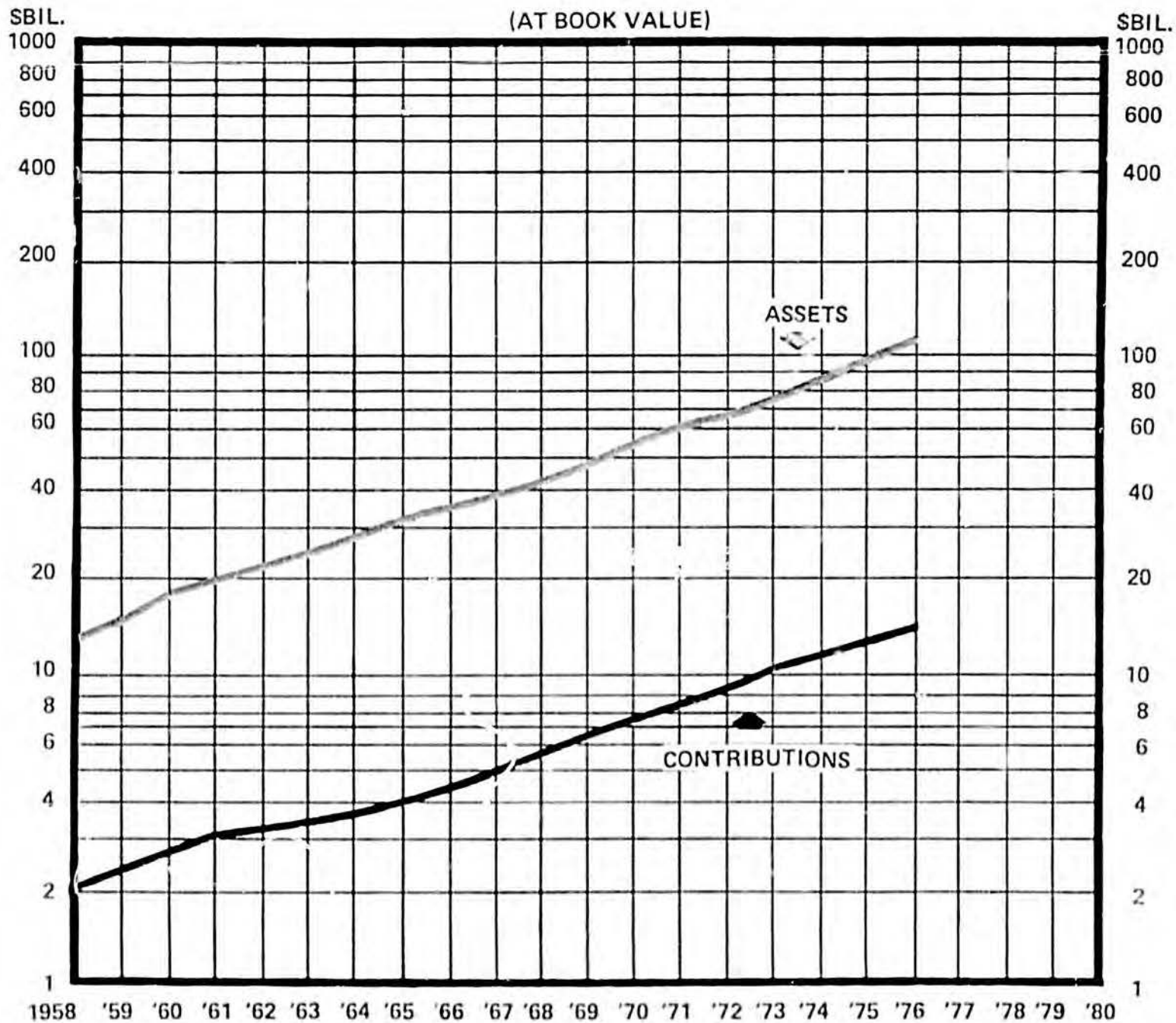
The shift to common stocks was caused by a desire to take advantage of the substantial rise in the value of corporate stocks in the 1960's and early 1970's, and an attempt to hedge the real value of investment portfolios against the effects of inflation which became serious in the late 1960's. This was important because of the rising costs of pension benefits, the base of which was shifting to three to five years' final salary as against career average salary to counter inflation. As pension liabilities and assets grew, performance became critical to the plan sponsors who increasingly felt the impact of fund contributions on their earnings.

The late 1950's and early 1960's saw some developments which inured to the benefit of insurance companies. The Federal Income Tax Law was amended to exempt the investment income on insurance company reserves held for qualified pension plans, thus removing a portion of the competitive disadvantage of insurance companies. Many insurance companies also started adopting the "new money" method of allocating investment income to pension funds. Under this method, the results of each year's investments rather than total portfolio rates were allocated to the contract holders which provided money for these investments. Also, legislation permitting "separate accounts" or "segregated accounts" was passed in several states. These accounts are entirely independent of an insurer's general investment account, and therefore, do not offer any guarantees; actual investment results are shared by the participants.

STATE & LOCAL GOVT. RETIREMENT FUNDS CONTRIBUTIONS & ASSETS



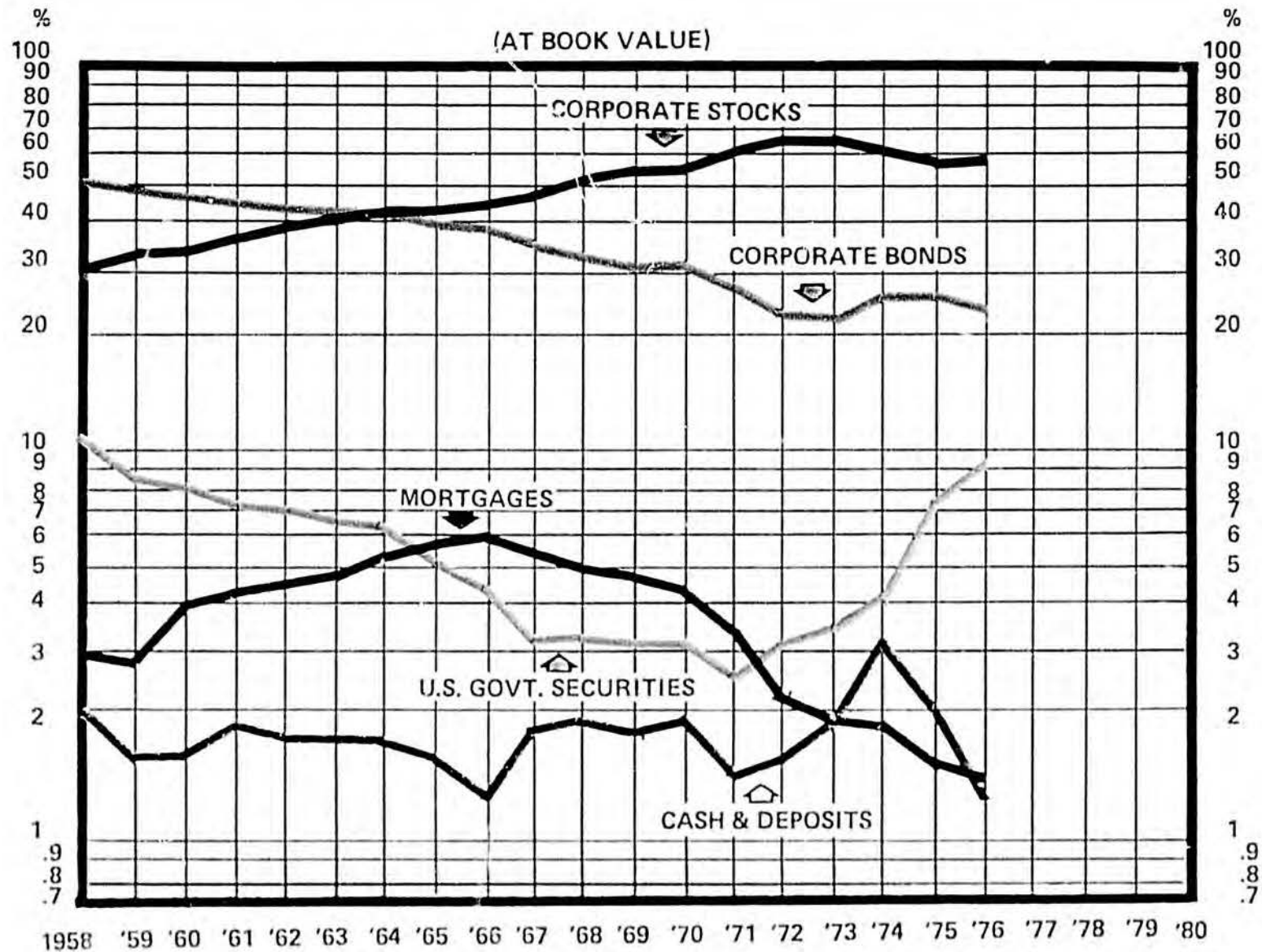
MANUFACTURERS HANOVER TRUST



NON-INSURED PENSION PLANS PERCENTAGE DISTRIBUTION OF ASSETS



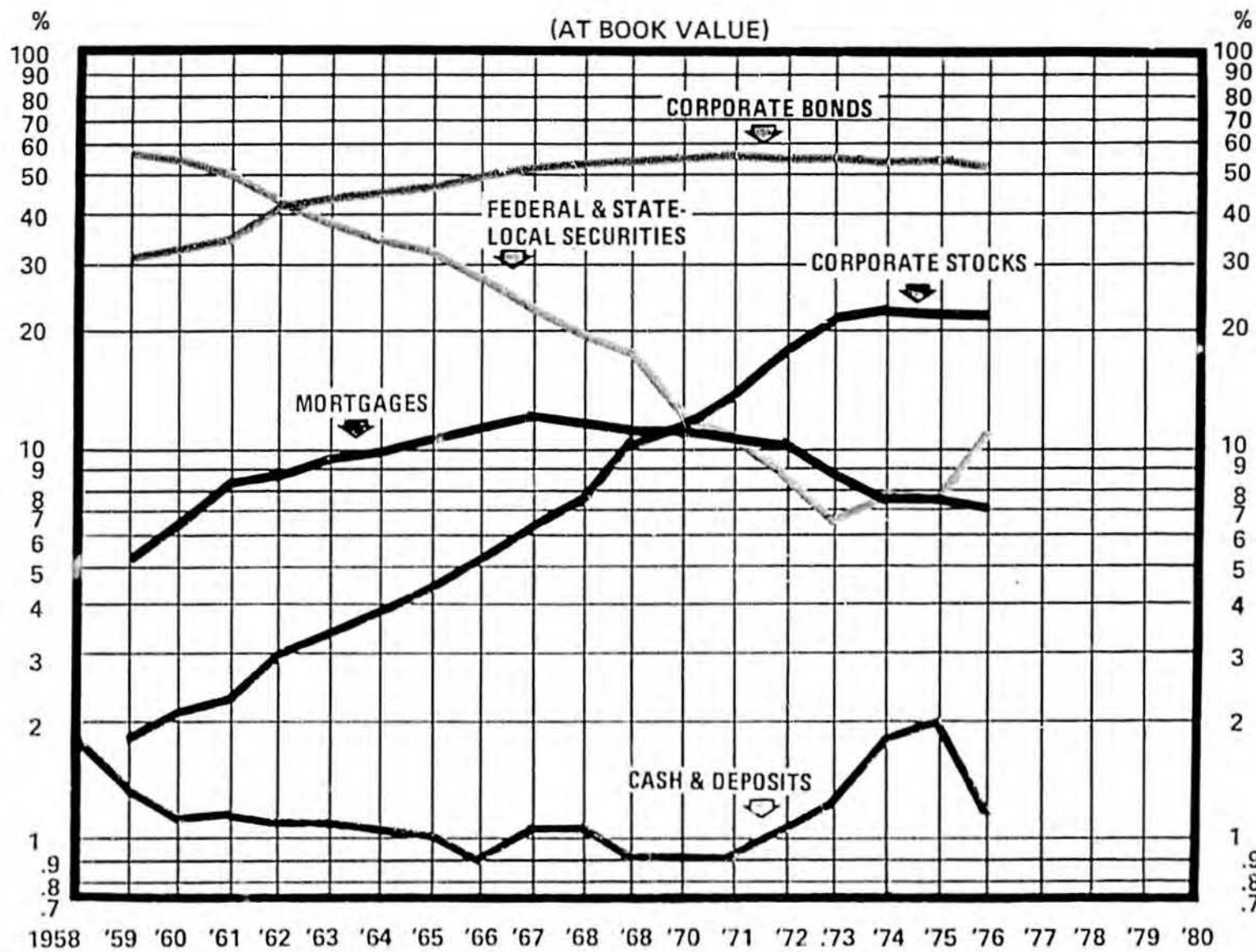
MANUFACTURERS HANOVER TRUST



STATE & LOCAL GOVT. RETIREMENT FUNDS PERCENTAGE DISTRIBUTION OF ASSETS



MANUFACTURERS HANOVER TRUST



Because of the magnitude of pension assets for management, other institutions such as brokerage firms and mutual funds started competing with banks and insurance companies. Lately, there seems to be a trend among private pension funds towards multiple investment managers for the purpose of spreading risks. Presently more than 80% of the 346 largest corporations use more than one investment manager. A 1977 survey of public pension funds by Greenwich Research Associates however shows that only 20% of 120 public funds responding use three or more managers. 25% use two managers, and the balance of 55% still employ one manager. The survey also shows that 11% of 137 responding funds are managed internally and the balance of 89% are managed by banks, insurance companies, brokerage firms and investment counseling firms.

A continuous growth in contributions and pension fund assets is projected for the future. These assets are the fastest growing source of savings in our economy and are expected to provide much of the debt and equity capital of American corporations. The sheer size of these funds will inevitably attract more competition and lead to increased product innovations among banks, insurance companies, and other investment managers. At the same time, as the next section will demonstrate, there has been an increased awareness of the importance of integrity, financial responsibility and experience in the funds' choice of investment managers.

III. IMPACT OF ERISA

The Employee Retirement Income Security Act (ERISA) was enacted in 1974 to protect the rights of pension plan beneficiaries. Protection is provided against such things as: overly restrictive requirements for participation in pension plans, failure to provide pension plan benefits to participants who leave before retirement, mishandling of assets, inadequate rate of build-up of pension assets, and termination of plans with assets insufficient to pay participants. As a result, ERISA has imposed a number of procedures and guidelines for pension funds to follow. This discussion will not attempt to cover all aspects of the Act, but will present the areas that may be of interest to the administrators and managers of the Alaska Permanent Fund.

ERISA does not presently apply to certain plans such as governmental plans, church plans, and plans maintained outside the United States for the benefit of non resident aliens. However, bills such as the Public Employees' Retirement Income Security Act have been introduced to extend ERISA'S standards to public plans. Full extension is not expected for constitutional reasons, but the fiduciary standards of ERISA may be used as guidelines in cases involving fiduciary money such as public pension funds and other public monies.

A fiduciary, according to ERISA, is "any person who exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, or renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of such plan, or has any authority or responsibility to do so, or has any discretionary authority or discretionary responsibility in the administration of such plan." Under this definition, the members of the plan's investment committee are fiduciaries, and so are the investment advisors, and other consultants.

The basic duties of a fiduciary under ERISA are the following:

1. To act in accordance with the prudent man rule;
2. To operate the plan for the exclusive benefit of the participants;
3. To diversify the investments of the plan to minimize the risk of large losses; and
4. To prevent the plan from engaging in certain prohibited transactions.

The prudent man rule enunciated in ERISA states that each fiduciary must act "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in conducting an enterprise of like character and with like aims". The original prudent man rule which was formulated in 1830 dealt mainly with a trustee's conduct in the investments of funds. ERISA's prudent man standard is applied to all actions of a fiduciary regardless of whether or not they involve investments. Furthermore, ERISA's specific requirement that a trustee be familiar with the matters he acts on is not contained in the original rule. The courts are expected to interpret the prudent man rule in conjunction with the special nature and purpose of employee benefit plans.

A plan fiduciary is expected to act for the exclusive benefit of the plan's participants and beneficiaries. This requires, among others, that the plan assets are never to be returned to the employer except under certain limited conditions.

Another mandate for a fiduciary is that he diversify the plan assets to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so. In determining the degree of diversification, the facts and circumstances of each case must be considered. The factors to be studied are the plan's purpose, the size of the plan's assets, and financial and industrial conditions. The portfolio should reflect diversification by type of investment, geographical location, industrial classification and dates of maturity.

ERISA also prohibits fiduciaries and parties-in-interest from engaging in a number of so-called prohibited transactions. A party-in-interest includes (1) a plan administrator, officer, fiduciary, trustee, custodian, counsel or employee; (2) a person providing services to the plan; (3) an employer, any of whose employees are covered by the plan; (4) employee organizations with members covered by the plan; and (5) certain relatives and partners of parties-in-interest. Plan fiduciaries and parties-in-interest are prohibited from engaging, for their own account, in a number of specific transactions which involve the plan's assets or income. Certain transactions are exempt from these provisions especially when they are made according to established business practices, and when adequate safeguards are provided to the plan and its beneficiaries.

A fiduciary who breaches the fiduciary requirements of ERISA is penalized under the labor and/or tax provisions of the Act. The labor provisions make a fiduciary personally liable to the plan for losses resulting from the breach. Profit made through improper use of assets should be turned over to the plan, and the courts may order removal of the fiduciary under appropriate civil actions. Insurance may be purchased by a fiduciary or by the employer to cover the fiduciary's liability, but it cannot be paid for with plan funds.

Under the tax provisions of ERISA, civil penalties are in the form of a two-level excise tax. The first level is at the rate of 5% per year of the amount involved in the breach. The second level is at the rate of 100% per year of the amount involved, imposed if the transaction is not corrected within 90 days after the Internal Revenue Service mails a notice that the 5% tax is due.

IV. OTHER SERVICES AVAILABLE TO A LARGE PUBLIC FUND

Before discussing the details of our investment approach, members of the Committee should be aware that there are other ancillary services available from financial institutions to aid in the management of large public funds.

A. Custodial Service

Most public pension funds prefer to place their securities in safekeeping with a bank, preferably one located in a money center where custody of assets will provide efficient handling of security transactions, the collection and disbursement of principal and income, accurate record-keeping and timely reports. These advantages can be realized while the fund sponsor or appointed investment manager retains complete control of the management of the assets.

B. Performance Measurement

Investors increasingly look to performance reports for measurements that reflect differences in the skill of fund managers. Both sponsors and investment managers use performance reporting to develop and communicate investment objectives which are well conceived, practical, and clearly stated. Performance reports support a constructive dialogue between the manager and client to understand the sources of past performance and the possibilities for improvement in future performance.

C. Master Custodial Reporting Service

Should a fund employ several investment advisors, uniform reporting treatment of the assets is needed. A Master Custodial Reporting Service can be provided by a number of larger banks whether or not a Bank acts as trustee. Providing the assets are in its custody, a bank can provide through this Service, an overview of the total funds' results by reporting on each investment advisor and the total fund. Under such an arrangement, advisors are selected by the fund administrators and the advisors in turn direct the transactions of their respective portions. Each advisor is treated as an account of the total fund.

D. Index Fund

Many banks and a number of non-banking institutions have Index Fund capability. It is estimated that over \$3 billion of pension assets or 1% of the approximate \$320 billion in Public and Corporate non-insured retirement assets at the close of 1976, are currently invested in Index Funds. Many of the larger pension funds, especially those already employing more than several advisors, have invested a portion of their equity funds in Index Funds primarily to provide further diversification of investment strategy.

E. Short-Term Investment Management

Many pension funds utilize short-term investment funds to provide more efficient management of their assets. Short-term (fixed income) funds are used primarily to relieve investment advisors of the burden of maintaining temporary investments for market timing purposes; to invest new monies temporarily for the plan administrator before distribution to investment advisors; and to insure that all funds are earning a return at all times.

V. INVESTMENT STRATEGY

The following brief sketch of historical rates of return on various asset classes suggests that successful investing cannot be undertaken lightly.

Below is a table which shows the nominal and inflation adjusted total annual returns (including interest, dividends and capital gains or losses) for four asset classes during the periods 1926-76 and 1966-76.

TABLE I

TOTAL RATE OF RETURN
(Percent Per Annum Compounded Annually)

	1926-76	Standard Deviation	1966-76
Common Stocks	9.2%	22.4%	5.0%
Long-Term Corporate Bonds	4.1	5.6	4.9
Long-Term Government Bonds	3.4	5.8	4.2
U.S. Treasury Bills	2.4	2.1	5.6
Consumer Price Index	2.3	4.7	5.6
Common Stocks, inflation adjusted	6.7	22.6	-0.7
Long-Term Corp. bonds, inflation adjusted	1.7	7.8	-0.8
Long-Term Govt. bonds, inflation adjusted	1.0	8.1	-1.3
U.S. Treas. Bills, inflation adjusted	0.0	4.6	-0.1

Several observations can be made from the above table for the period 1926-76.

1. U.S. Treasury bills, considered a riskless investment, failed to earn a real return.
2. Common stocks had the highest real return but experienced appreciable volatility. Further examination of the data indicates that there were long periods of time when the return was negative.
3. Long bonds had a positive real return and the returns were considerably less volatile than those of common stocks.
4. Inflation and volatility have impacted significantly the annual returns on various classes of assets.

U.S. Treasury bills, did no better than the 2.3% inflation rate over the period, from 1926 to 1976. While common stocks did appreciably better than the other assets, their returns were decidedly more volatile. Common stocks returned 9.2% per year compounded annually and the inflation-adjusted return was 6.7% per annum. The standard deviation of the annual nominal returns was 22.4%. That is, in 34 of the 51 years, the annual return ranged from plus 31.6% to minus 13.2%. During the entire period the common stock annual return ranged from plus 54.0% to minus 43.3%. Stock returns were positive in 34 of the 51 years. The longest period an investor would have earned a negative return in real terms covered the 15 year and 2 month period from mid-1959 through 1974.

In contrast to U.S. Treasury bills, long-term bonds earned a positive real return over the period 1926-76 and, as you would expect, the annual returns were significantly less volatile than those of common stocks, (Refer to the Charts on pages 16 to 18.)

Long-term corporate bonds returned 4.1% per year compounded annually while the inflation-adjusted annual return was 1.7%, again with significantly less volatility than that for stocks. (See Charts on pages 16 to 18.) The standard deviation was 5.6% or similar to that of long government bonds. Long-term corporate bonds had positive returns in 41 of the 51 years of the period and their returns ranged from 18.7% in 1976 to -8.1% in 1969. Although the real return from long corporate bonds was less than from stocks, it was appreciably less risky.

The return from long-term U.S. government bonds more closely approximated that of corporate bonds. Over the period 1926-76 they returned 3.4% per year compounded annually. The standard deviation was 5.8%. The inflation-adjusted or real return was 1.0% per annum. Long-term government bond returns were positive 38 out of the 51 years. And although the annual returns ranged from 16.8% to -9.2%, in two-thirds of the 51 years they ranged from 9.2% to -2.4%. Therefore, these annual returns were much less volatile than those of common stocks. (See charts on pages 16 to 18.)

Over the period 1926-76 U.S. Treasury bills returned 2.4% per year compounded annually. The return approximated the 2.3% inflation rate as measured by the Consumer Price Index. The standard deviation was 2.1%. In two-thirds of the 51 years of the survey, the annual return ranged from 4.5% to 0.3%. So although this asset had the lowest volatility and therefore the least risk, its real return (inflation-adjusted) was 0.0%.

In the most recent ten year period, 1966-76, a time when the annual rate of inflation was a high 5.6%, all of these classes of assets had a negative real return ranging from -0.1% for U.S. Treasury bills to -1.3% for long-term government bonds.

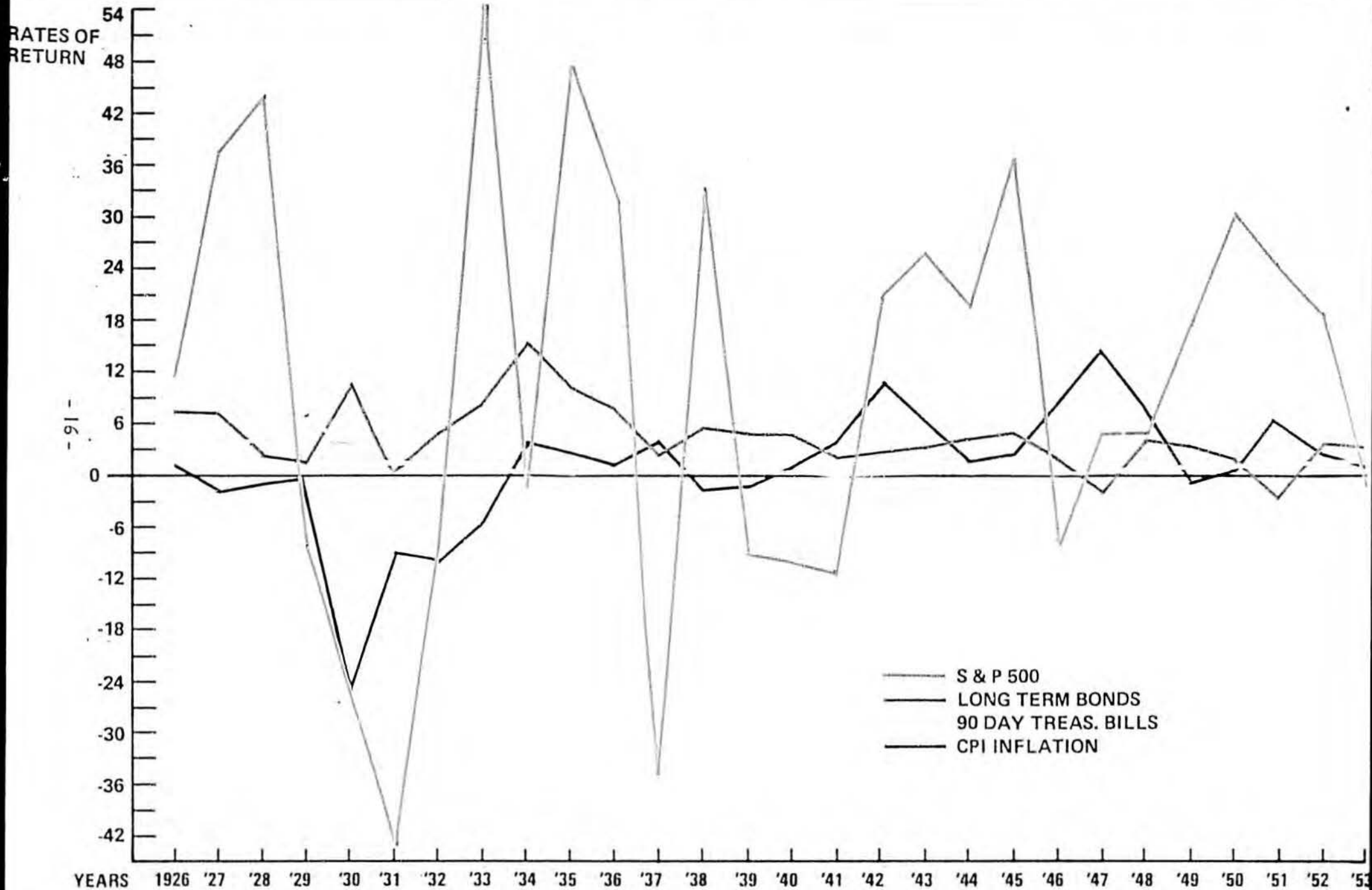
As these results demonstrate, successful investing is a complex task that requires a multitude of specialized skills and resources. As a large commercial bank, Manufacturers Hanover is able to make the commitment to those resources, and in particular to those specialized skills necessary to accomplish the client's investment objectives.

In our case the commitment begins with senior management who are experienced investment professionals supported by a large and specialized staff. This senior management comprises the Senior Investment Committee which formulates

VARIOUS RATES OF RETURN



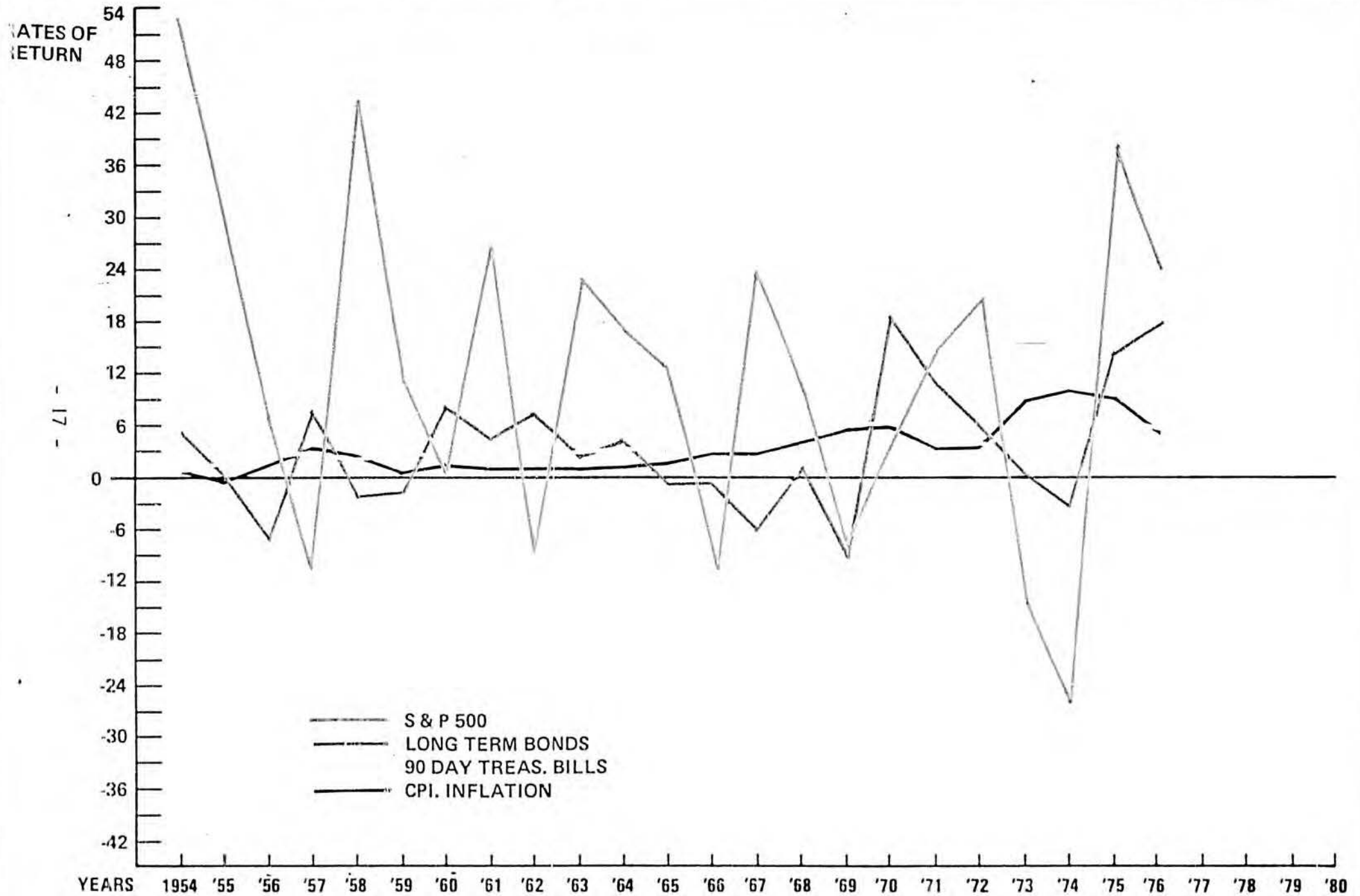
MANUFACTURERS HANOVER TRUST



VARIOUS RATES OF RETURN



MANUFACTURERS HANOVER TRUST

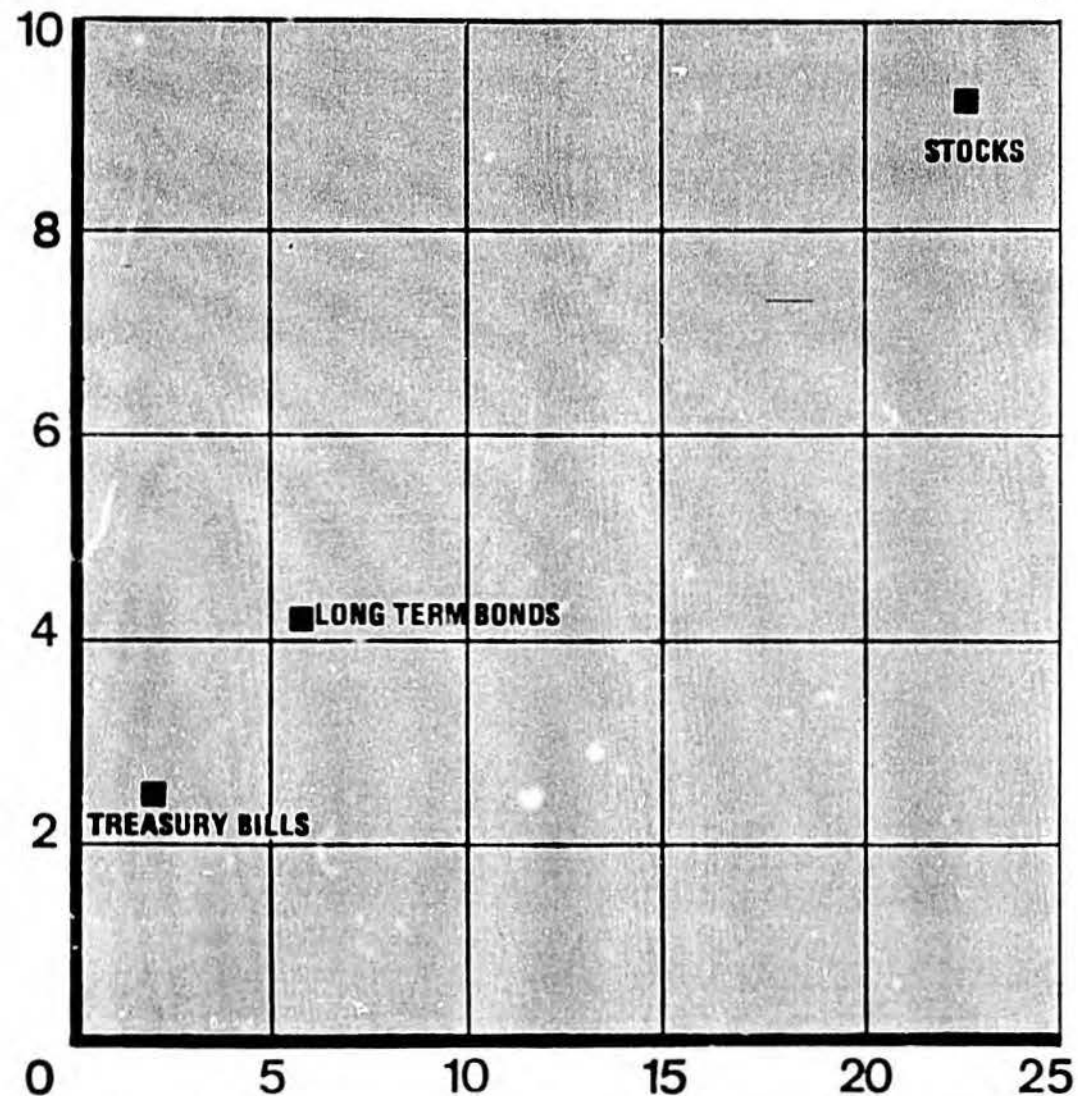


COMPOUND ANNUAL RATE OF TOTAL RETURN 1926-1976 [%]



MANUFACTURERS HANOVER TRUST

COMPOUND
ANNUAL RATE
OF TOTAL RETURN
1926-1976 (%)



STANDARD DEVIATION IN RATE OF NOMINAL TOTAL RETURN (%)

investment policy for the Trust Division with the Senior Investment Officer as Chairman of this Committee. The other members are the head of the Trust Division along with the heads of the Employee Benefit Trust Department and Personal Trust Department, the Director of Investment Research, the heads of the three Portfolio Management Departments, and the group leader in charge of fixed income research.

The primary task of this Committee is to develop an economic overview and to forecast the money and capital markets with particular focus on the direction of short and long-term interest rates and stock prices. It also establishes diversification policy, approves the Recommended List of securities and forecasts the relative attractiveness of sectors of both the equity and fixed income markets. In these tasks it is supported by the Economic, Equity and Fixed Income Research Departments.

Manufacturers Hanover Trust has its own Economics Department consisting of five economists and a supporting staff. The Department is headed by Dr. Tilford C. Gaines, Senior Vice President. Dr. Irwin Kellner, Vice President, is our domestic Economist; Dimitri Balatsos, Vice President, specializes in the financial and capital markets and William Schwarz, Vice President, specializes in the foreign economies. These economists are among the most respected experts on the United States as well as the European economies and contribute to the management process by participating actively in the Senior Investment Committee meetings.

The Economics Department, together with input from respected economists of leading investment firms, provides the strategic economic data needed by the Senior Investment Committee to make its economic and money and capital market forecasts in order to formulate a dynamic investment strategy.

In the case of Manufacturers Hanover, the equity management staff in the Pension Department consists of three separate groups working under the direction of the Senior Investment Committee:

First, is a group of ten portfolio managers each of whom manage equity accounts. One manager devotes his entire time to managing a portfolio of small capitalization companies and a second portfolio manager specializes in companies of intermediate-sized capitalization. The primary responsibility of the other eight portfolio managers is to construct a portfolio consistent with the investment policy and strategy established by the Senior Investment Committee and consistent with the unique objectives of the client. The manager is responsible to both the client and the Committee for the investment performance of each account.

Second, an equity research group of sixteen Security Analysts and a supporting staff whose function is to prepare and maintain a Representative Stock List from which portfolio managers select individual securities. Each analyst is a specialist on one or more industries and one analyst is a specialist on smaller companies. The group maintains current investment appraisals of over 25 major industries and more than 300 U.S. corporations. The equity research staff prepares monthly a proprietary Earnings Ranking report which ranks those securities in the Representative List in order of expected earnings per share change for each of the next two consecutive years. In addition, to identifying potential valuation risk or opportunity relative to all equity issues in our universe and to the S&P 400, the staff prepares a monthly

Valuation Screen report. This decision-making tool ranks issues in our Representative List to determine value, utilizing four series of data which focus on the expected or future performance of a security rather than only historical data.

The third part of our equity staff is a Specialized Support Group--a team of ten specialists, reporting to the head of Investment Research, Rudolph Abel, Vice President. Each is responsible for an important function necessary to actively and effectively manage equity portfolios. One individual, a specialist in modern portfolio theory and practice, evaluates investment decision-making techniques and systems. Another evaluates econometric models and analyzes and synthesizes the various economic forecasts available to us. In addition this individual provides sector analysis, identifying those segments of the economy that can be expected to show unusual strength or weakness. We have one individual who coordinates and synthesizes the research product available from the leading investment banks and consultants. One individual investigates and recommends specialized equity securities, such as convertible preferred stock and private placements. Lastly, this Specialized Support Group has within its structure six equity traders--five of whom trade blocks; one who specializes in over-the-counter issues; one who trades options; one who specializes in new issues; and one who specializes in arbitrage.

Our fixed income management staff also consists of three groups:

First, in the group of ten portfolio managers, three manage fixed income securities for pure fixed income accounts only.

Second, a Specialized Support Group - a team of six fixed income specialists providing analytical and trading capabilities and headed by Harald S. deRopp, Vice President. Each individual under his supervision is responsible for an important function necessary to actively manage fixed income portfolios. One individual devotes his entire time to developing swap situations and evaluating arbitrage possibilities. Another is responsible for cash management and short-term investments. We have one individual who investigates and recommends the use of specialized fixed income securities, such as primary and secondary private placements, convertibles selling on an investment value basis and Euro-dollar bonds. Lastly, this Specialized Support Group has within its structure three bond traders--one who specializes in Treasury issues and two who trade Agency, Corporate and Special types of debt issues.

The third part of our fixed income staff is a group of three Credit Analysts whose function is to prepare and maintain a Representative Bond List from which portfolio managers can make individual security selections. Each security listed in this Representative List is ranked by quality through our own Ratio Ranking System, a method of evaluating an issue's credit standing relative to all issues in our universe and relative to all issues within its particular industry.

Finally, in addition to our own staff, a bank of our size commands the attention of all leading investment bankers giving us easy access to their resources and investment information, preferential treatment in purchasing new issues and generally, first call on large blocks of debt and equity issues in the secondary markets.

To evaluate alternative investments effectively requires the systematic analysis of a broad range of economic opportunities and risks which could affect the valuation (and yields) of those alternatives. Our approach defines those opportunities and risks in

the form of four alternative economic and capital market forecasts which are judged as to their relative likelihood (probability) by the Senior Investment Committee. The use of probabilities in this approach is an indicator of the degree of uncertainty associated with the future. To the extent that one forecast is considered overwhelmingly more likely than the rest, the future is more certain than if in the extreme, all possible forecasts were considered equally likely. In our opinion, the level of uncertainty, in the current investor environment as measured by this set of probabilities directly affects the general level of stock prices, and, to a lesser extent, bond prices.

Specifically, we develop an economic forecast which appears to be the most likely path of economic events over the next 2 to 3 years, in the current case through 1979. It is this outlook, for example, which the Investment Research Department uses as an economic framework for earnings judgments for individual companies. It is also this "most probable" forecast which provides the basis for determining relative sector/industry performance and for estimating the demand for funds in credit markets, an important component of interest rate forecasts.

The possibility that economic events will not unfold as expected, is considered explicitly by developing other economic forecasts. Taken together, the set of economic forecasts is an attempt to define a full range of economic outcomes which have either favorable or unfavorable implications for U.S. credit markets. These forecasts are based both on objective economic analysis and subjective judgments about the future and do not contain forecasts which, while possible, represent catastrophic and essentially unpredictable events, such as drought, war, oil embargos and the like.

After the set of relevant forecasts has been defined and probabilities assigned, a capital market forecast is developed for each economic scenario. These capital market forecasts include forecasts of short, intermediate and long-term interest rates and stock prices. Specifically, forecasts are developed for 90 day Treasury bills, 12 AA Medium-Term Industrials, and Long-Term AA Corporate Bonds. The S&P 400 Index is used as a proxy for the general level of stock prices.

At present, our investment strategy is based on the following four economic forecasts for the period 1977 through 1979: (1) Extended Expansion; (2) Delayed Expansion; (3) Stagnation; and (4) Recession. Notably, while detailed forecasts have been developed for the entire three year period, the emphasis is intended to be on the years 1977 and 1978. The forecast for 1979 is more indicative of the trend of events at the end of 1978 than precise projections for 1979.

Among these four forecasts, the Extended Expansion forecast is considered the most likely, and is assigned a 49% probability. This forecast, however is considered more likely than the Recession forecast alternative which is accorded a 34% probability. The remaining two forecasts, Delayed Expansion and Stagnation, are assigned probabilities of 9% and 8%, respectively. Similarly, regarding capital markets, those forecasts which imply a generally favorable outlook for stock and bond markets are considered more likely (a combined probability of 58%) than those which favor short-term investments (42%). The following discussion includes: (A) our economic outlook; (B) specific risks to the forecast which are included in the alternative forecasts; and (C) the outlook for capital markets.

A. ECONOMIC OUTLOOK

The economy is expected to grow at average annual rates of 4-5% through 1979. These above trend rates of real growth, further, are expected to be accompanied by stable or only moderately rising inflation rates. This forecast is based on the view that, despite considerable near-term uncertainty, this economic cycle will not differ substantially from previous cycles and, specifically, that the capital investment required to sustain the momentum of the expansion will be forthcoming.

While this forecast may appear optimistic, there are several important trends which tend to support this view. First personal and corporate income has continued to grow rapidly through the first three quarters of 1977 despite concerns that cyclical forces would slow growth considerably. Second, while growth in consumption has outpaced growth in income resulting in a rise in the indebtedness of the consumer sector, confidence levels remain high and the consumer is more likely to continue to spend, though at lower rates, than to retrench. Finally, cyclical indicators of capital spending are showing strength. For example, the Conference Board Survey of Capital Appropriations estimates that new plant and equipment appropriations during the second quarter, 1977, were 24% above the second quarter, 1976, and that the number of industries reporting rising capital appropriations also had increased. In addition, the Commerce Department's series, contracts and orders for plant and equipment (a leading indicator of investment spending), has risen at about a 20% annual rate for the six months ending September, 1977. With production rising and corporate liquidity and interest rate conditions favorable, capital spending should begin to increase--though possibly less robustly than in past cycles.

Specifically this forecast shows business investment (in constant dollar terms) rising at a 9% annual rate in the fourth quarter, 1977, and continuing at similar rates each quarter throughout 1978. The continued delay of capital spending to the fourth quarter 1977 is due to a slowing in the growth of production which is expected during the second half of 1977. On an annual basis, this forecast shows real business investment rising 7% in 1977 and 7% in 1978 and 8 1/2% in 1979.

While capital spending is key to the continuation of the economic recovery, the consumer also is important--providing about 60% of total income and demand. This forecast indicates that the momentum of consumer spending is likely to slow slightly during the second half of 1977 and to begin to grow more in line with real personal disposable income. In real terms, total consumption is expected to grow 4.2% in 1977, 4.0% in 1978, and 3.3% in 1979. Consumer durable spending is expected to remain relatively strong throughout the period, increasing more than 10% in real terms in 1977, 3% in 1978 and 5 1/2% in 1979. Durable spending which was concentrated in autos during the first half of 1977, shifted to housing related and other durables in the third quarter and is expected to continue to favor housing-related products throughout 1978.

The rate of inflation is expected to remain relatively stable through 1978 and then rise in response to normal cyclical pressures on unit capacity. In part, the stability of prices during this period is due to an expected moderation in compensation increases. This forecast shows compensation per man-hour rising to an 8% annual rate during 1977 and then declining in subsequent years to about a 7 1/2% annual rate. Wage increases are expected to moderate because of the close relationship between the

trend in wages and the trend in prices in previous periods which has become apparent since 1970. Prior to 1979, wage changes tended to precede price changes, but, since that time, wage changes have lagged price changes. Since inflation rates generally have declined or remained stable for the past two and one half years and are expected to remain stable except to the extent they are affected by commodity-based price shocks, the pressure on compensation for "inflation catch-up" should lessen. Moreover, recent data for average hourly earnings, which are considered by the Bureau of Labor Statistics as the single most reliable measure of wage change, increased at a 6.3% annual rate during the March through September quarter and a 7.8% annual rate since December, 1976. The declining trend in this series suggests that the 9% increase in compensation per man-hour for the first half of 1977, also is likely to decline. Based on this wage outlook, unit labor cost increases are expected to average 5 1/2% through 1979.

While volatility in food and other commodity prices could contribute additional percentage points to the inflation rate, pressure on inflation from these sources appears to have lessened at least in the near term. On a trendline basis, for example, the rise in both raw material and food prices which began in October, 1976, has peaked and has declined to the trough levels of 1975 and 1976. On a September to September basis, raw materials prices are about the same as they were two years ago. While unit labor costs are the ultimate determinant of prices, a decline in commodity price inflation usually is followed by a subsequent slowing in the rise of other inflation measures like the Wholesale Price Index for Industrial Commodities and the Consumer Price Index. Correspondingly, the rate of increase in the Wholesale Price Index of Industrial Commodities has slowed consistently since March while the rate of increase in the Consumer Price Index began to subside in August. Despite the fact that rising meat prices are expected to boost food prices at year end, the inflation rate during the second half of 1977 is expected to average 5%, which is considerably less than the 9% average inflation rate during the first half of the year.

Based on the preceding economic forecast, corporate profits are expected to rise 11.8% in 1977, 10.9% in 1978, and 9% in 1979. This gross corporate profits forecast implies earnings for the S&P 400 of \$11.94 for 1977, \$13.24 for 1978 and \$14.43 for 1979. This favorable but less than ebullient forecast is based on the perception that, although sales growth should average about 10% per year through 1979, corporations will experience periodic margin pressure which will limit profitability. The experience of the past two years suggests that, as long as the business environment is cautious, especially with respect to inventories, a sustained acceleration in demand is not likely to occur. A persistent rise in demand, in contrast to the halting pattern of the past two years, appears to be necessary in order to create the favorable environment for price increases required (under conditions of stable costs) for margin improvement.

Corporate dividend payments are expected to grow at generally slower rates than earnings - 15% in 1977, 6% in 1978, and 7% in 1979. Corporate payout ratios are expected to decline slightly in 1978 and 1979 as competing uses of corporate funds (investment in inventories and capacity) take precedence over dividend payments. The above dividend forecasts indicate a \$4.90 dividend for the S&P 400 in 1977, \$5.19 in 1978 and \$5.55 in 1979.

B. FORECAST RISKS

The preceding forecast contains a number of risks which could alter the outcome considerably. These risks are considered explicitly in the alternative forecasts and figure importantly, according to their relative probability, in the final calculation of expected asset returns. These risks include:

- (1) that consumer spending is nearing a peak turning point which will lead the economy into recession;
- (2) that wage rates will rise more rapidly than forecast;
- (3) that inflation, especially in energy costs, has altered incentives to invest;
- (4) that effective capacity in the economy is lower than generally believed.

Credit data from the first eight months of 1977 indicate that the net change in consumer installment debt is at a record level. Moreover, the ratio of credit outstanding to personal disposable income is rising to levels which, since 1965, have indicated that a contraction in consumer spending was imminent. While it does not appear from an analysis of the consumer sector's balance sheet that these trends indicate financial weakness and could induce the consumer to cut spending sharply, it is possible that these data are misinterpreted. In this case, the last half of 1977 could represent the turning point in this cycle and, in the absence of capital spending, the economy could slip into recession in 1978. This event is described by Alternative Forecast 3, Stagnation.

A rapidly rising wage rate represents a second risk to the forecast. Generally, as a business cycle progresses and labor market conditions become tighter (e.g., the unemployment rate falls), the union-nonunion wage differential narrows favoring the union or high wage sectors of the economy. The decline in compensation increases forecast for 1978 and 1979 runs contrary to this demonstrated tendency of wages to rise as the cycle progresses. Clearly, the bias in the forecast implies that wages are more sensitive to past and current changes in prices than to labor market conditions.

In addition to the possible rise in wage rates, nonwage-based costs have become an increasingly important supplement to hourly compensation in recent years. These costs include cost of living escalators (which currently pass through about 70% of the increase in the CPI directly to wages) and increases in employer social security contributions and unemployment compensation insurance. These costs can raise the Index of Hourly Compensation by 0.5 to 1.0%. The bias in wage rates clearly is upward and the direction of compensation-based costs should be monitored closely.

Finally, inflation affects capital investment decisions in several ways and its net effect on the level of capital spending in coming months is a crucial determinant of the duration of this economic cycle. For example, inflation affects corporations' ability to finance capital projects by increasing the replacement cost of existing plant above the contributions of depreciation allowances to cashflow. The Department of Commerce estimates the extent of "underdepreciation" for nonfinancial corporate business of about \$15.5 billion in 1976 or about 15% of total depreciation. Because of the higher cost of investment, inflation also implies that higher rates of return are required to make new investment profitable. Finally, rising energy costs appear to

have altered the relative cost of labor vs. capital—especially in capital intensive industries. Rising energy costs also may have reduced the effective capacity of existing plant, exacerbating the need for new investment at a time when cost projections are a deterrent.

To some extent, the Extended Expansion forecast incorporates the expectation that the current environment for capital spending is not as favorable as it has been during past cycles. The average rate of growth in real business investment forecast through 1979 is about 7 1/2%, which is less than the 8% plus rates which typically characterize a capital spending cycle, and far below the 10% average growth in investment during the mid-1960's. However, the delay in capital spending and its weakness relative to past cycles, especially after the absence of investment in recent years, lend credibility to those who believe that incentives for capital investment have been altered. The effects of weak capital spending and capacity limitations on real growth and prices are shown in Alternative Forecast 4, Recession.

An alternative to the above "risks" that could provide a particularly attractive opportunity for investors is a distinct weakening in demand during the second half of 1977, which could reduce inflationary pressures much like 1976 and set the stage for a recovery in 1978—but at lower inflation rates. This combination of rising rates of real growth combined with productivity-supported reductions in the inflation rate provides the most favorable outlook for capital markets and is included as Alternative Forecast 2, Delayed Expansion. Table II outlined on page 26 summarizes each of these four economic forecasts and Appendix I provides a detailed description. The charts on pages 27 and 28 show the extent to which these forecasts (colored lines) conform to the range of forecasts that currently are available from government, Wall Street, and academic economists.

C. CAPITAL MARKET OUTLOOK

The outlook for capital markets described below is based on a weighted composite of the capital market forecasts associated with each of the economic forecasts which have been described previously. The use of a weighted forecast for capital markets, rather than a single forecast, enables portfolio managers to incorporate uncertainty explicitly into the range of valuations expected in bond and stock markets. The rationale for including uncertainty into the valuation process is based on the observation that capital market prices, especially stock prices, frequently diverge from what might have been expected given the economic fundamentals. In our investment decision making process, then, uncertainty, as measured by the distribution of probabilities among the forecasts, can affect stock and bond prices as the probabilities become more diffused among more or less favorable economic outcomes. The behavior of the stock market in recent months is clearly a reflection of the effect of uncertainty about a possible recession (as well as public policy decisions and other concerns) on stock prices. Analyzing the expected relative rates of return of stocks, bonds, and cash-equivalents, using this probabilistic approach provides our portfolio strategy effort with an indication of the extent to which our expectations for stock and bond prices based not only on our single most probable forecast but, more importantly, on the full range of possible outcomes are fully discounted by current credit market prices.

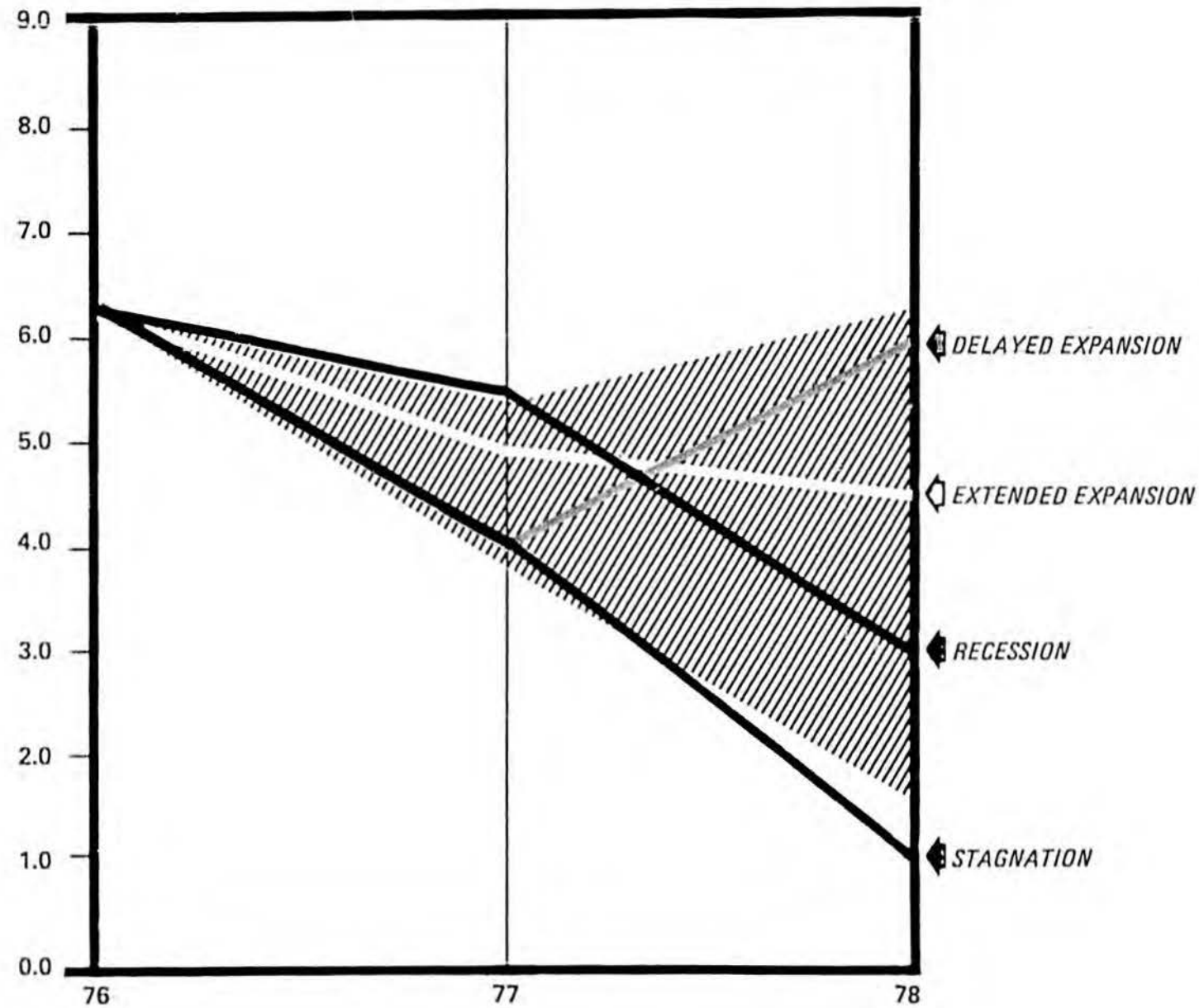
For example under the "most probable" forecast, Extended Expansion, stock prices are expected to reach a high of about 130 through 1978. However, there is a small chance (9%) that the economic expansion will be more prolonged and that the

TABLE II
ECONOMIC FORECASTS

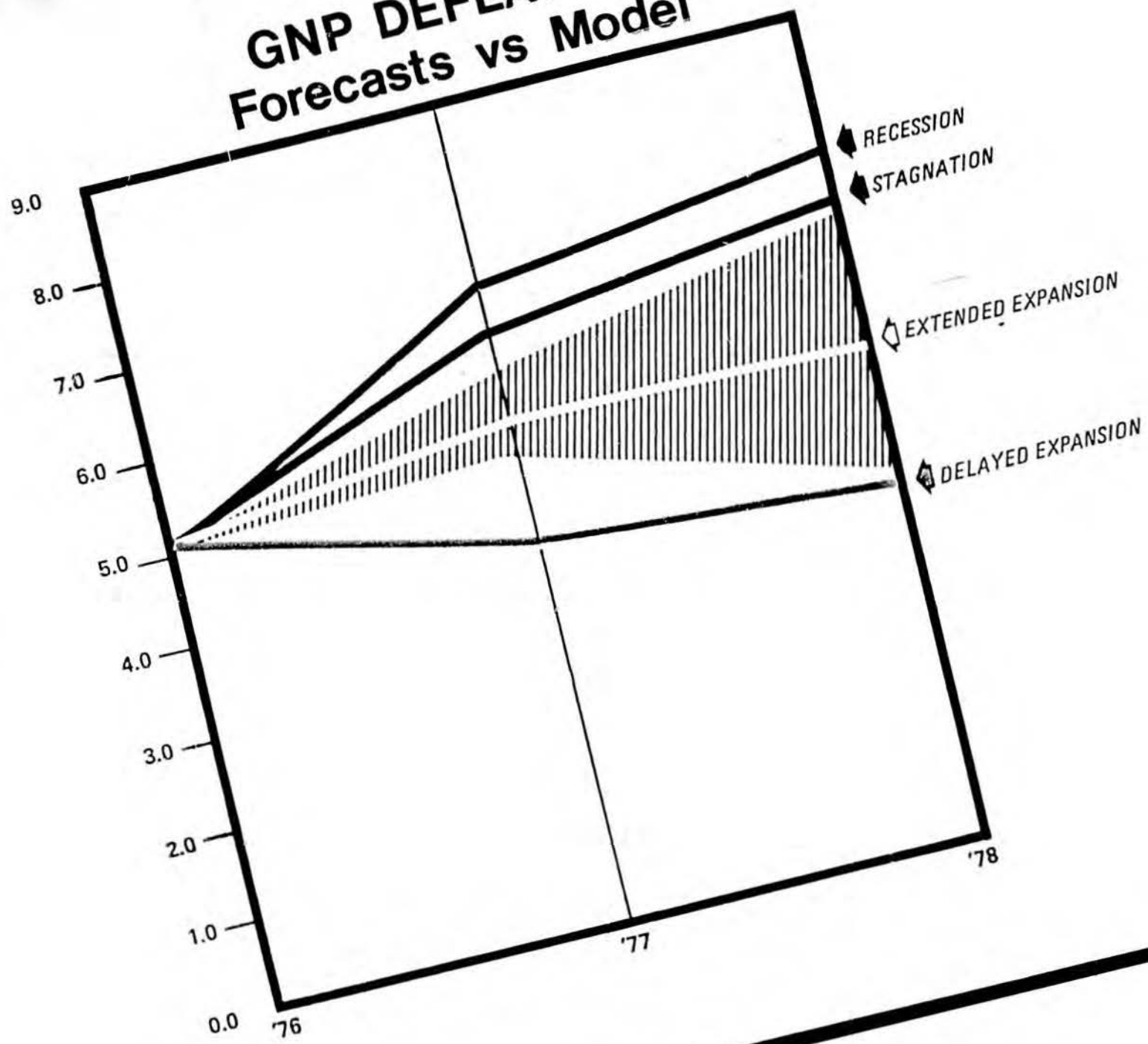
	#1 Extended Expansion				#2 Delayed Expansion				#3 Stagnation/Recession				#4 Recession			
	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979
GNP	11.3	10.5	10.0	10.0	11.3	8.5	10.0	8.5	11.3	10.5	8.0	5.5	11.3	12.5	10.5	6.0
GNP 72 Deflator	6.1 5.1	5.0 5.5	4.5 5.5	4.0 6.0	6.1 5.1	4.0 4.5	6.0 4.0	5.0 3.5	6.1 5.1	4.0 6.5	1.0 7.0	-0.5 6	6.1 5.1	5.5 7.0	3.0 7.5	-0.5 6.5
Corp. Profits	28	12.4	11.7	9	28	7.8	17.4	5.0	28	10.2	-3.4	-10.0	28	20.5	7.3	-10
Unit Labor Costs	3.6	6.2	5.5	5.5	3.6	4.5	3.0	3.5	3.6	6.0	8.5	8.0	3.6	5.0	7.5	9
Compensation	7.4	8.75	8.75	7.5	7.5	7.4	7.0	6.5	7.4	8.0	8.5	7.0	7.4	8.0	8.5	7
Productivity	3.6	2.3	2.0	2.0	3.6	2.5	3.5	3.0	3.6	2.0	0	-1.0	3.6	3.0	1.0	-2
Interest Rates																
T-Bills	5.02	5.16	5.73	5.98	5.02	4.64	4.75	4.50	5.02	5.32	6.42	6.50	5.02	5.32	6.43	6.25
Intermediate AA	7.89	7.58	7.98	7.91	7.89	7.56	7.39	6.74	7.89	7.94	8.52	8.62	7.89	7.97	8.56	8.55
Long AA	8.30	7.96	8.44	8.52	8.30	7.87	7.40	7.52	8.30	8.22	9.05	9.42	8.30	8.23	8.98	9.21
Dividends (S&P)	12.4	15	6	7	12.4	8	14	3	12.4	9	1	0	12.4	14	5	2
Return on Capital	9.2	9.8	10.4	10.6	9.2	9.4	10.5	10.5	9.2	9.5	8.6	7.3	9.2	10.4	10.4	8.9
S&P EPS	10.68	11.94	13.29	14.43	10.68	11.46	13.42	14.09	10.68	11.73	11.31	10.18	10.68	12.82	13.73	12.36
S&P DPS	4.25	4.90	5.19	5.55	4.25	4.59	5.23	5.65	4.25	4.68	4.73	4.73	4.25	4.84	5.09	5.19
S&P Index	101-121	103-133	102-132	104-134	101-121	105-135	118-152	145-187	101-121	95-123	85-106	80-100	101-121	95-119	86-110	100-125
Probability		<u>49</u>					<u>9</u>				<u>8</u>				<u>34</u>	



REAL GNP GROWTH: Forecasts vs Model



GNP DEFLATOR: Forecasts vs Model



inflation rate will decline. This forecast (Delayed Expansion) estimates that stock prices could reach a high of 152 by the end of 1978. Similarly, there are two forecasts (Stagnation/Recession and Recession) with a combined probability of 42% which predict that stock prices may decline from current levels to 85-86 in 1978. The effect of including these less favorable forecasts in the calculation of expected stock prices is to reduce the range of expected stock prices over the next 18 months to 97 to 125. Similarly the use of a weighted interest rate forecast raises the projected level of long-term AA corporate bond rates from an average level of 8.34 during 1978 to 8.53. Table III shows the weighted forecasts for key money market instruments and stock prices. The charts on pages 30 and 31 show schematically the relationship between the individual bond and stock market forecasts associated with each economic forecast (colored lines) and the weighted price range (shaded area) for bonds and stocks, respectively.

TABLE III
SUMMARY OF WEIGHTED CAPITAL MARKET FORECASTS

	<u>1977</u>	<u>1978</u>	<u>1979</u>
Money Market Rates			
90 day T-bills	5.19	5.94	5.99
Intermediate AA Industrial	7.74	8.16	8.08
Long AA Industrial	8.05	8.57	8.73
Stock Market (S&P 400)	100-128	97-125	104-134

Outlined on the following pages is Manufacturers Hanover Trust's approach to equity and fixed income management.

A. EQUITY MANAGEMENT

The ultimate purpose of this complex organization and disciplined investigative process leads inevitably to what is best known as stock and bond selection. This final step in the investment process carries with it a number of other highly specialized and demanding skills that result in the final appearance of the portfolios themselves.

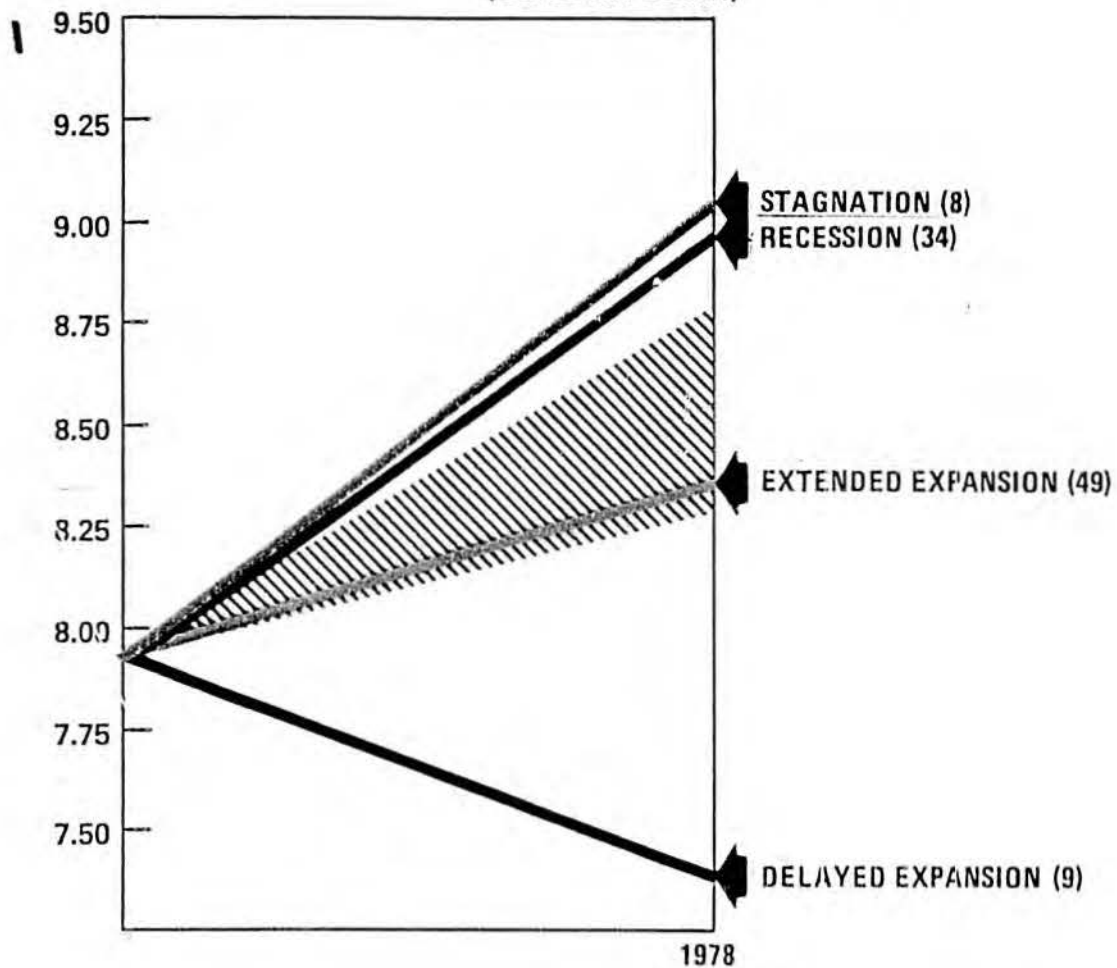
At Manufacturers Hanover Trust, our approach to professional investment in common stocks is based on an analysis of fundamental factors while preserving the flexibility to react to rapid and unexpected change. Such changes can be purely economic, some inexplicable and others political, both international and in the United States.

Our fundamental basis for equity investments, described earlier in this section, begins with a careful evaluation of the current and future economic environment as presented and analyzed by the Senior Investment Committee. This process consists of a systematic consideration of supply and demand relationships, interest rates and profit margins, and their impact on the capital markets. The development and selection of a most probable economic forecast was discussed in detail.



MANUFACTURERS HANOVER TRUST

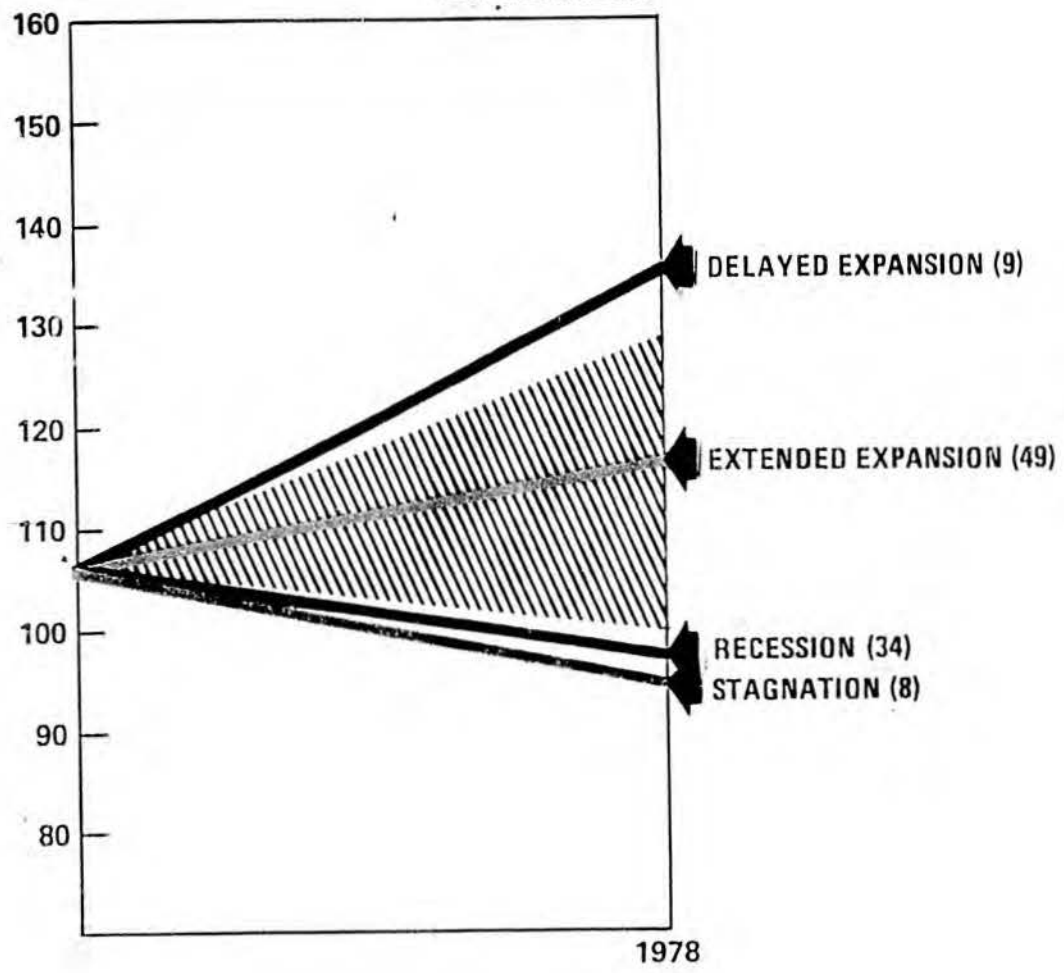
BOND MARKET FORECASTS
(LONG AA CORP.)





MANUFACTURERS HANOVER TRUST

STOCK MARKET FORECASTS
S&P 400 INDEX



Industry specialists on the research staff then consider the impact of major macro-economic factors on their various industries and make considered judgments using all of the analytical tools at their disposal. Primarily, they estimate units, prices and profits. The techniques used are several including balance sheet and income statement analysis and interviews with the top management of the companies for which they are responsible. Outside experts in specific industries are also consulted.

This systematic approach is designed to produce the best estimate of the future paths of corporate earnings and dividends. Studies have shown, and our own experience confirms, that a careful and accurate analysis of corporate earnings and dividends that can be projected over a period of time, is the best determinant of future stock prices. The three exhibits on pages 33 to 35 will illustrate the inter-relationship between earnings, dividends and stock prices for the fifty year period 1926 through 1976. These relationships and our ability to anticipate them are the heart of our investment approach.

Exhibit 1 (Page 33) shows that a strong positive relationship has existed over the last 50 years between the growth of earnings per share and the growth of dividends per share as measured by the experience of the S&P 500 Index. During this period earnings grew at about a 4.4 percent compound rate while dividends grew at about 4.0 percent compound rate. In other words, if an investor can identify an increase in earnings, there is a high probability that he will receive a similar increase in return through dividends at some point in the future.

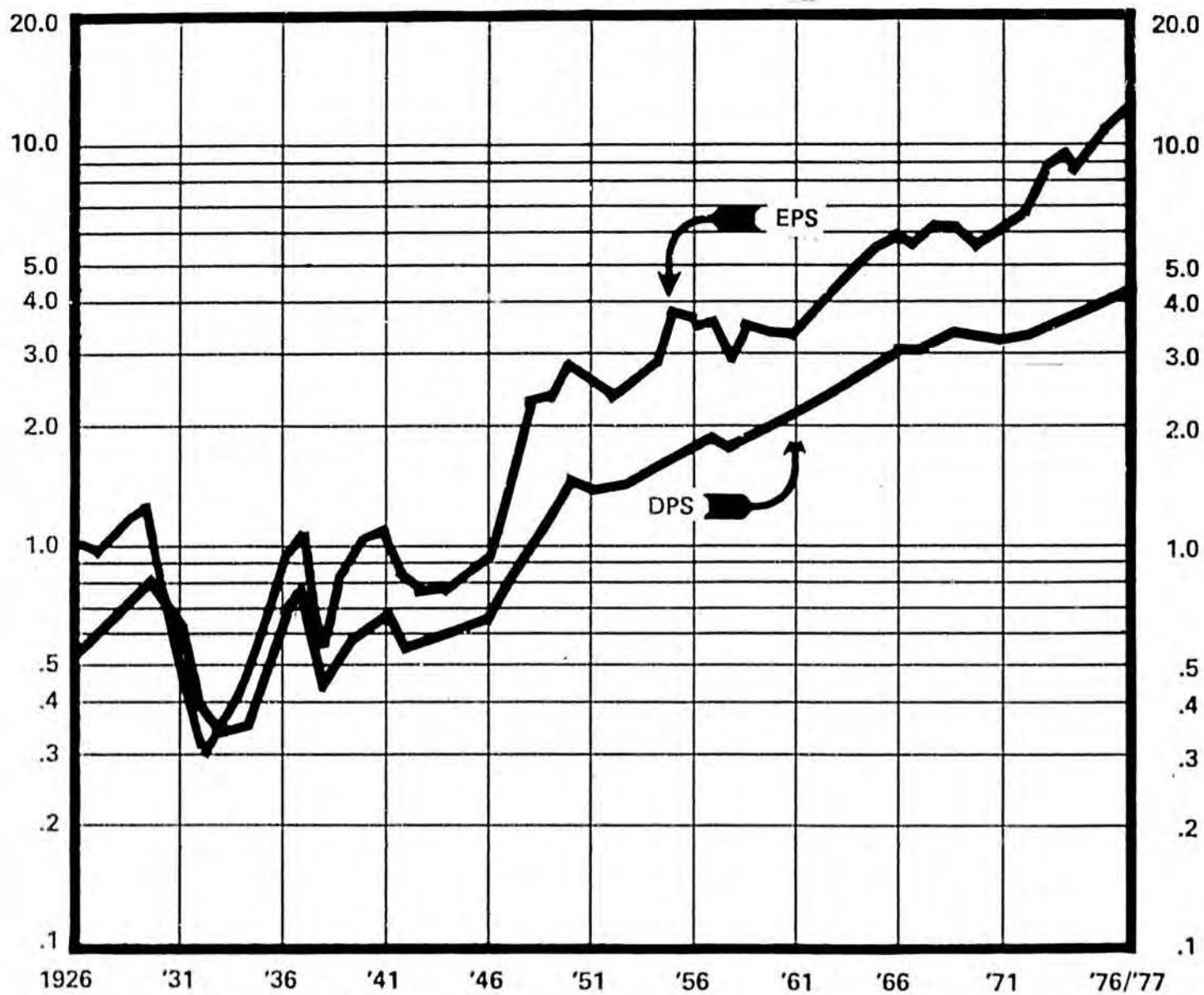
Exhibit 2 (Page 34) presents the fifty year historical relationship between nominal dividends and stock prices. As you can see in this exhibit, the post World War II rise in the stock market corresponds with a fourfold increase in dividends. The only apparent exception to this relationship seems to have occurred in the period 1971-1976 when dividends continued to increase in nominal terms but stock prices fell.

Exhibit 3 (Page 35) explains this paradox by comparing the growth of real dividends with stock prices. Real dividends are dividends that have been adjusted for the effects of inflation. As the exhibit shows, real dividends have been declining since 1966 with the result that investors have been receiving lower real returns from their investments in common stocks. It is not surprising, therefore, that stock prices have made little progress in the past ten years since investors were not receiving an adequate (in their minds) real return for investing in common stocks.

To further aid our equity selection process, we rank each of the industries we follow according to their expected profit gain over the forecasted period. Using various valuation techniques, we attempt to determine whether such gains are likely to produce stock price increases; and we then concentrate our portfolio heavily in those industries with the greatest potential gain. The expected earnings gains by company in turn produces a ranking within each industry to further aid in the selection process.

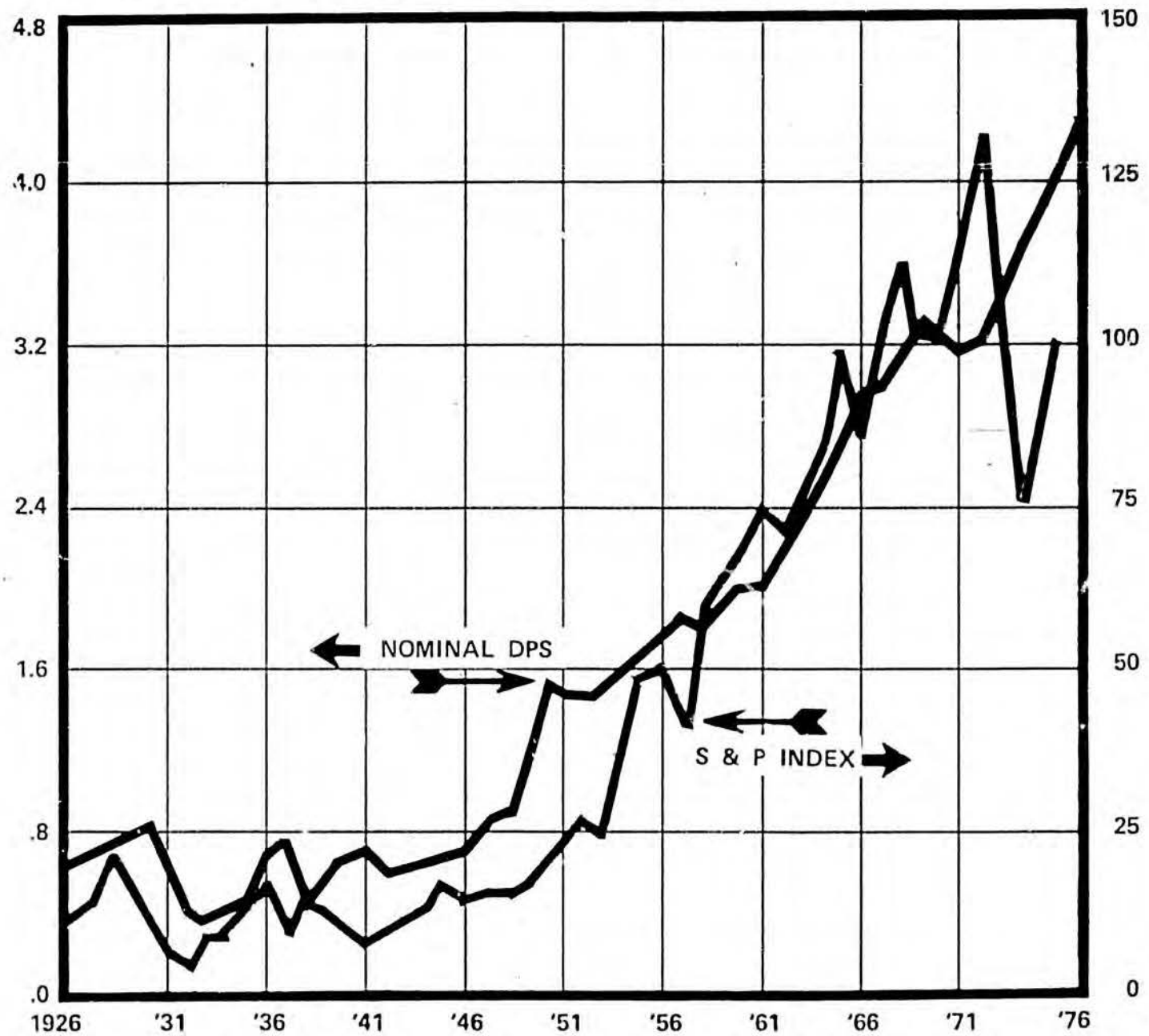
An important benefit of this system is that it introduces a selling discipline to the process of equity investment. We have found it is systematically logical to concentrate our holdings in those companies and industries ranked in the upper one-third of our list. We also question our continued ownership of those stocks in industries in the bottom one-third. Unless the analyst or portfolio manager can provide a strong argument to continue to hold such issues, the Senior Investment Committee will take action to reduce or eliminate these holdings from the portfolio.

Dividends Per Share (DPS) & Earnings Per Share (EPS) 1926 - 1976



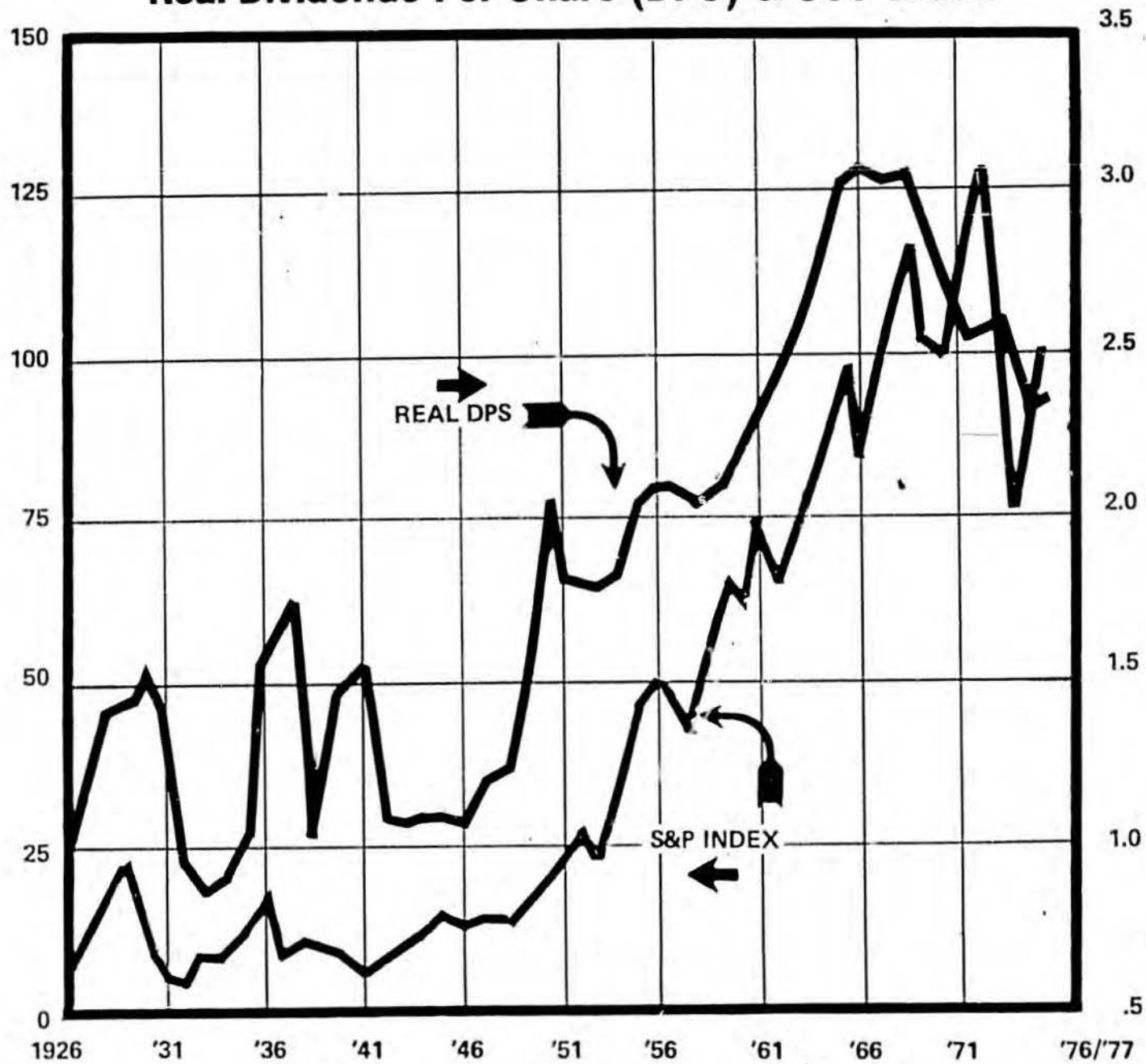
SOURCE: S & P INDEX

Relationship Between Nominal Dividends Per Share (DPS) & S&P Index



SOURCE: STANDARD & POOR'S

Relationship Between Real Dividends Per Share (DPS) & S&P Index



SOURCE: STANDARD & POOR'S & MHTCO

In addition to the fundamental approach to investing which can produce well-founded estimates of where equities should sell, the marketplace determines where equities will sell. Deviations do occur but ordinarily do not exist for long periods.

Our organization is sensitive to market trends and has the flexibility to act decisively when warranted. In order to anticipate these factors and to minimize their impact or to take advantage of the opportunities they present, we ask a lot of "What If" questions. We simulate econometric models to predict the potential impact of a tax cut, a sharp increase in the price of oil, an increase in taxes, an incomes policy, or other forms of government intervention. Through our frequent contact with the investment community and in discussions within our own offices, we attempt to analyze the specific factors that seem to be affecting investments at the moment, whether it be ERISA legislation, index funds, the trend towards growth stocks or away from growth stocks, or the desire for high dividend income.

It is only through such extensive analysis of all factors, both fundamental and external, that might have an impact on the future course of prices that we can hope to use equity investments as an effective hedge against inflation and at the same time reduce the volatility that has characterized equity investments.

Given a well-founded investment philosophy, the security selection decision becomes a straightforward activity. An illustration of what we try to accomplish with a common stock portfolio at Manufacturers Hanover Trust is shown on page 37. This exhibit describes the characteristics of a portfolio as of September 30, 1977 in comparison with the characteristics of the S&P 400 Index. As you can see in the exhibit, the Manufacturers Hanover portfolio is superior to the S&P 400 Index in historical and estimated earnings and dividend growth. In addition, we show two measures of comparative quality with our analyses of Return on Capital and Debt as a Percent of Total Capital. Finally, the exhibit shows that the portfolio has managed to acquire these characteristics at a price that is not much higher than the price of the S&P 400 as shown by the P/E (price-earnings) ratio.

B. FIXED INCOME MANAGEMENT

The investment philosophy is just as important to fixed income management as it is to equity management. Our investment philosophy calls for the preservation of capital and purchasing power through the use of active management techniques that help us to maximize returns.

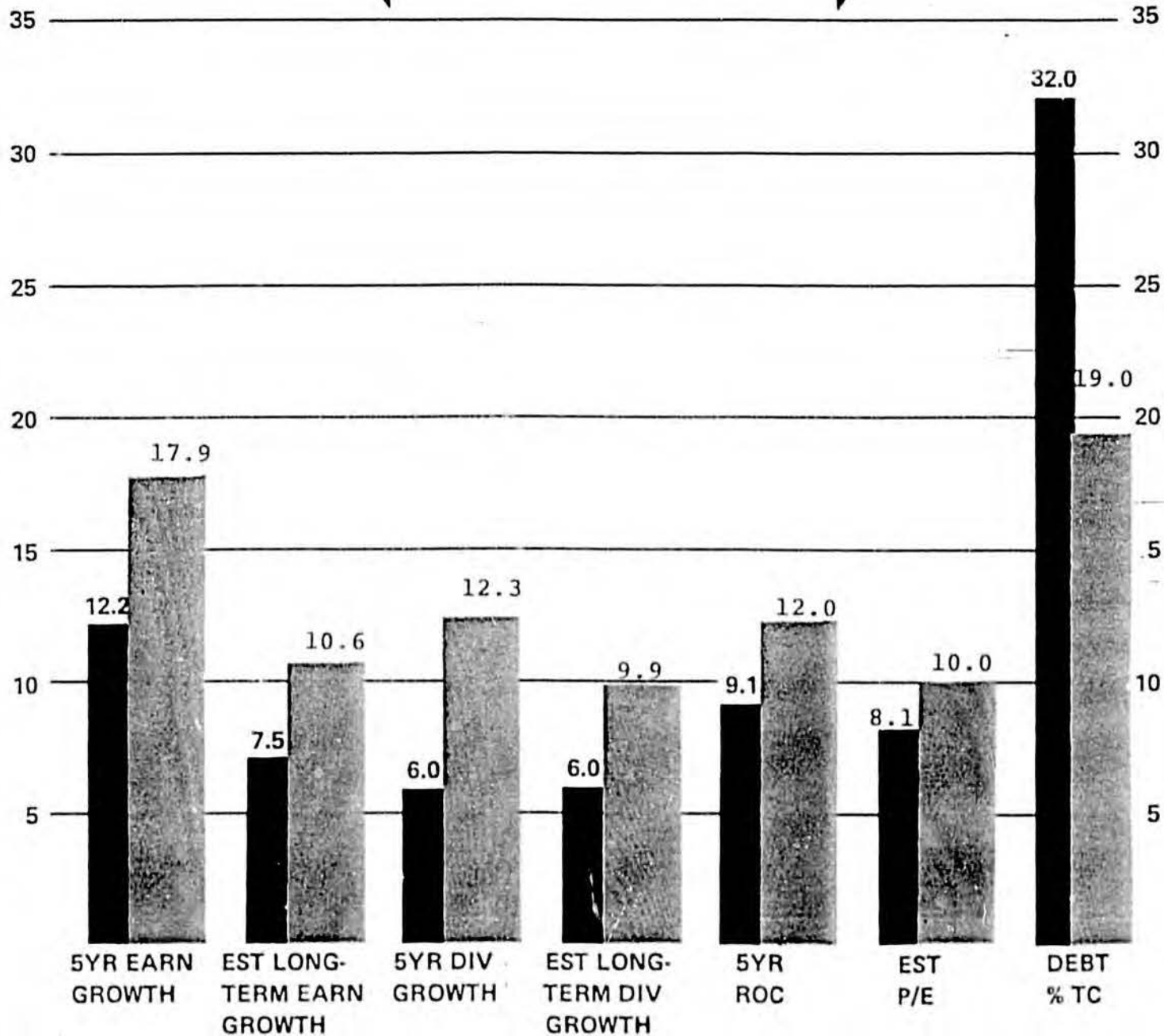
To give a perspective on fixed income management, let us review two realities of the marketplace that affect all fixed income managers.

The chart on page 38 shows the fluctuation of interest rates as measured by the experience of newly-issued AA Industrials for the period 1969 through 1976. As you can see, interest rates have fluctuated 1 per cent or more in nearly every year since 1969. These interest rate fluctuations have a strong impact on the total return of a fixed income portfolio depending upon its maturity structure. The successful fixed income manager will try to anticipate changes in interest rates in order to take advantage of positive movements and to avoid negative movements.

COMPARATIVE ANALYSIS

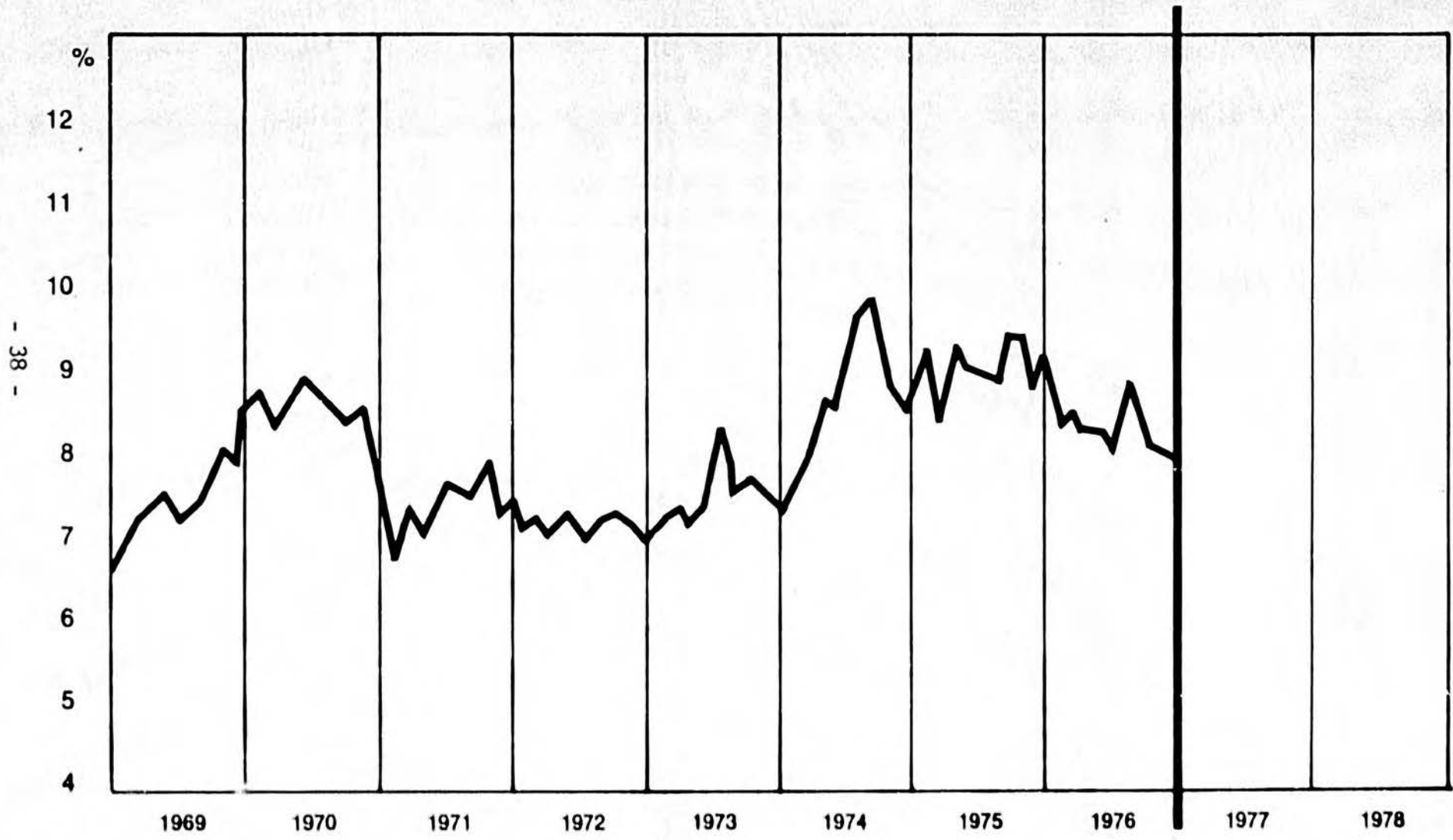
S & P 400 ◀

▶ ACC'T



YIELDS OF NEW AA INDUSTRIALS* 1969 through 1976

M MANUFACTURERS HANOVER TRUST



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* call protected

The second reality of fixed income management concerns the changes in quality ratings for individual companies issuing debt. As you can see in the chart on page 40, the number of changes in quality ratings has been substantial. The fixed income manager who can anticipate rating changes through a detailed analysis of a company's financial position will be in an excellent position to take advantage of improving returns resulting from rating upgrades and to avoid deteriorating returns resulting from rating downgrades.

Given the realities of fixed income management described above, the fixed income manager tries to take actions that help him maximize returns and, at the same time, minimize the negative realities of the marketplace. To accomplish this objective the fixed income manager has to use active management techniques.

The three principal active management techniques available to the fixed income manager are: 1) positioning in anticipation of interest rates by varying maturity, quality and sector; 2) swapping to improve quality or add incremental returns; and 3) avoiding losses resulting from credit deterioration.

The chart on page 41 shows the relationship between long, intermediate and short-term fixed income investments. The fixed income manager wants to shorten maturities in anticipation of rising interest rates and to lengthen maturities in anticipation of falling interest rates. Any success the fixed income manager has in making these judgments will improve the total return of his portfolio.

The chart on page 42 shows the relationship between issues of differing quality. In this exhibit long government securities indicated by the solid line at the zero level of the chart are compared with the premiums an investor receives for issues of lesser quality. As you can see in the exhibit, an investor generally receives a return inversely proportional to the quality of the issue. Nevertheless, there are times when the spread between issues of differing qualities becomes particularly narrow or wide. These instances give the fixed income manager an opportunity to maximize returns by positioning and swapping securities according to the existing and anticipated spread relationship.

The chart on page 43 shows the same type of relationship but in this instance using differences among sectors, as illustrated by government issues, AA industrials and AAA utilities. Again, by effective positioning and swapping the fixed income manager can maximize the returns of his bond portfolio.

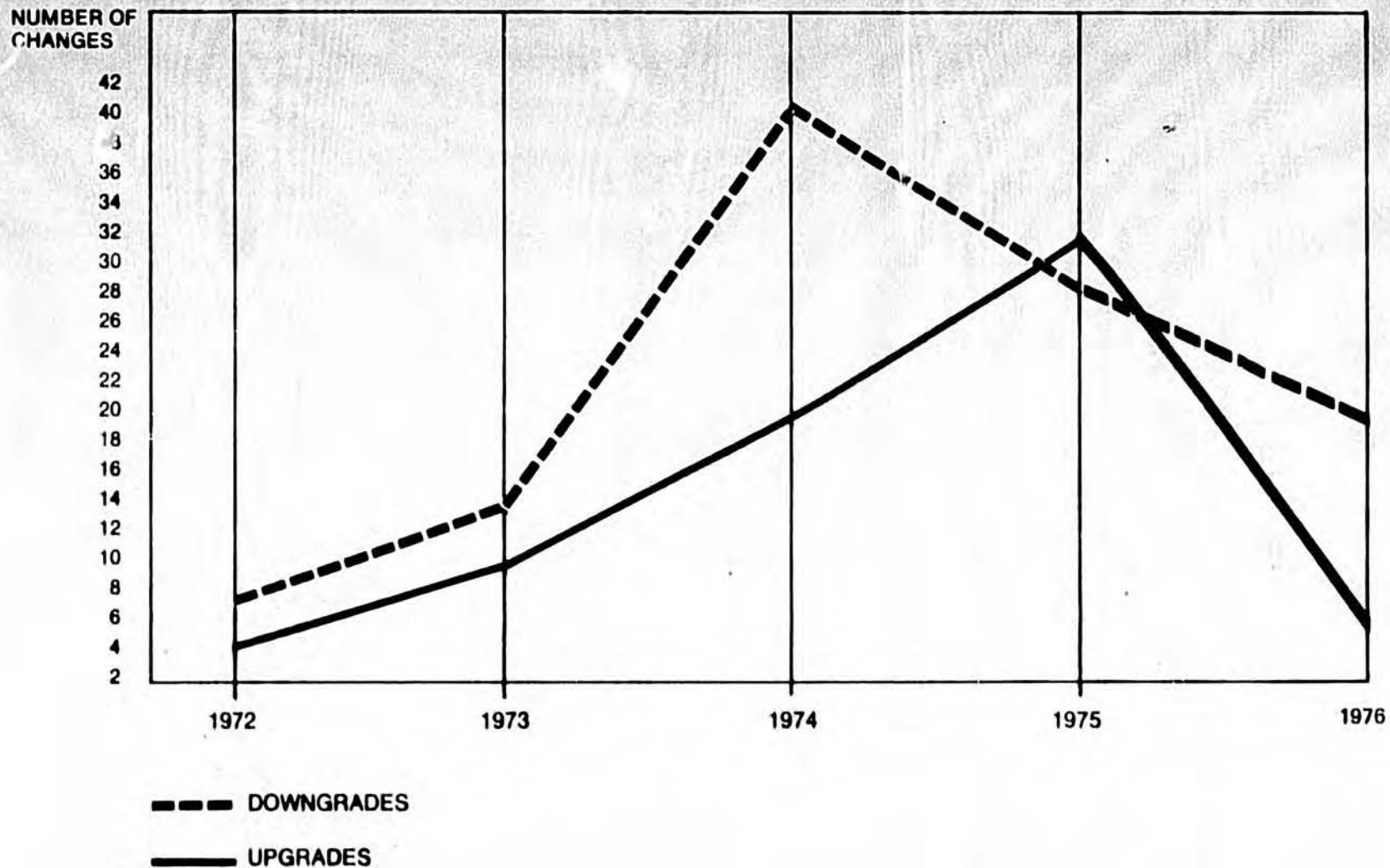
To illustrate the second active management technique -- swapping to improve quality or add incremental returns -- let us return to an earlier exhibit which shows the relationship between long government securities, AAA, AA, and A industrials. Just as the spreads among these securities are used to make positioning decisions, within each category (for instance, AA industrials) there are short-term opportunities to improve quality or add incremental returns by swapping one security for another. These opportunities arise because of aberrations in historical yield spreads that result from sinking fund operations, supply-demand imbalances, and temporary emotional outbursts. An active bond manager is generally able to recognize these opportunities and capitalize on them.

ISSUER CREDITS IMPROVE AND DETERIORATE

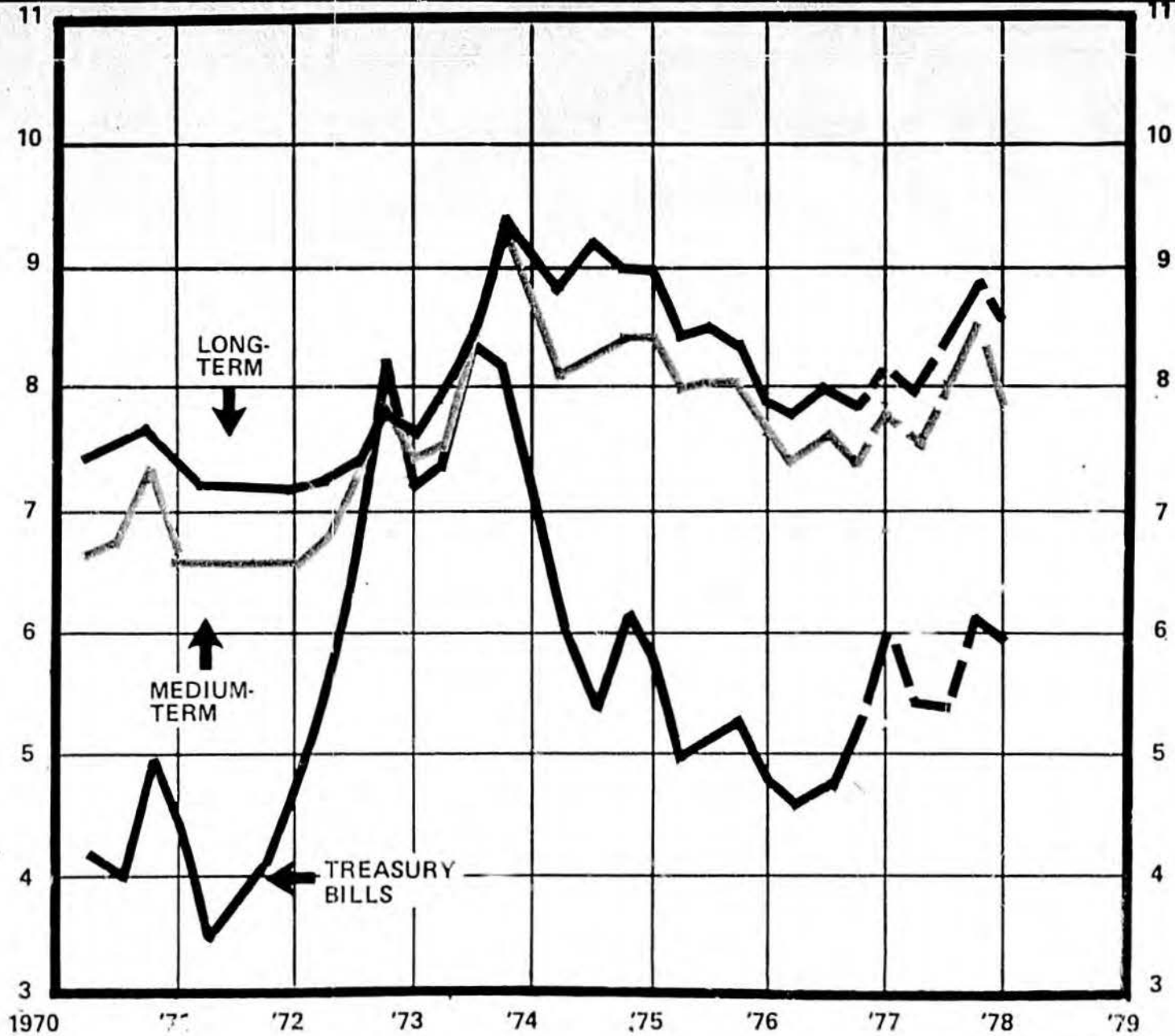


MANUFACTURERS HANOVER TRUST

Number of rating revisions by Moody's for industrials and utilities



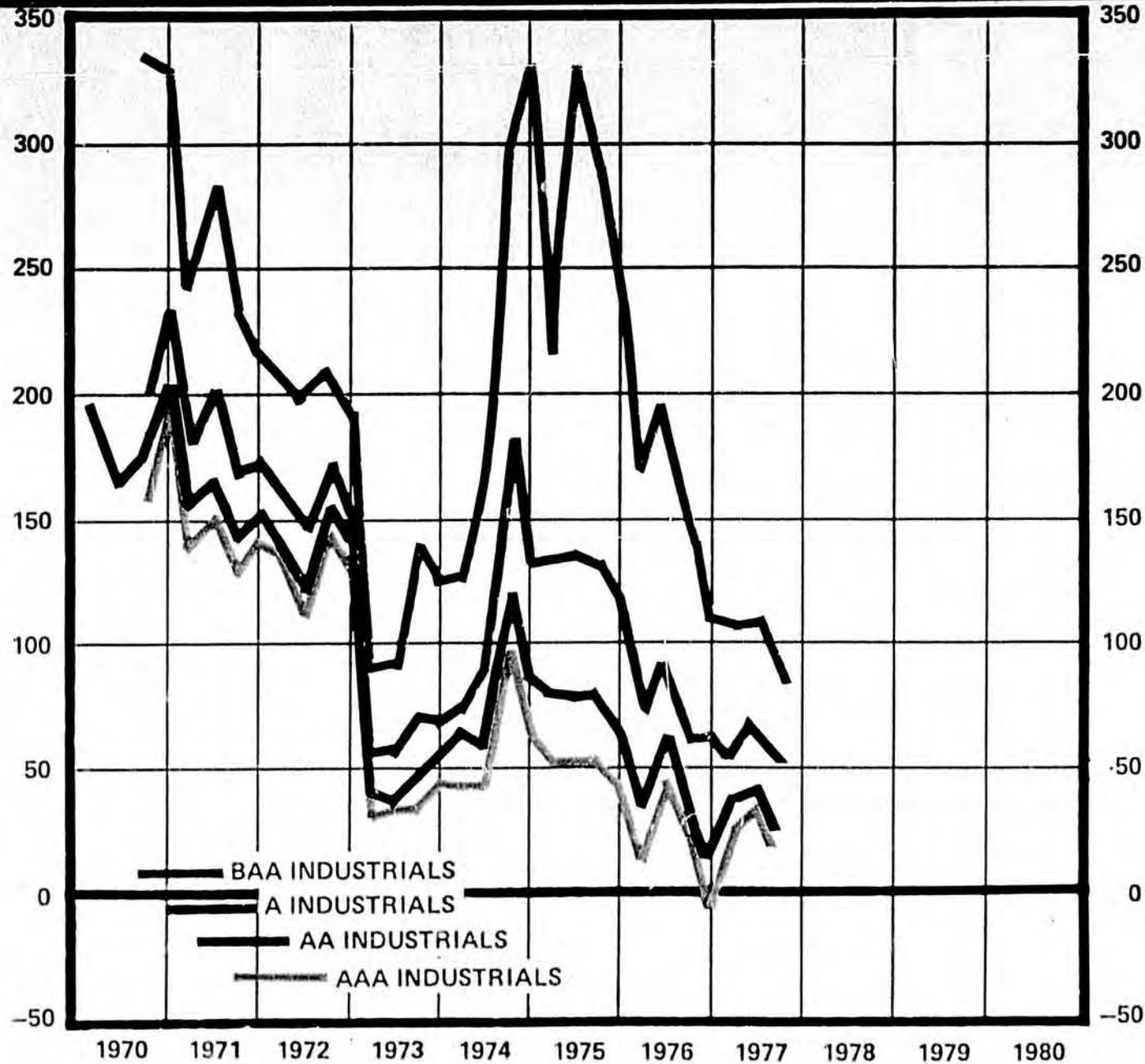
Yield of 90 Day Treasury Bills, AA Medium-Term Industrials and AA Long-Term Industrials



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QUALITY DECISIONS

Long Govts vs AAA, AA, A, & BAA Industrials

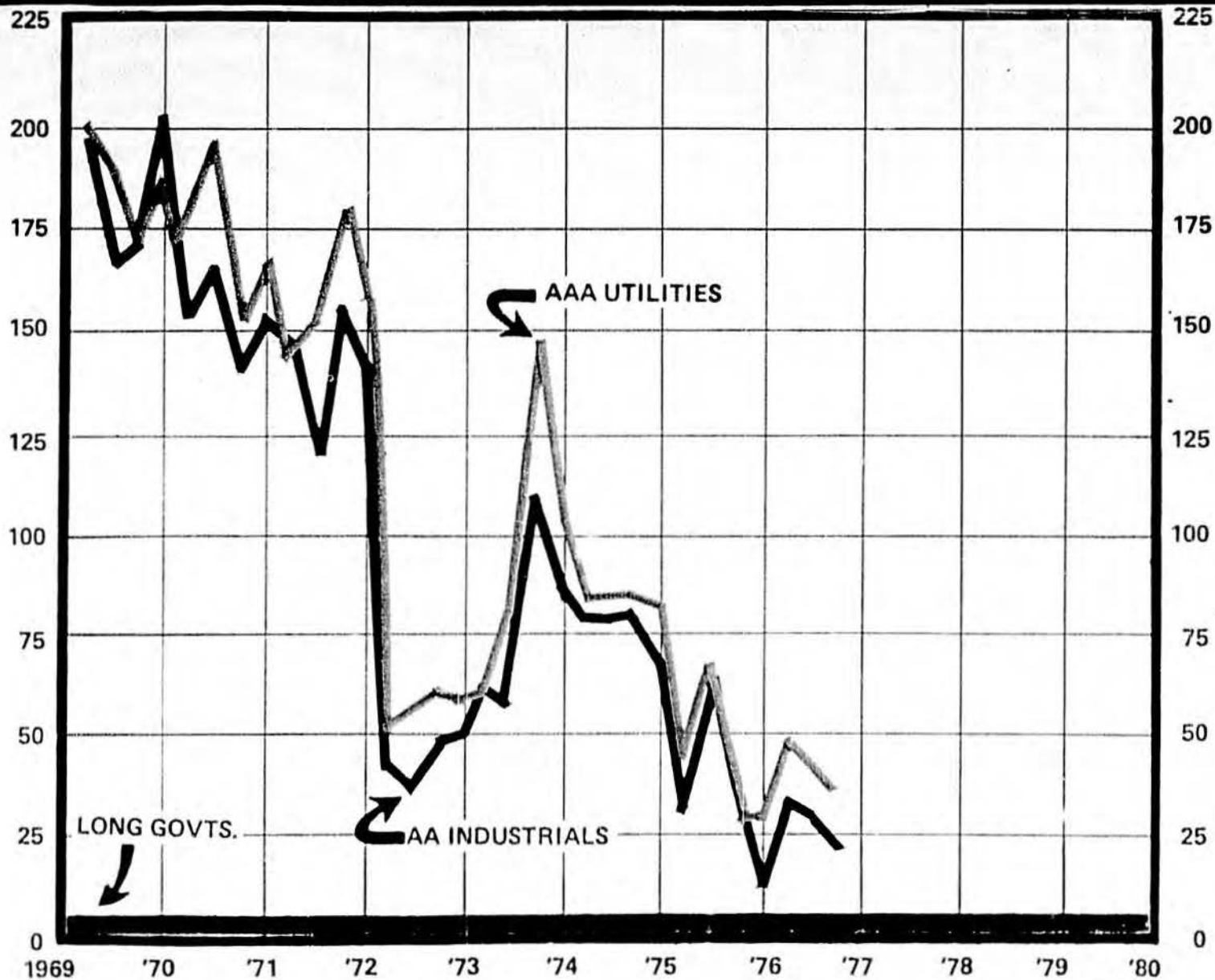


- 42 -



SECTOR DECISIONS

Yield Spreads - Long Govts. vs "A.A" Industrials & "AAA" Utilities



- 43 -

The third active management technique concerns avoiding losses from issuer credit deterioration. As soon as the credit worthiness of a debt issuer is downgraded, the price of the security will also decline. At Manufacturers Hanover Trust we try to anticipate these instances of credit deterioration (which you saw earlier to be quite numerous) through a proprietary analysis of the financial health of all issuers. This Ratio Ranking System is shown in the next exhibit (page 45) and is designed to monitor eight important financial ratios which describe the credit worthiness of a company and its industry.

As you can see in the exhibit, we examine a company's financial health from a historical and future perspective and then assign our own rating to the company's credit worthiness. In this manner, our bond portfolio managers have advance warning about which companies may have poor future returns from credit deterioration.

The capital markets of the United States are the largest and most liquid in the world with a wide range of instruments available to investors. We have outlined below the various direct obligations of the U.S. Treasury, Federal Agency and corporate obligations. The data is based on the latest Treasury Survey of Ownership (July 31) made available in October 1977.

TREASURY OBLIGATIONS

The total public debt of the Treasury outstanding is about \$671 billion of which about \$430 billion is marketable debt. The discussion to follow will treat only marketable issues.

Treasury Bills

The largest and most liquid investment market is the Treasury Bill market. The latest Treasury Survey of Ownership showed that there were 40 different issues outstanding amounting to about \$154 billion of which \$40 billion was held by the Federal Reserve Banks, U.S. Government Agencies and Trust Funds (such as the Social Security Trust Fund). Thus about \$114 billion were publicly held by various classes of investors.

Every Monday there are auctions for 13 week (91 day) and 26 week (182 day) Treasury Bills. There are, in addition, monthly auctions of one year Bills and occasionally special auctions of various other maturities depending upon the Treasury's short-term cash needs.

The daily average volume of gross dealer transactions in the secondary Bill market reported to the Federal Reserve was \$8.1 billion in a recent week.

Other Treasury Issues Maturing Within One Year

As of the latest survey, there were 19 issues of Bonds and Notes outstanding maturing within one year for a total \$61 billion of which \$13 billion were held in Federal Reserve, government agency and Trust Fund accounts.

The daily average volume of gross dealer transactions in the secondary market for such Treasury issues was recently \$242 million.

Table IV on page 46 presents comparable data on other outstanding Treasury issues.

ILLUSTRATION OF REPRESENTATIVE BOND LIST ANALYSIS

M MANUFACTURERS HANOVER TRUST

ISSUE	HISTORICAL DATA								TOTAL RANKING	THREE-YEAR AVERAGE	FUTURE TREND	MHT RATING (b)	
	FINANCIAL RATIO RANKINGS (a)											PROJECTED RATIO	QUALITY
	1	2	3	4	5	6	7	8					
AUTOMOTIVE													
FORD	4	3	4	7	6	5	2	10	41	46	IMPROVING	-	-
GENERAL MOTORS	2	2	2	3	1	4	1	7	22	27	IMPROVING	+	
INDUSTRY AVERAGE									40	47			
OIL													
AMERADA HESS	5	8	4	7	3	8	8	9	52	51	IMPROVING	0	
EXXON	3	3	3	5	1	5	8	9	37	34	DECLINING	0	+
INDUSTRY AVERAGE									44	41			
CHEMICALS													
ALLIED CHEMICAL	5	8	7	7	8	8	9	7	59	51	DECLINING	-	
MONSANTO	4	6	4	3	3	7	9	2	38	31	DECLINING	+	+
INDUSTRY AVERAGE									45	43			

a) Financial Ratios Analyzed Are:

- 1) Cash Flow/Fixed Charges
- 2) Debt/Equity
- 3) Pretax Fixed Charge Coverage
- 4) Total Assets/Total Stockholder's Equity
- 5) Earnings Before Interest and Taxes/Total Assets
- 6) Cash Flow—Dividends/Capital Expenditures + Changes in Inventories and Receivables
- 7) Cash Flow/Capital Expenditures
- 8) Current Assets/Current Liabilities

b) Rating System

- ++ = Above Average in rating category and industry group
- + = Above Average in rating category
- 0 = Neutral relative to rating category
- = Below Average in rating category
- = Below Average in rating category and industry group

TABLE IV

<u>Maturity Range</u>	<u>No. of Issues</u>	<u>Amount Outstanding</u>	<u>Held by U.S. Government Accounts & Fed. Reserve Banks</u>	<u>Publicly Held</u>	<u>Recent Daily Average Gross Dealer Transactions Secondary Market</u>
0 to 1 year	59	\$215 bil.	\$ 53 bil.	\$162 bil.	\$ 8,342 million
Treasury Bills	40	154	40	114	8,100
Other Treasurys	19	61	13	48	242
1 to 5 Years	47	142	36	106	2,589
5 to 10 Years	11	43	13	30	1,470
Beyond 10 Years	17	30	12	18	363
	<u>134</u>	<u>\$430 bil.</u>	<u>\$114 bil.</u>	<u>\$316 bil.</u>	<u>\$12,764 million</u>

General Comments

The liquidity of three month, six month and one year Bills is generally higher than that for other maturities. Under normal conditions, it is possible to purchase or sell \$100 million or more of the very actively traded Bills in a single day compared to \$25-50 million of the less active issues.

Factors affecting the marketability of Treasury issues include general economic activity, government fiscal and monetary policy (especially open market operations), the level and direction of interest rates, and the cost to dealers of financing their inventories. An additional factor affecting the marketability of specific issues is the proportion of the issue held by the Federal Reserve Banks, U.S. Government Agencies and Trust Funds.

Another device that contributes to the liquidity of the Treasury market is the Repurchase Agreement whereby an investor may commit substantial sums by lending funds to a government dealer at negotiated terms for a specified term (usually short) and, as collateral, the investor receives Treasury securities for the full amount of the repurchase agreement or "repo". At the end of the term, the dealer repurchases the securities on the agreed terms and the collateral is surrendered to the dealer. The "repo" makes it possible to invest substantial sums of money readily for short periods of time, such as two or three days, which could otherwise involve risk or difficulties.

There is also the Reverse Repurchase Agreement where instead of selling a Treasury holding on the open market, an investor may enter into an agreement with a dealer whereby the dealer purchases the securities from the investor and makes a concurrent commitment to sell the securities back to the investor at agreed upon terms at a later date. The essence of repurchase agreements and "reverse repos" is to adjust the original maturity of a particular instrument to better accommodate the needs of buyers and sellers.

Depending upon the state of dealer inventories and the condition of the market, it is usually possible to negotiate "repos" in volumes of \$100 million to \$200 million without difficulty. This summer, however, dealer inventories were very tight and even the monetary authorities were somewhat constrained at times in pursuing open market operations.

FEDERAL AGENCY OBLIGATIONS

Federally sponsored agencies largely created to benefit the agricultural and housing sectors of the U.S. economy have long been an important factor in the money and capital markets of the United States. In recent years, however, the volume of obligations issued by Federal Agencies has increased substantially.

Some agency issues are backed by the full faith and credit of the United States, others are guaranteed by the Treasury or are supported by the issuing agency's right to borrow from the Treasury, while a few lack any formal government backing. The latter are, nevertheless, generally regarded by professionals as very high quality investments.

Issues Backed by the Full Faith and Credit of the United States, Guaranteed by the Treasury or Supported by Borrowing Rights Against the Treasury

Federal Home Loan Mortgage Corp.

The Federal Home Loan Mortgage Corporation was created in 1970 for the purpose of strengthening the existing secondary market in government insured residential mortgages and to assist in the development of secondary markets in non-insured or conventional residential mortgages. These objectives are to be achieved by purchasing such mortgages from various financial institutions including members of the Federal Home Loan Bank System. To finance these secondary mortgage market operations, the Federal Home Loan Mortgage Corp. may issue mortgage-backed bonds which are supported by the full faith and credit of the United States. There are three such issues outstanding with maturities ranging from 1995 to 1997 aggregating \$433 million. In addition, this Agency has \$1.3 billion in six issues maturing 1999 to 2007 which are not backed by the full faith and credit of the United States.

All of the stock of the Federal Home Loan Mortgage Corp. is owned by the twelve Federal Home Loan Banks, another Federal Agency.

Government National Mortgage Association

The Government National Mortgage Association (GNMA) is a wholly owned government corporation established to provide special assistance for financing certain types of residential mortgages. GNMA purchases mortgages or mortgage commitments from private lenders in the mortgage market at higher than prevailing prices and then sells those mortgages or commitments at lower prices to investors, thus providing a form of subsidy. Frequently, the mortgages are sold at auction with the individual mortgages combined into pools which in turn are then sold to the major investment banking houses for resale to the institutional investment market. The mortgage pools are guaranteed by GNMA which in turn is backed by the full faith and credit of the U.S. The pools are of the "pass-through" type whereby monthly interest and amortization of the mortgages in the pool are distributed to investors.

Over \$40 billion of GNMA pass-through mortgage backed securities have been issued with final maturities of from 12 to 40 years and average lives (because of mortgage amortization) of from 5 to 40 years. These securities are actively traded.

GNMA has also sold participations in its mortgage portfolio. The participation certificates which do not have principal prepayments before maturity are also backed by the full faith and credit of the U.S. There are 21 issues outstanding aggregating \$3.8 billion with maturities ranging from 1977 to 1990. Only a few of these issues are large enough to offer a reasonable degree of marketability.

Export-Import Bank

The Eximbank was founded in 1934 and has broad powers for assisting exports by extending loans, guarantees and credit insurance. One issue of \$300 million falls within the money market maturity range, and five others aggregating \$1.4 billion mature in 1978, 1979, and 1982.

The Eximbank has also guaranteed the Notes of Private Export Funding Corporation (PEFCO), a corporation established in 1970 with the support of the U.S. Treasury Department and Eximbank to assist in the financing of exports by mobilizing private capital. PEFCO is owned by 54 commercial banks, seven manufacturing companies involved in export markets and one investment banking firm. PEFCO has six issues outstanding amounting to \$750 million with maturities from 1981 to 1987 which are backed by the full faith and credit of the U.S.

Farmers Home Administration

The Farmers Home Administration in the Department of Agriculture extends loans in rural areas for homes, farms and community facilities. To finance its activities, the Farmers Home Administration sells insured notes and certificates of beneficial ownership which are secured by the full faith and credit of the U.S. government. This agency has 18 issues outstanding aggregating \$4.7 billion with maturities ranging from 1977 to 1989.

Federal Housing Administration

The Federal Housing Administration insures mortgage loans for a wide variety of purposes but mostly related to residential housing. Holders of FHA insured mortgages that have defaulted are paid in cash or FHA debentures at the FHA's option. Although the debentures are unconditionally guaranteed by the U.S., the maturities are long and there are a large number of issues. As a result, secondary markets are quite inactive.

Federal Agency Issues Not Formally Guaranteed or Backed by the United States

Banks for Cooperatives

The Banks for Cooperatives were organized in 1933 to make loans to cooperatives owned and controlled by farmers engaged in marketing farm products, purchasing farm supplies or providing farm business services. There are 12 district Banks and the Central Bank for Cooperatives. The Central Banks' primary lending function is that of acquiring loan participations of the district Banks. To finance these activities, the 13 Banks for Cooperatives issue consolidated bonds which are joint and several obligations of the 13 Banks and are secured by notes and other obligations of borrowers, obligations of the U.S. and its agencies, cash and other readily marketable securities approved by the Farm Credit Administration.

Although the Federal Government provides no formal guarantees direct or indirect for the bonds of this agency, the obligations are secured as described above and the Banks operate under Federal charter with government supervision. The Banks for Cooperatives typically sell 6 month bond issues monthly although longer term issues are sometimes brought to market. There are ten issues outstanding aggregating \$4.3 billion, three of which mature in 1979 or later.

Federal Intermediate Credit Banks

The Federal Intermediate Credit Banks established in 1923, discount and purchase notes originating from loans extended to farmers by agricultural credit corporations, commercial banks, livestock loan companies and similar financial institutions. The consolidated bonds this agency issues are joint and several obligations of the 12

Federal Intermediate Credit Banks and are secured by collateral consisting of notes or other obligations of borrowers and other readily marketable securities approved by the Farm Credit Administration. Although obligations of the Banks are not guaranteed either directly or indirectly by the Federal government, they represent secured obligations of banks operating under Federal Charter and under government supervision.

The Banks issue bonds monthly with maturities of nine months but occasionally, issues of intermediate term will be brought to market.

There are 16 issues outstanding aggregating \$11.6 billion, six of which mature in 1979 or later.

Federal Land Banks

Organized in 1917, the Federal Land Banks provide funds to local Federal Land Bank Associations which, in turn make long-term real estate loans secured by first mortgages to farmers.

Consolidated Federal Land Bank Bonds are joint and several obligations of the Twelve Federal Land Banks and are fully collateralized by notes and obligations of borrowers and other readily marketable securities approved by the Farm Credit Administration.

The obligations of the Banks, while not guaranteed directly or indirectly by the Government, are nonetheless secured obligations of banks operating under Federal charter supervised by the Government. There are 45 issues outstanding aggregating \$18.7 billion with maturities ranging from 1977 to 1997.

Farm Credit System

The Farm Credit Administration is an independent agency of the U.S. Government and is responsible for supervising, auditing and examining the federally sponsored lending agencies providing credit and closely related services to the farming and farm related businesses. Each of the 12 Farm Credit districts into which the country is divided contains a Federal Land Bank, Federal Intermediate Credit Bank and a Bank for Cooperatives. In addition, there is a Central Bank for Cooperatives that is part of the system.

The Farm Credit Banks issue Consolidated Systemwide Discount Notes which are secured joint and several obligations of the 37 Farm Credit Banks comprising the system described above. The Federal Farm Credit Banks had \$1.3 billion in discount notes outstanding with maturities out to 270 days and in August raised \$962 million in 5 and 12 year bonds.

Federal Home Loan Banks

The Federal Home Loan Banks were organized in 1932. The 11 regional Home Loan Banks lend funds to thrift institutions, largely savings and loan associations that are members of the Federal Home Loan Bank System. The loans are used to accommodate unusual credit demands arising from seasonal factors as well as cyclical developments such as heavy deposit withdrawals due to "disintermediation".

Obligations issued by the Federal Home Loan Banks although not guaranteed by the United States are joint and several obligations of banks operating under Federal Charter with governmental supervision. There are 38 issues outstanding aggregating \$16.8 billion with maturities ranging from 1977 to 1997 in addition to \$472 million in discount notes.

As indicated previously, the Federal Home Loan Banks own all of the stock of the Federal Home Loan Mortgage Corp. This Corporation has Federally guaranteed debt outstanding in addition to six issues amounting to \$1.3 billion in mortgage backed securities guaranteed only by Federal Home Loan Mortgage Corp. Such securities represent an undivided interest in pools of conventional mortgages. Interest is paid semi-annually to note holders and mortgage amortization is passed through also and paid annually. Holders may "put" the securities back to the Federal Home Loan Mortgage Corp. in 15, 20, or 25 years depending upon the issue.

Federal National Mortgage Association

Federal National Mortgage Association is a Federally sponsored corporation but owned entirely by private stockholders. It was originally chartered by the Federal Government in 1938 to provide a degree of liquidity to the mortgage market by purchasing government insured and guaranteed mortgages when investment funds are in short supply. There are 70 issues outstanding aggregating \$28.2 billion with maturities ranging from 1977 to 1997. In addition, FNMA has 4 issues of Capital debentures outstanding amounting to \$1.0 billion with maturities from 1980 to 2002 and \$1.4 billion of discounts notes.

Tennessee Valley Authority

The TVA was established in 1933 for the purpose of developing the Tennessee River and adjacent areas. Obligations are secured by a first charge upon net proceeds from power generation. Principal and interest on TVA's obligations rank ahead of annual payments to the Treasury. There are 17 issues outstanding aggregating \$1.8 billion with maturities ranging from 1977 to 1999. This agency has not been actively financing in the public markets.

United States Postal Service

The U.S. Postal Service was created as successor to the Post Office Department which was responsible for operating the postal system in the United States. Obligations of the Postal Service may be fully guaranteed by the U.S. Government if the Postal Service requests the guarantee and if the Treasury Department determines the guarantee is in the public interest. There is one issue of the U.S. Postal Service outstanding in the amount of \$250 million due in 1997 which is not guaranteed by the U.S. Government.

OTHER MONEY MARKET INSTRUMENTS

There are a number of money market instruments available in the United States with acceptable marketability that offer higher returns than Treasury or Federal Agency obligations.

Bankers Acceptances

In terms of quality, Bankers Acceptances, representing senior debt of the accepting bank, rank just below Treasury Bills. Maximum maturities run to 270 days. There are about \$23 billion in Acceptances outstanding. During a recent week, the principal dealers in Bankers Acceptances reported a total weekly volume of \$2.2 billion and daily average inventories of \$1.3 billion.

Certificates of Deposit

Bearer certificates of deposit of major banks provide excellent portfolio liquidity. There exists a large active secondary market in the CDs. There are about \$67 billion of CD's for large reporting banks outstanding. During a recent week, government securities dealers reported an average daily turnover of \$1.1 billion in certificates of deposit.

Dealer Placed Commercial Paper

Dealer placed commercial paper enjoys an active market with a good quantity of high quality issuers currently having paper placed for them. Dealer placed paper is somewhat less liquid than certificates of deposit, since only the originating dealer is willing to repurchase the paper. Depending upon conditions, it is possible to place \$30 million or more without difficulty. There is about \$25 billion of such paper outstanding.

Direct Issue Commercial Paper

With outstandings in the amount of about \$36 billion, this market tends to be less liquid with some issuers reluctant at times to take back their own paper prior to maturity. There is no secondary market for this paper, as with other instruments. Unlike the dealer market currently, it is possible to purchase longer-term paper out to the maximum of 270 days.

CORPORATE BOND MARKET WITH MATURITIES BEYOND ONE YEAR

The long-term public corporate bond market is larger than the Treasury market. Excluding Treasury Bills, the aggregate amount of outstanding publicly held corporate issues was about \$214 billion at year end 1976. Excluding Treasury Bills, the amount of marketable Treasury Bonds and Notes held by various classes of public investors was \$186 billion at the end of 1976.

The gross volumes of publicly offered corporate bonds, privately placed corporate debt, new issues to the public by the US Government and new issues made by State and Local governments are shown below in Table V.

TABLE V

	<u>Corporate Bonds</u>		<u>U.S. Gov't. Public Debt</u>	<u>State & Local Gov't.</u>
	<u>Public</u>	<u>Private</u>		
1974	\$24.9 billion	\$ 6.2 billion	\$11.2 billion	\$24.3 billion
1975	32.6	10.2	85.8	30.6
1976	26.5	15.8	69.1	35.3

At the end of 1975, the amount of outstanding publicly held corporate debt issues was \$196.6 billion. Of this amount, 53% was debt of public utilities (probably 40% of which was Telephone Company debt), 29% Industrials, 12% Finance Company and 4% Transportation Company debt. About 23% of such corporate debt was rated AAA or better, 26% AA rated and 33% was rated A. About 49% of the debt outstanding had maturities of 1991 or longer and another 26% had maturities between 1981 and 1990.

On page 54 we have constructed a profile of a recommended portfolio based on the assumption that the Alaska Fund will have a substantial cash inflow from natural resource based revenues to take advantage of the higher yield opportunities expected to be available and to provide considerable flexibility in case conditions and value relationships change enough to dictate utilizing alternate investment strategies. Accordingly, the portfolio profile is quite different from one which would not have major new infusions of cash.

Assuming a 12 year average life for the Government National Mortgage Association Pass Throughs, the portfolio's weighted maturity is about 22 years, (a little more than the corporate bond market's 18.7 years and somewhat longer than we would normally recommend at this time.) The 50% position in GNMA 8% Pass Throughs is in recognition of the superior cash flow such investments provide. This adds flexibility for reinvestment in a rising interest rate environment.

Quality is another predominant characteristic of this portfolio as 50% is represented by Government guaranteed obligations and another 40% is invested in AAA securities. Normally, the riskier an investment, the more an investor should expect to be compensated in the form of higher yield or return. At times, however, it is possible to sacrifice very little yield or return in order to switch into less riskier or high quality investments. We have thus recognized the compression that has occurred in the yield spreads during this economic recovery between the various quality sectors of the bond market. When interest rates rise, the yield spread between issuers of different quality tends to widen as investors become more sensitive to gradations of risk.

Representation in the particular corporate sectors of the bond market was made largely on the basis of the attractiveness on a relative yield basis. The yield relationship of these sectors to each other, and other sectors is studied and a sense of value can be developed about these sector relationships when fundamental or technical data affecting individual issuers or industries are taken into consideration.

ALASKA FUND

PROFILE OF RECOMMENDED PORTFOLIO

		<u>Market Price</u>	<u>Maturity Yield</u>
50%	Government National Mortgage Association Mortgage Backed Pass Thru Securities 8% (Average Life 12 Years)	98 3/8	8.32%*
20%	AAA American Tel. & Tel. and Subsidiary Companies 8 1/4% 40 Year Bonds	100 1/4	8.23%
10%	AAA Oil Company (Various) 8 1/2% 25 Year Bonds	103 1/4	8.20%
10%	AA Industrial Companies (Various) 8 1/2% 27 Year Bonds	103	8.22%
10%	AAA Financial Companies (Various) 8 7/8% 25 Year Bonds	105 1/4	8.35%
	Weighted Average Yield to Maturity		8.28%

*Corporate equivalent yield to average life

APPENDIX I

ALTERNATIVE ECONOMIC FORECASTS

(I) Extended Expansion

The period 1976 through 1979 is one of above-trend rates of real economic growth and moderate inflation rates. The suspension of the \$11 billion Carter rebate in April, 1977 only slightly diminishes the rate of economic growth and enhances substantially the prospect for continued stable rates of inflation. Moderate inflation rates (e.g., 5-6%) and increasing employment spur real income growth (e.g., 4-5% per year) and the consumer continues to spend at above-trend rates (3-4% rate of growth in personal consumption expenditures) during the entire forecast period. Recent consumption patterns, which have emphasized auto purchases, do not indicate a peak in the thrust of consumer spending. The current high levels in consumer credit extensions relative to income decline as the composition of consumption shifts to other durables and nondurables which involve less extensive use of credit.

Business spending on plant and equipment begins to increase markedly during the second half of 1977 as operating rates rise. Real capital spending increases about 7-8% both in 1978 and 1979, which, while modest in comparison to prior capital spending cycles, is sufficient to maintain capacity utilization rates below an inflationary threshold of 86%.

The increase in capital spending by business is a response to a favorable outlook for sales growth financed by considerably improved internal cashflow. Corporate profits (which increase at a 12% rate through 1978) benefit from moderate rates of productivity growth which suppress cost increases. This increase in profitability is sufficient to finance both inventory and capital investment as well as increased dividend payments to shareholders.

Throughout the expansion, the Federal Reserve follows a policy of mild accommodation. The recent rise in the Federal Funds rate of 100 basis points is a successful attempt by the Fed to choke excessive money supply growth while credit demands are relatively weak. A combination of business caution regarding long-term investment (despite record increases in profitability) and a decline in the Federal government's net demand for funds moderates upward pressure on interest rates.

In addition, the flow of funds from commercial bank time deposits to open market credit instruments, as open market rates rise above bank deposit rates, reduces the rate of growth in M2 to the middle of the Federal Reserve's target range (about 10%). In summary, the Fed is able to control the rates of growth in the various monetary aggregates without inviting a political confrontation over rising interest rates.

Finally, the international outlook improves. Inflation rates, especially in the weaker European countries, France, England and Italy begin to decline in response to domestic austerity programs and internally imposed limits on money supply growth.

The U.S., Japan, and Germany, as a result of their relatively high rates of economic growth, provide needed export markets for weaker countries, and the OECD countries, excluding the United States, achieve a 4% average rate of real growth during 1977, 1978 and 1979.

Summary of Extended Expansion
(percent change - annual rate)

	Actual	Forecast		
	1976	1977	1978	1978
GNP	11.3	10.5	10.5	10.0
GNP 72 Deflator	6.1 5.1	5.0 5.5	5.0 5.5	4.0 6.0
Corp. Profits	28			9.0
Unit Labor Costs	3.6	5.0	5.5	5.5
Compensation	7.4	8.75	7.5	7.5
Productivity	3.6	2.3	2.0	2.0

Source MHTCo. Trust Division and Data Resources, Inc.

(2) Delayed Expansion

The economy slows in 1977 as a result of weak final demand. The rate of growth in final demand has averaged only 4.1% since the beginning of the year and has suggested an unsustainable dependence on abnormally high levels of automobile and truck demand during most of the year. In fact, recently released Gross National Product data for the third quarter indicates a sharp shift in durable spending away from autos. Thus, growth in the consumer durable sector, which has contributed a substantial portion of the increase in economic growth during the current expansion, is forecast to decline to rates of growth more in line with other consumer sectors (4%) during the remainder of 1977.

Business investment also is weaker than expected and the capital spending cycle that was expected to provide a substantial impetus to real growth in 1977 does not materialize until 1978. Moreover, inventories are considered excessive in light of the short-term weakness in demand, and some liquidation takes place in 1977.

The result of weaker demand is to dampen the inflation rate, boosting real personal income and prolonging stable or slightly declining interest rates through 1978. The pattern of the business cycle is altered considerably, showing an intermediate term reduction in the growth rate in 1977--and a recovery in real growth (accompanied by lower inflation rates) in 1978.

In general, 1978 and 1979 are years of above-trend growth in both the consumer and investment sectors. Business, encouraged by a continued stable pattern of unit labor costs and an exceptionally favorable outlook for sales, begins to invest heavily. Nonresidential fixed investment increases more than 10% in both 1978 and 1979 which extends the availability of capacity and contributes to price stability.

Corporate profits increase slowly in 1977 and then accelerate in 1978 providing substantial internal liquidity from which to finance investment. Because of the relatively modest credit demands and declining inflation rates in late 1978 and 1979, the Federal Reserve is able to pursue a policy of mild accommodation throughout the period.

Summary of Delayed Expansion Forecast
(percent change - annual rate)

	Actual	Forecast		
	1976	1977	1978	1979
GNP	11.3	8.5	10.0	8.5
GNP 72 Deflator	6.1 5.1	4.0 4.5	6.0 4.0	5.0 3.5
Corp. Profits	28	7.8	17.4	5.0
Unit Labor Costs	3.6	4.5	3.0	3.5
Compensation	7.4	7.0	6.5	6.5
Productivity	3.6	2.5	3.5	3.0

Source: Donaldson, Lufkin, & Jenrette and MHTCo Trust Division estimates.

(3) Stagnation/Recession

After a moderate recovery in 1976, the economy settles into a period of high but not accelerating inflation (7-7 1/2%) and moderate to slow rates of economic growth. Food and fuel prices (which together comprise about 30% of the CPI) continue to rise throughout 1977 and 1978. Drought conditions in the United States reduce crop yields which affect meat, grain and fruit and vegetable supplies. Moreover, a combination of natural gas deregulation and OPEC oil price increases put upward pressure on fuel prices adding about .5 to 1.0% to the CPI over the period. Real personal income growth declines from 5% in 1976 to 2.5 to 3.0% through the end of 1978 so the growth consumption is no more than about 2%. The unemployment rate fluctuates around 7% and the Federal government expands job programs in an attempt to reduce the rate further.

This forecast describes a generally stagnant economy in which there is no significant addition to productive capacity. Unit labor cost increases absorb most of the profit advantage of increased prices and productivity remains below average. The Federal government is confronted by a policy dilemma: either to increase spending substantially in the hope of encouraging private investment, or to attempt to reduce inflation with another recession. Weaker foreign economies also experience relatively slow rates of real growth but at higher inflation rates. By the end of 1978, the level of unemployment is high in most industrialized countries and prospects indicate that the rate of real growth is likely to continue to deteriorate still further without any noticeable effect on the inflation rate.

Summary of Stagnation Forecast
(percent change - annual rate)

	Actual	1977	Forecast	
	1976		1978	1979
GNP	11.3	10.5	8.0	5.5
GNP 72	6.1	4.0	1.0	-0.5
Deflator	5.1	6.5	7.0	6.0
Corp. Profits	28	10.2	-3.4	-10.0
Unit Labor Costs	3.6	6.0	8.5	8
Compensation	7.9	8.0	8.5	7
Productivity	3.6	2.0	0	-1

Source: Data Resources and MHTCo Trust Division estimates.

(4) Recession

The expansion continues at above-trend rates of growth through the first half of 1978 accompanied by a decided cyclical rise in the inflation rate. The sources and pattern of growth under this scenario are very similar to the Extended Expansion forecast except that the rate of inflation begins to rise earlier and more sharply. In fact, this scenario describes the normal cyclical pattern of inflation where, despite productivity gains, costs begin to rise as the supply of resources (labor and capacity) becomes more limited and both wages and prices begin to drift upward. The problems of capacity limitations are particularly pronounced as a result of the delay in capacity additions in certain basic industries, such as aluminum and paper, and the adverse effect of rising energy costs on the effective utilization of existing capacity in other capital intensive industries.

The consumer becomes less confident as inflation rises and real income gains are pared. Consumer purchases of durables which have continued at relatively high levels throughout most of the expansion begin to deteriorate late in 1977 and nondurable purchases begin to decline in 1978.

In this forecast, corporate profits begin to diminish sharply during the second half of 1978 and capital projects are withdrawn. Capital spending by corporations deteriorates due both to the strain placed on internal funds as a result of declining profitability and to the relative unattractiveness of external funds as both long and short-term interest rates rise to peak levels. The effect of the deterioration in capital spending growth which is less than 10% of real GNP is not evident in the economy until 1979.

During 1979, real growth in the U.S. declines. Foreign countries that have depended on the economic leadership of the U.S. to spur their own internal economies begin also to contract. A decline in world-wide production reduces the level of oil imports of industrialized countries and consequently the marginal increase in their combined

balance of payments deficit with the OPEC countries. The decline in growth and income, however, strain the ability of industrialized countries to finance the existing deficit and the perception at the end of 1979 is one of both economic and financial crisis.

Summary of Recession Forecast
(percent change - annual rate)

	Actual	Forecast		
	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
GNP	11.3	12.5	10.5	6.0
GNP 72	6.1	5.5	3.0	-0.5
Deflator	5.1	7.0	7.5	6.5
Corp. Profits	28	20.5	7.3	-10.0
Unit Labor Costs	3.6	5.0	7.5	9
Compensation	7.4	8.0	8.5	7
Productivity	3.6	3.0	1.0	-2

Source: Data Resources, Inc. and MHTCo. Trust Division estimates.

JOSEPH L. McELROY, EXECUTIVE VICE PRESIDENT

Birth Date: May, 1929

Education: LL.B, New York Law School
BS, Georgetown University
Stonier Graduate School of Banking at Rutgers University
Advanced Management Program - Harvard University Business School

Business Experience: Manufacturers Hanover Trust Company

1977: Executive Vice President in charge of the Trust Division

1971-1977: The Bank of New York, Executive Vice President in charge of the Trust Division

1954-1971: The Bank of New York, Trust Division

1951-1954: First Lieutenant, U.S. Army

Organizations: President, Corporate Fiduciaries Association of New York City
Education Committee of the Trust Division the American Bankers Association

MHT Co. Boards and Committees: General Administrative Board
Personnel Policy Committee
Chairman, Corporate Trust Committee
Senior Investment Committee
Chairman, Board of Trustees of the MHT Co.
Quarter Century Club Scholarship Fund
Public Responsibility Committee
Chairman, Directors Trust Committee

VICTOR J. MELONE, SENIOR VICE PRESIDENT

Birth Date: November, 1933

Education: MBA, New York University Graduate School of Business
BA, Saint Peter's College

Business Experiences: Manufacturers Hanover Trust Company

1977: Senior Investment Officer - Trust Division

1974-1977: Vice President and Director of Research, Prudential Insurance Company

1972-1974: Senior Vice President and Director of National Research, Dean Witter & Company

1968-1972: Vice President and Director of Research, Blyth & Company, Inc.

1959-1968 Investment counseling, portfolio manager and research

Organizations: New York Society of Security Analysts
Chartered Financial Analyst

MHT Co. Committees: Chairman, Senior Investment Committee
Chairman, Investment Officers' Committee
Directors Trust Committee

WILLARD L. WHEELER, JR., SENIOR VICE PRESIDENT

Birth Date: October, 1932

Educations: MBA, University of Chicago
BA, Cornell University
National Trust School
Investment Management Program - Stanford University

Business Experience: Manufacturers Hanover Trust Company

1973 to date: Officer in Charge, Employee Benefit Trust Department

1971-1973: Senior Officer, Employee Benefit Trust Investment Department

1968-1970: Investment Officer, Employee Benefit Trust

1957-1968: Portfolio Officer, Northern Trust Co., Chicago

Organizations: Investment Analysts Society of Chicago
National Foundation of Health, Welfare and Pension Plans, Inc.
American Pension Conference
Cornell Alumni Society
Advisory Committee-Stanford University Graduate School of Business
Past Member, New York State Bankers Association
Employee Benefit Committee

MHT Co. Committees: Senior Investment Committee
Portfolio Management Committee (Ad Hoc Member)
Trust Investment Committee
Directors Trust Committee

DIMITRI N. BALATSOS, VICE PRESIDENT

Birth Date: 1941

Education: MA, University of California - Berkeley
BA, Knox College (top of class)

Business Experience: Manufacturers Hanover Trust Company
1973 to date: Vice President and Economist
1971-1973 Assistant Vice President
1965-1971 Life Insurance Association,
Associate Economist

Organizations: Various Economic Associations

MHT Co. Committees: Author of quarterly Financial Report
Co-author Weekly Financial Digest

HARALD S. deROPP, VICE PRESIDENT

Birth Dates: January, 1936

Education: MBA, Wharton Graduate School of Business
BA, University of Delaware

Business Experience: Manufacturers Hanover Trust Company
1962 to date Portfolio Manager, Employee
Benefit Trust Investment Department
1961-1962: Security Analyst, Investment
Research Department

Organizations: Bond Portfolio Managers Association

MHT Co. Committees: Portfolio Management Committee
Trust Investment Committee

JOEY L. McCANDLESS, VICE PRESIDENT

Birth Date: December, 1929

Educations: AB, Princeton University 1951
Princeton Graduate School of Psychology 1952
New York Trust School

Business Experience: 1973 to date: Manufacturers Hanover Trust
Company Trust Division

1958-72: Football Coach, Princeton University

1955-58: Teacher - Coach, The Kent School,
Kent, Connecticut

1952-55: Teacher - Coach, St. Mark's School,
Southboro, Massachusetts

Organizations: International Foundation of Employee Benefit Plans
Association of Private Pension & Welfare Plans,
Regional Chairman
National Association of State Retirement Administrators
National Council on Teacher Retirement
National Conference on Public Employee Retirement
Systems
American Pension Conference
National Football Foundation and Hall of Fame