

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

125 SCOMM 9: HOUSE SPEC. COMM. ON PERMANENT FUND 1977-78

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 per cent 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		78		LEVEL	% CH	78		79		LEVEL	% CH				
			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 $\frac{1}{2}$ % 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	
7¼s 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	6.45%
30- 89 days 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.

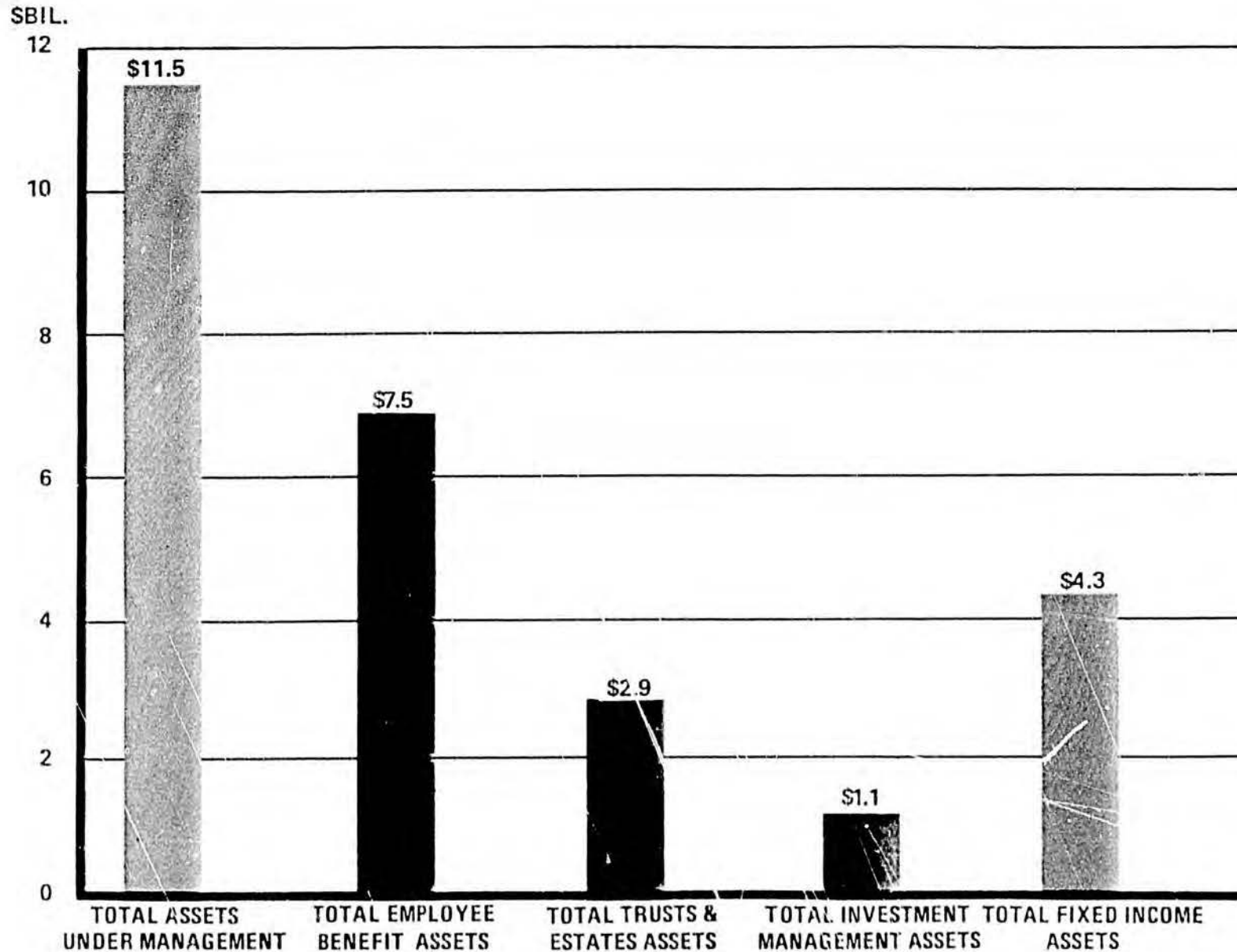
MANUFACTURERS HANOVER TRUST



SUMMARY OF ASSETS UNDER MANAGEMENT



MANUFACTURERS HANOVER TRUST

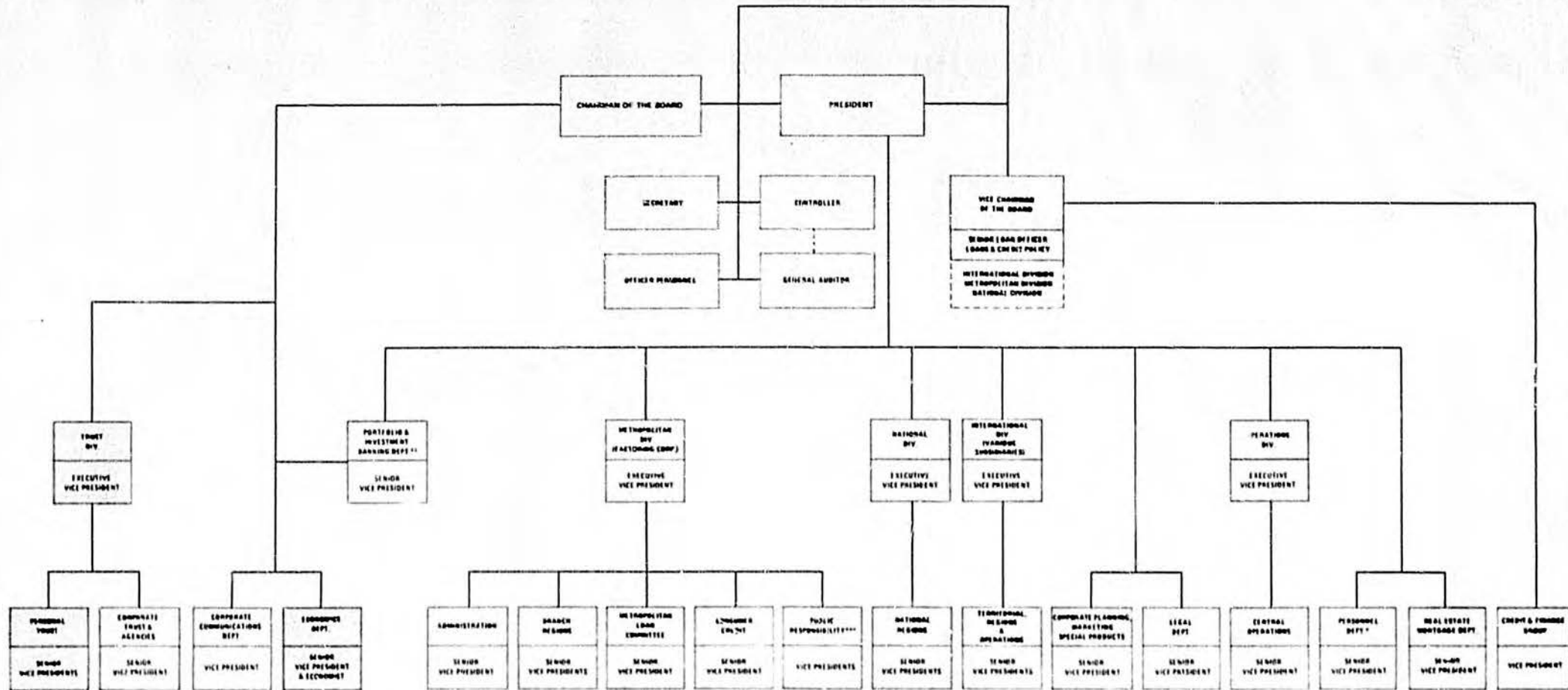


MANUFACTURERS HANOVER TRUST CO. ORGANIZATION CHART



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Savings, S. U. B., Trasops,
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Fixed Income

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T. Goepfert, AM
M. J. Tuttle

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W. C. Petty, VP
C. Stevenson

Common Stock

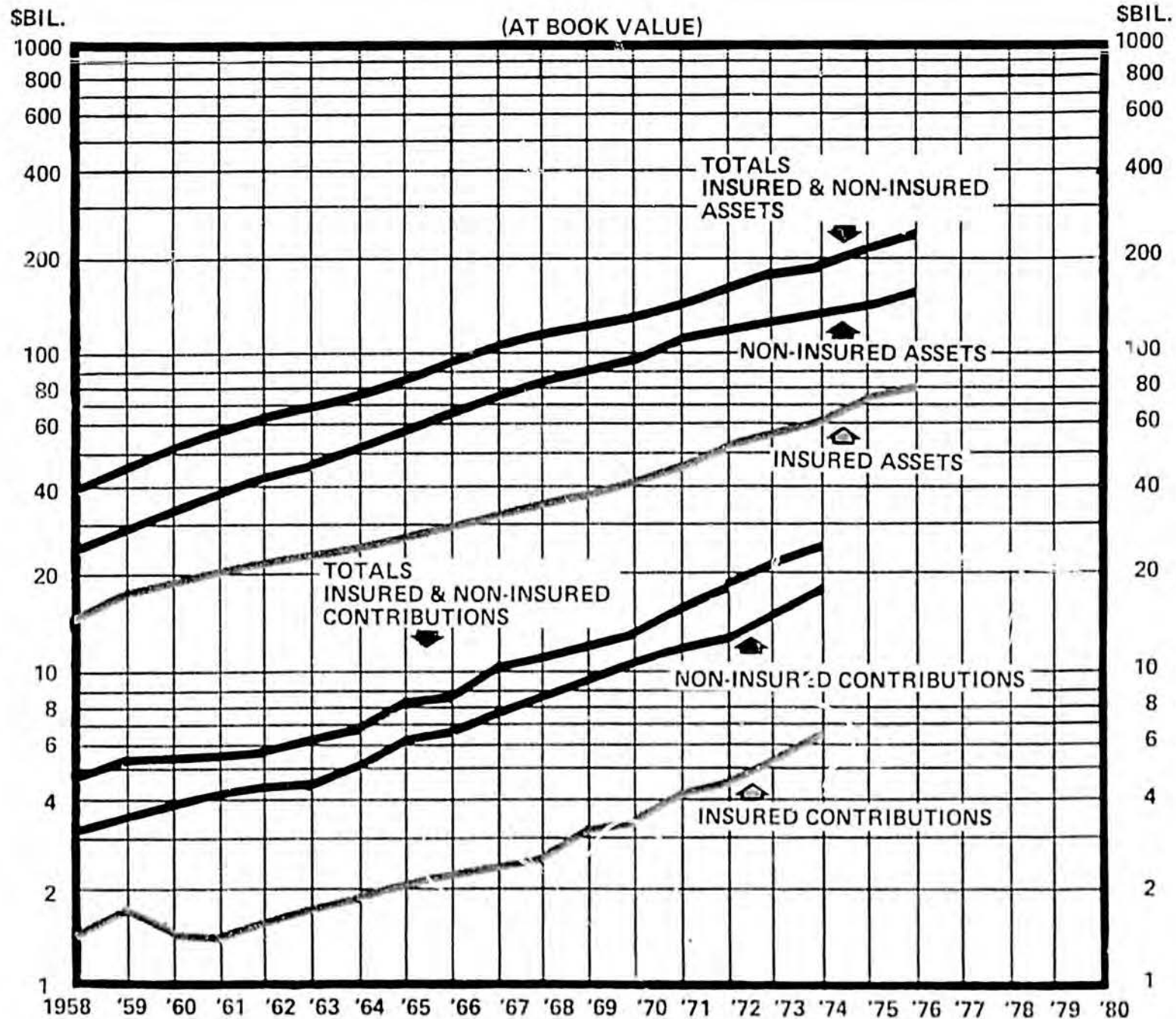
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*group head

INSURED & NON-INSURED PRIVATE PENSION PLANS CONTRIBUTIONS & ASSETS



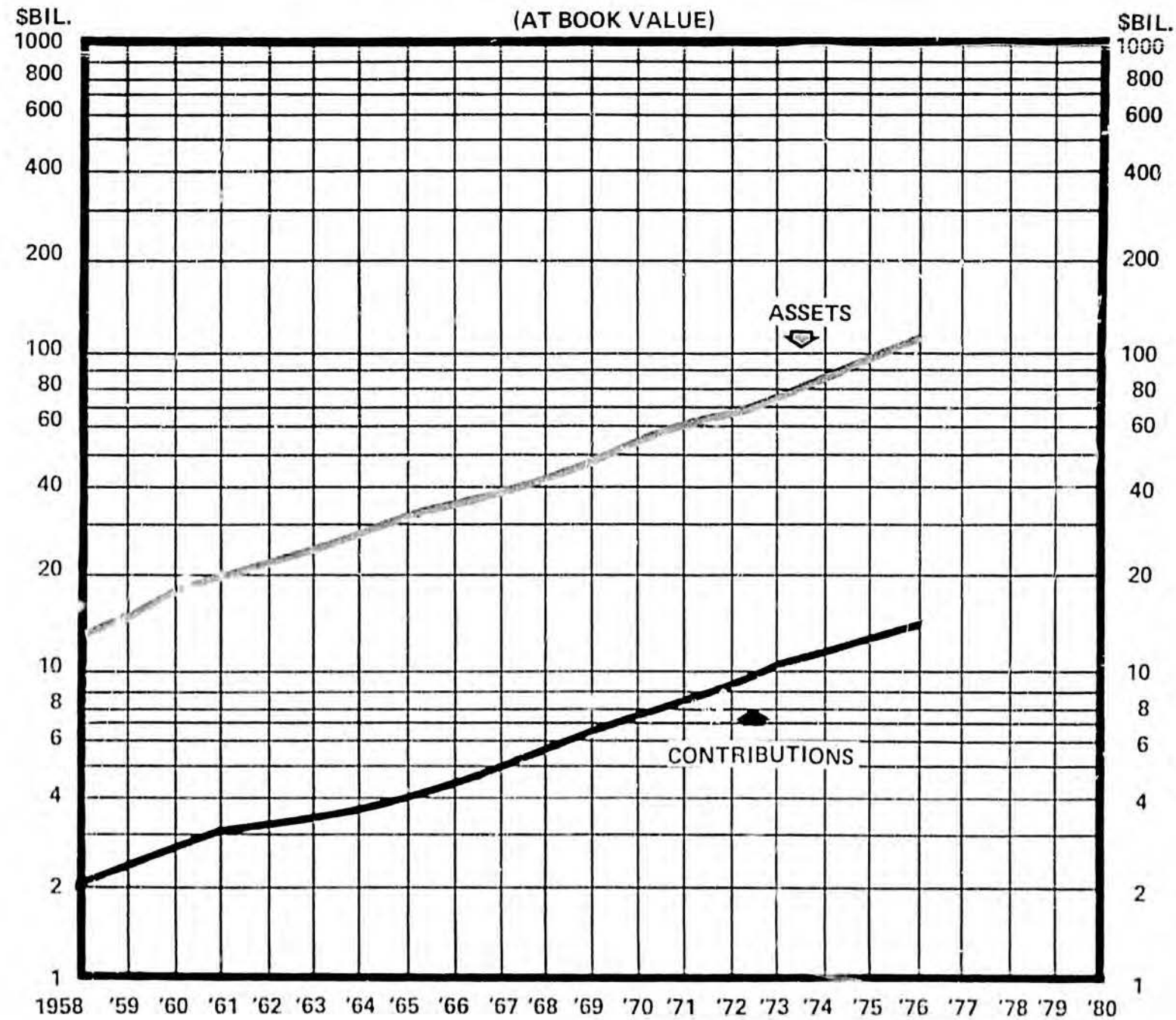
MANUFACTURERS HANOVER TRUST



STATE & LOCAL GOVT. RETIREMENT FUNDS CONTRIBUTIONS & ASSETS



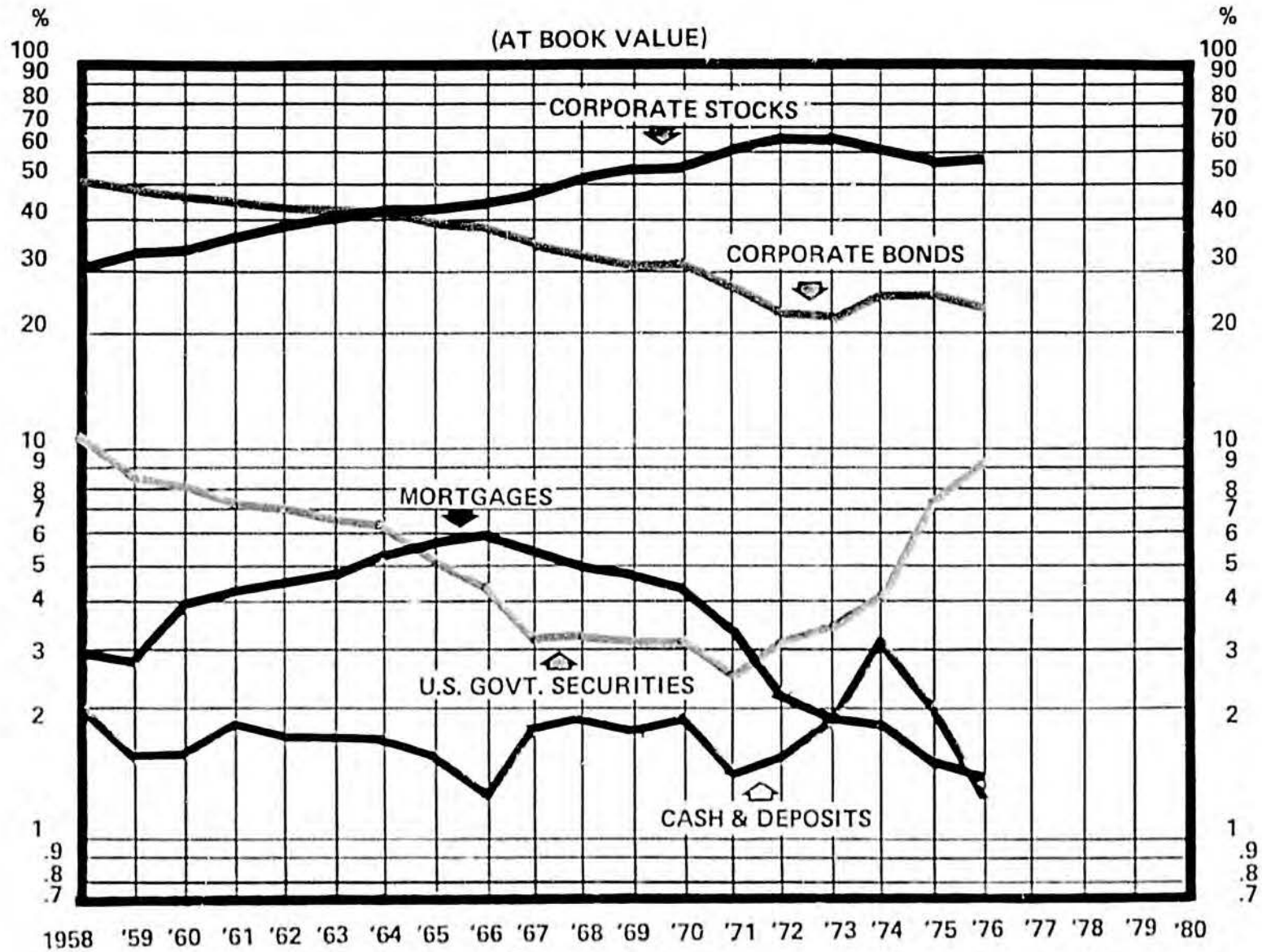
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NON-INSURED PENSION PLANS PERCENTAGE DISTRIBUTION OF ASSETS



MANUFACTURERS HANOVER TRUST



STATE & LOCAL GOVT. RETIREMENT FUNDS PERCENTAGE DISTRIBUTION OF ASSETS



MANUFACTURERS HANOVER TRUST

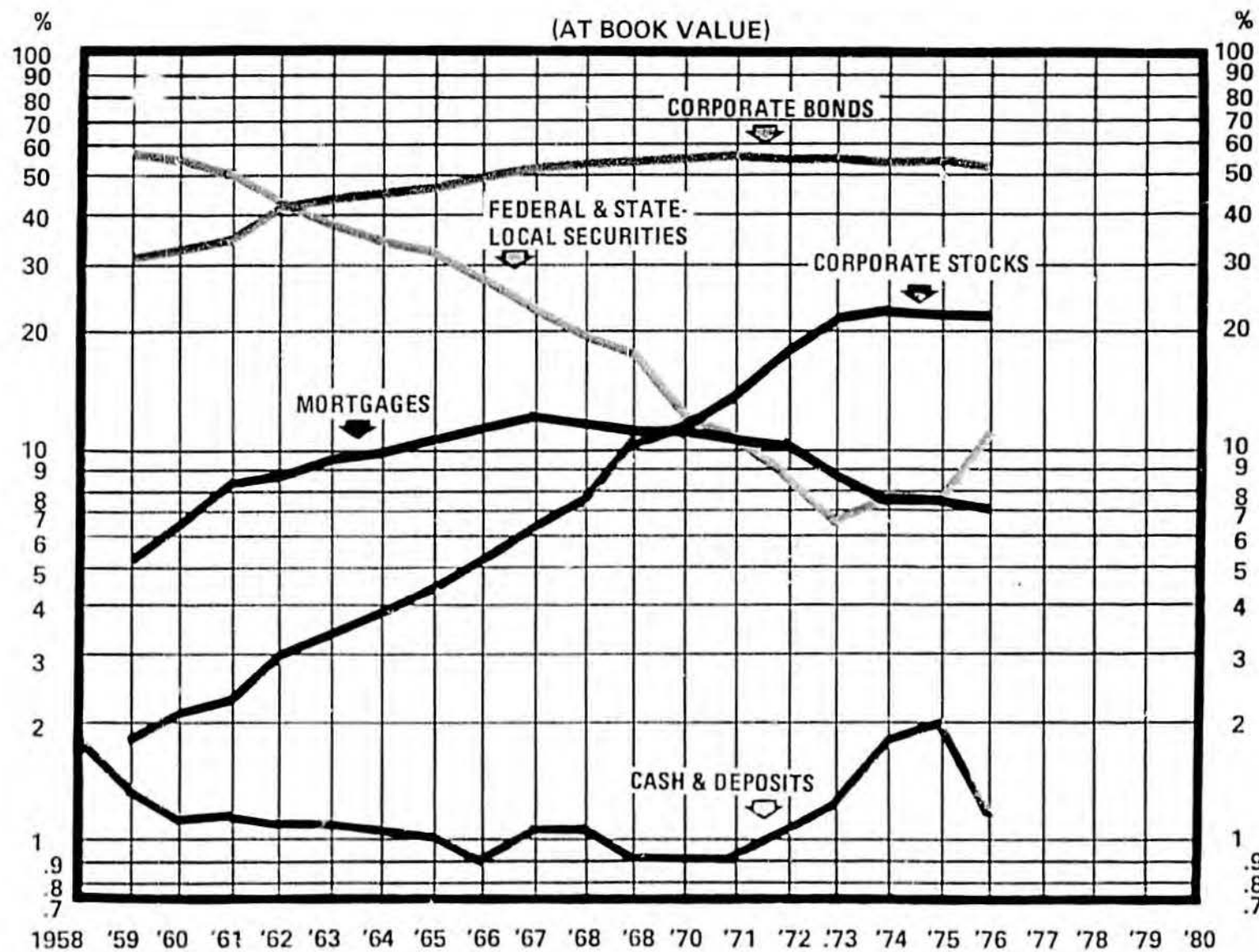


TABLE I

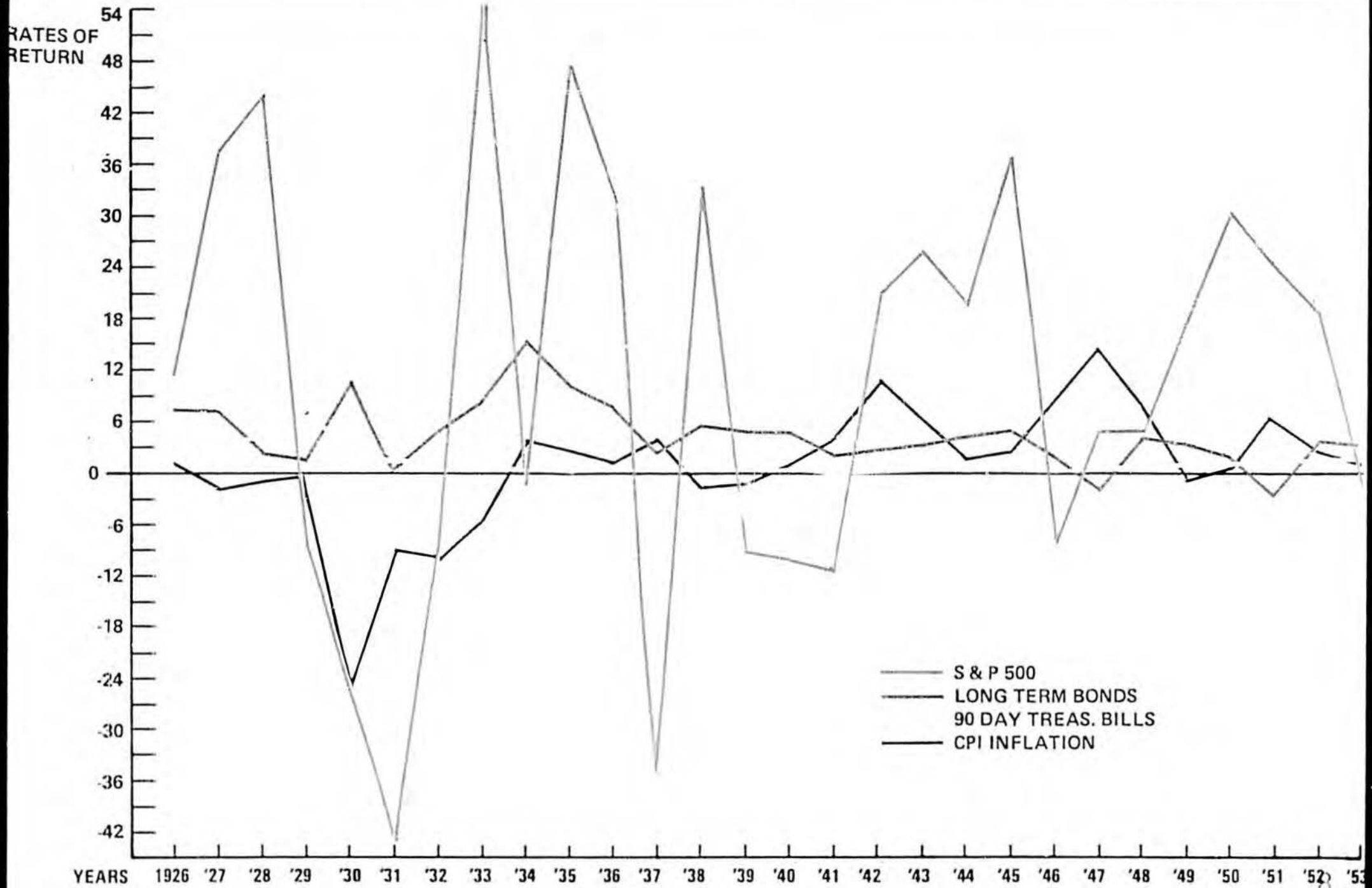
TOTAL RATE OF RETURN
(Percent Per Annum Compounded Annually)

	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



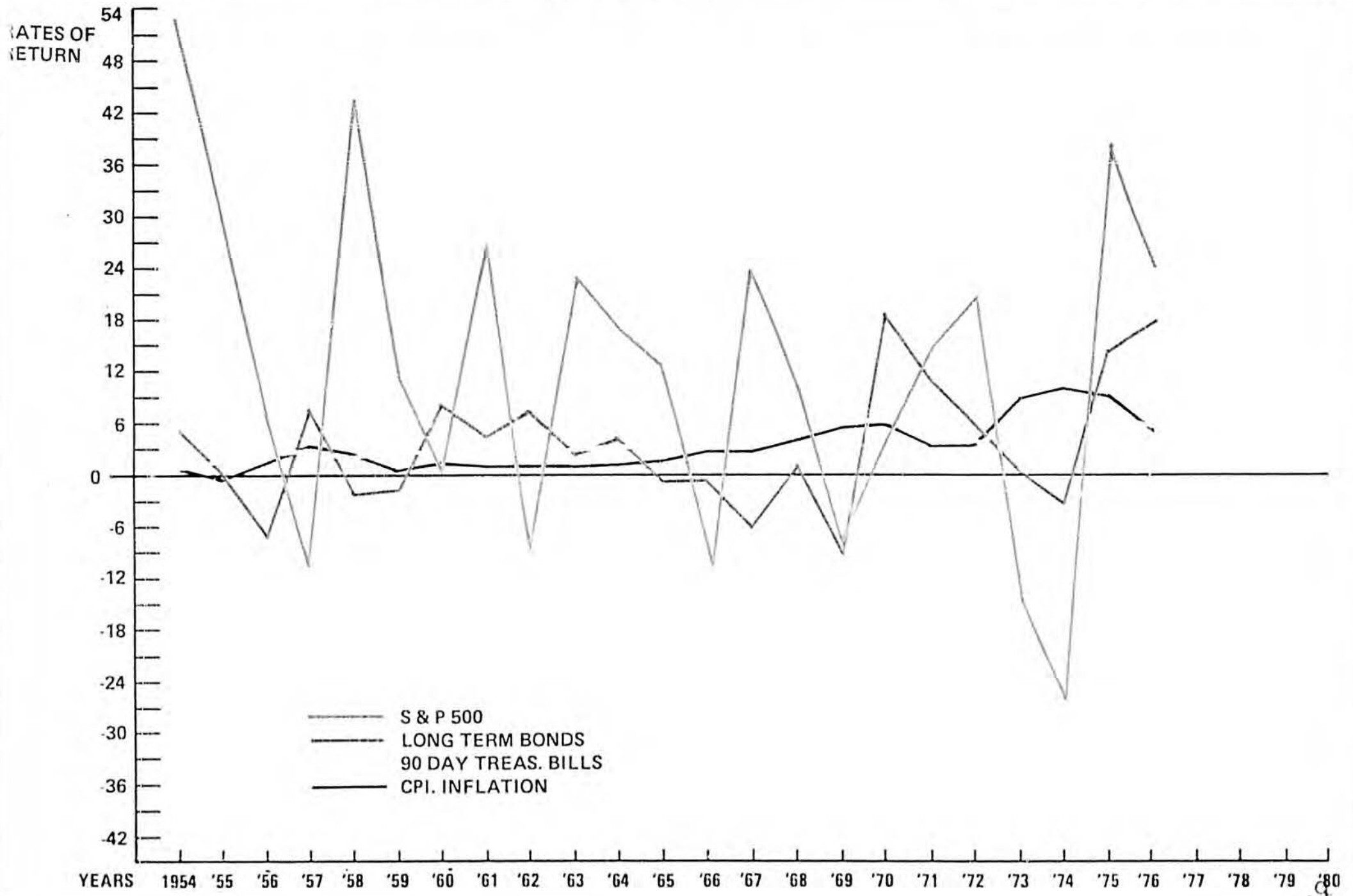
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VARIOUS RATES OF RETURN



MANUFACTURERS HANOVER TRUST

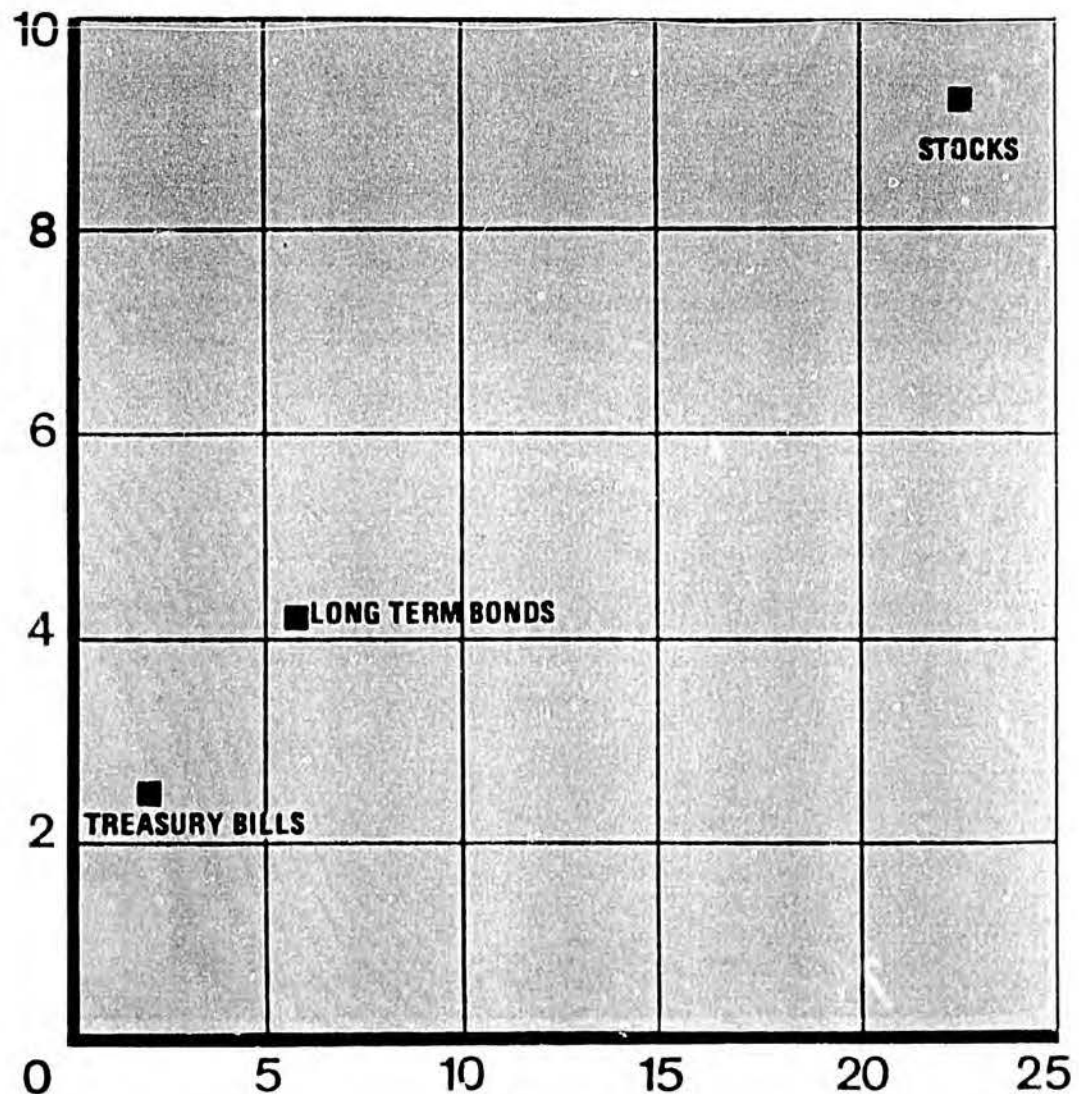


COMPOUND ANNUAL RATE OF TOTAL RETURN 1926-1976 [%]



MANUFACTURERS HANOVER TRUST

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

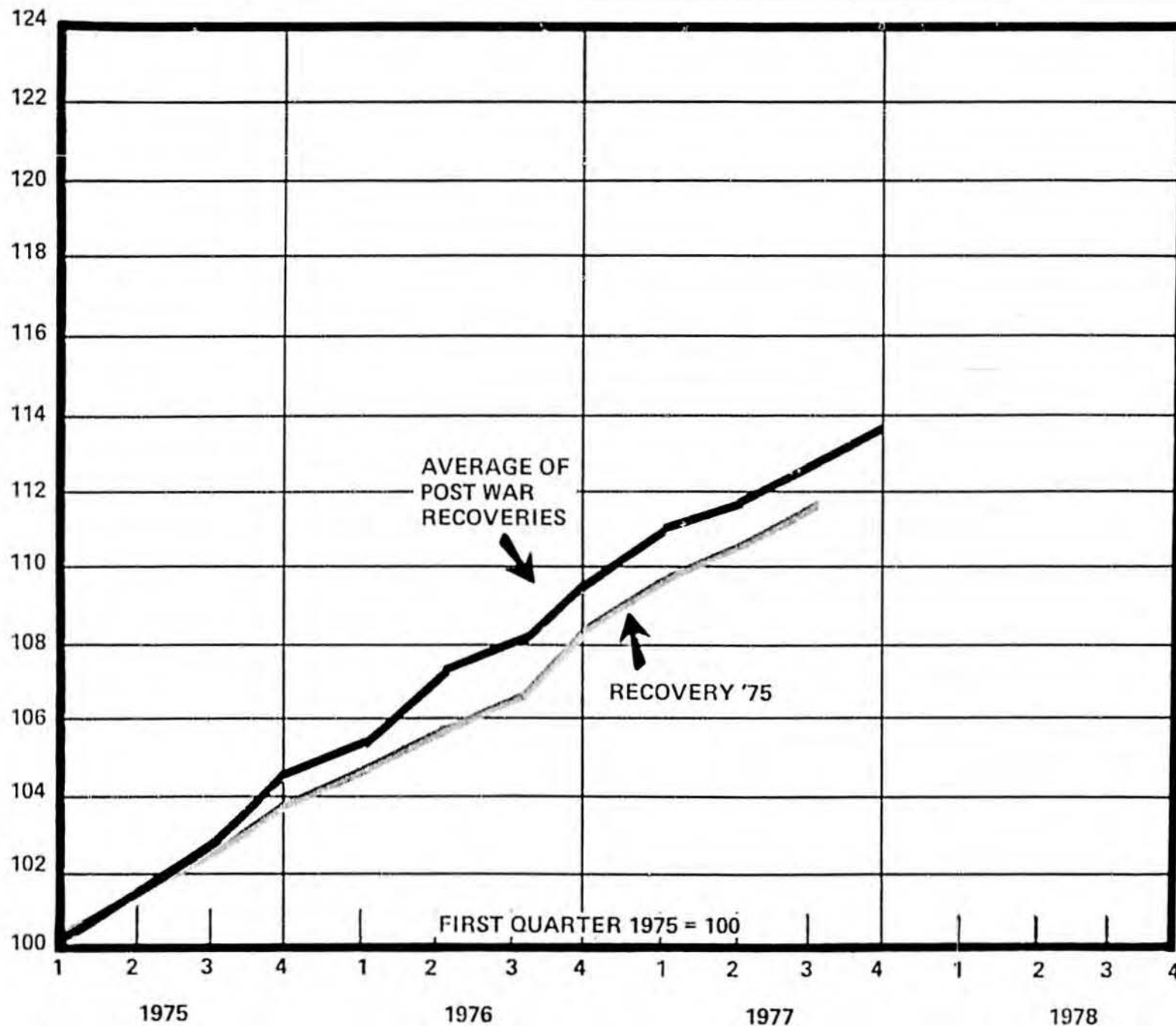


STANDARD DEVIATION IN RATE OF NOMINAL TOTAL RETURN (%)¹⁰

REAL FINAL SALES



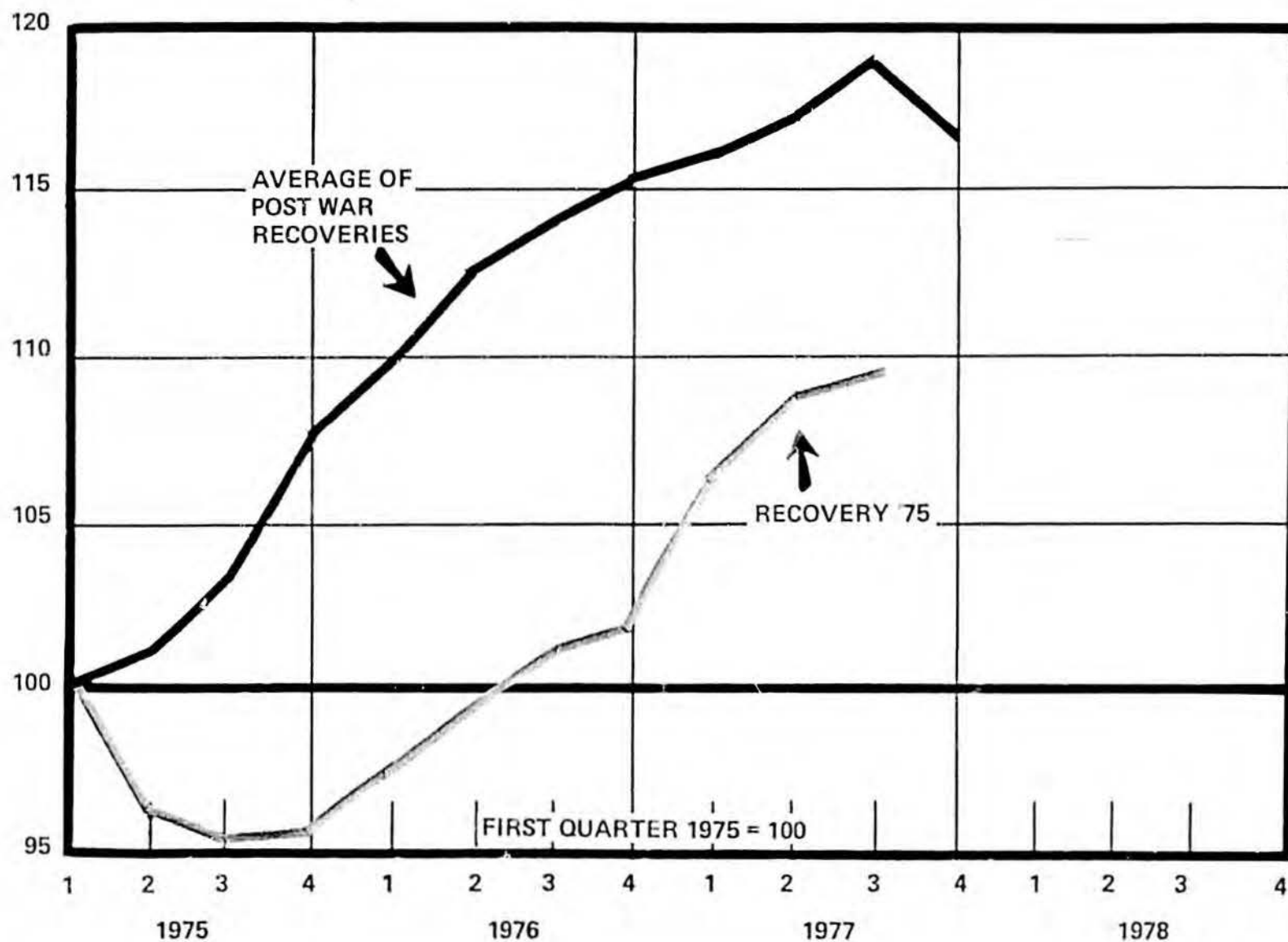
MANUFACTURERS HANOVER TRUST



“REAL” BUSINESS FIXED INVESTMENT



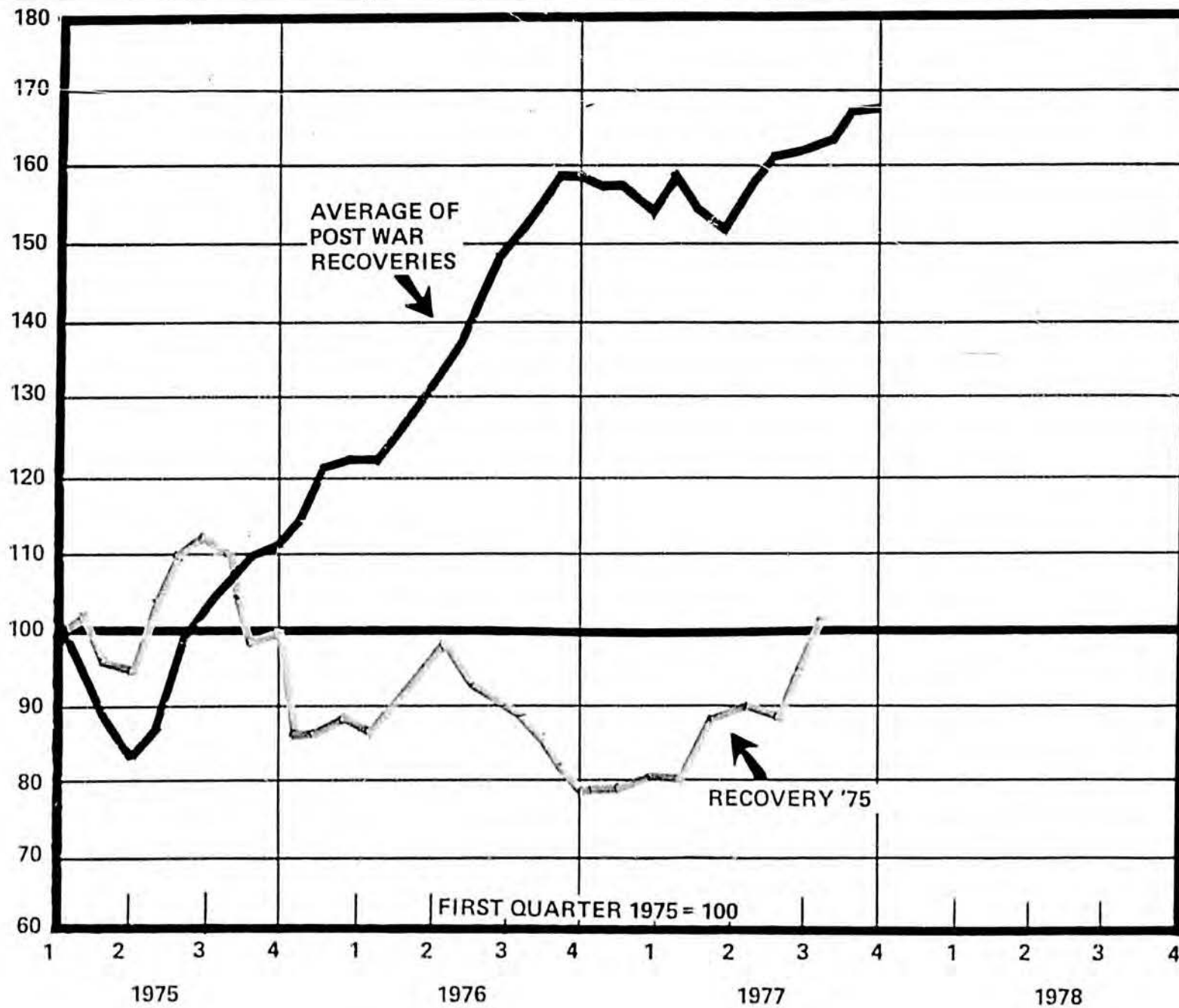
MANUFACTURERS HANOVER TRUST



SHORT TERM COMMERCIAL PAPER RATE



MANUFACTURERS HANOVER TRUST



YIELD ON AA CORP. UTILITY BONDS



MANUFACTURERS HANOVER TRUST

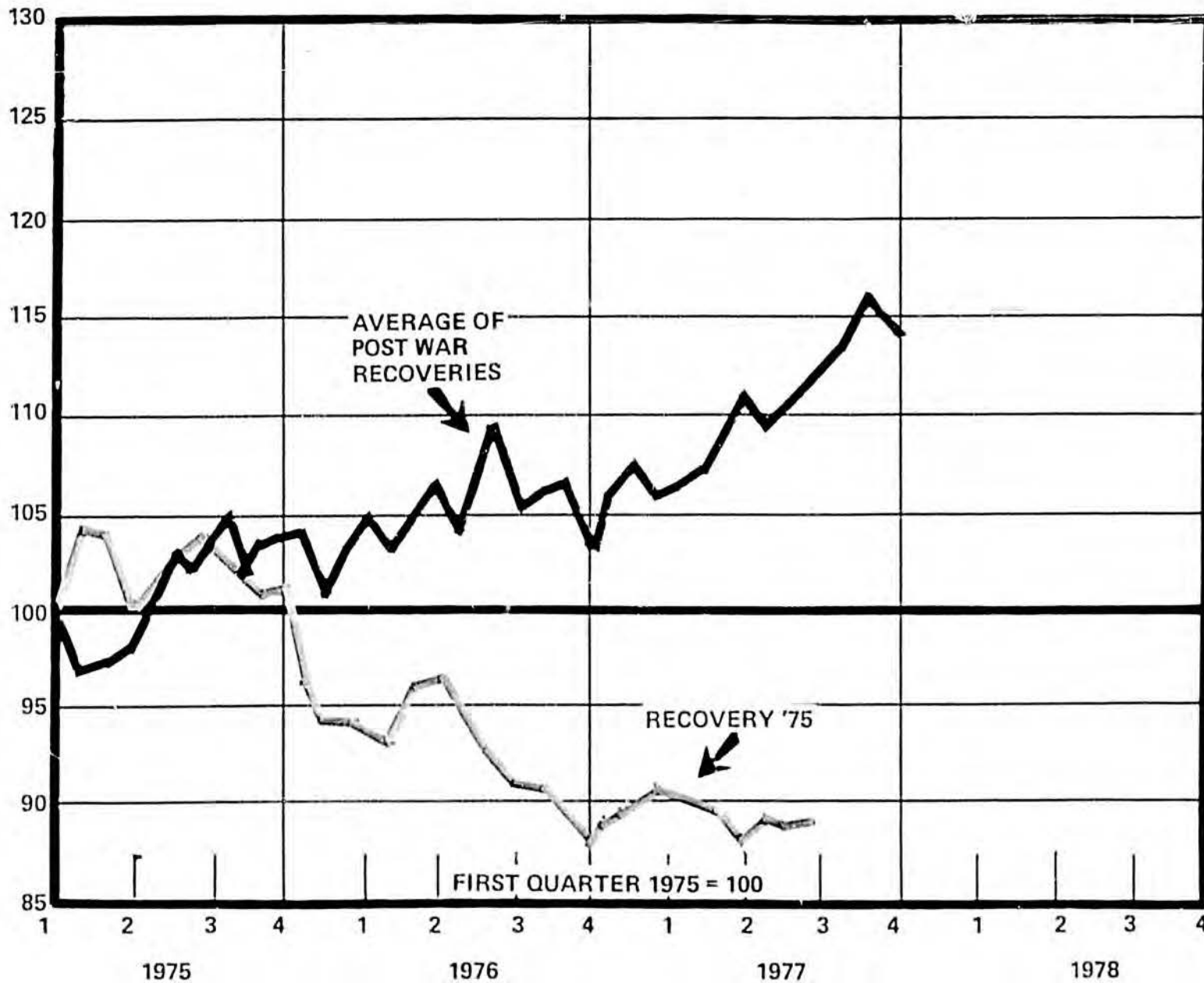
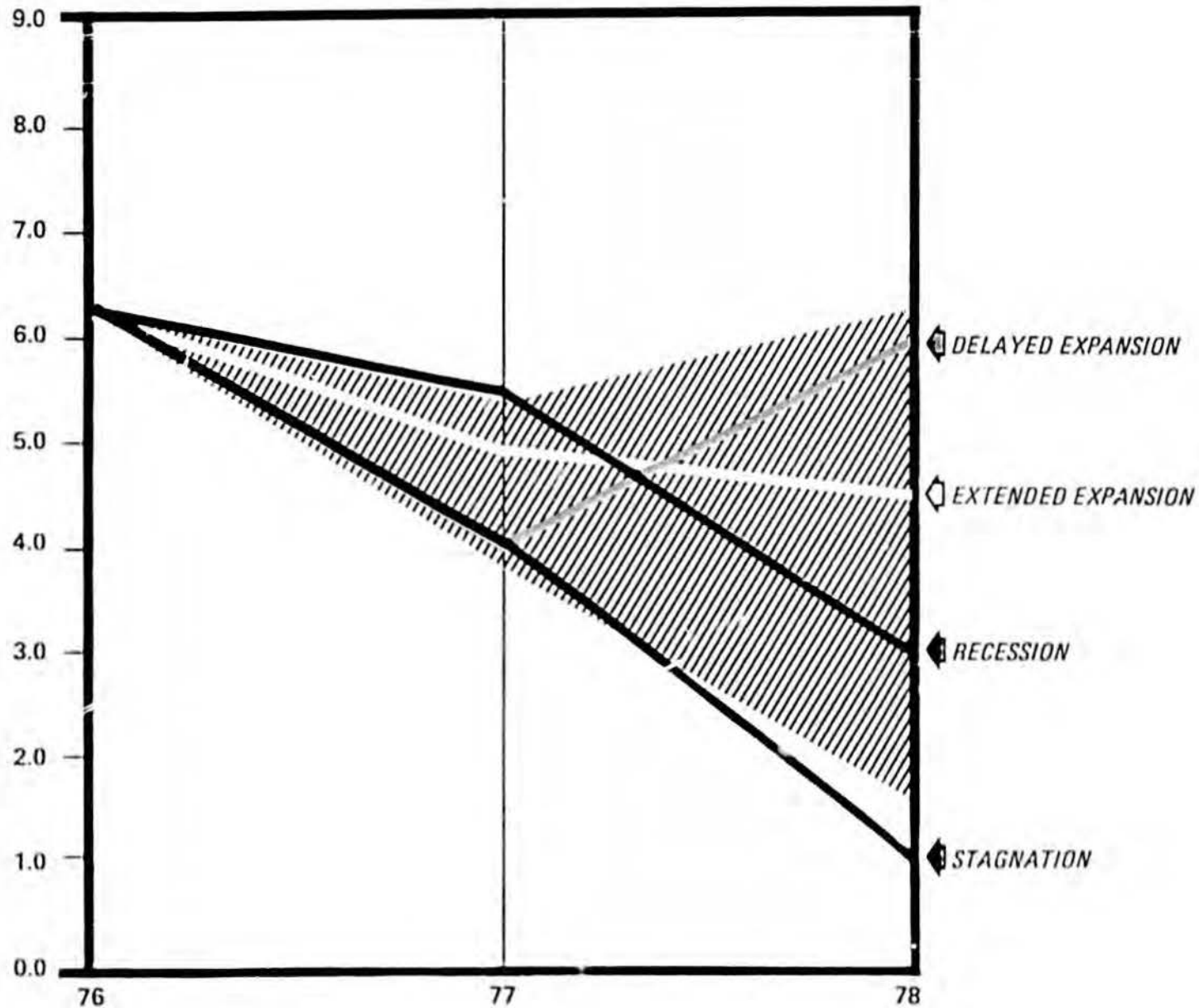


TABLE II
ECONOMIC FORECASTS

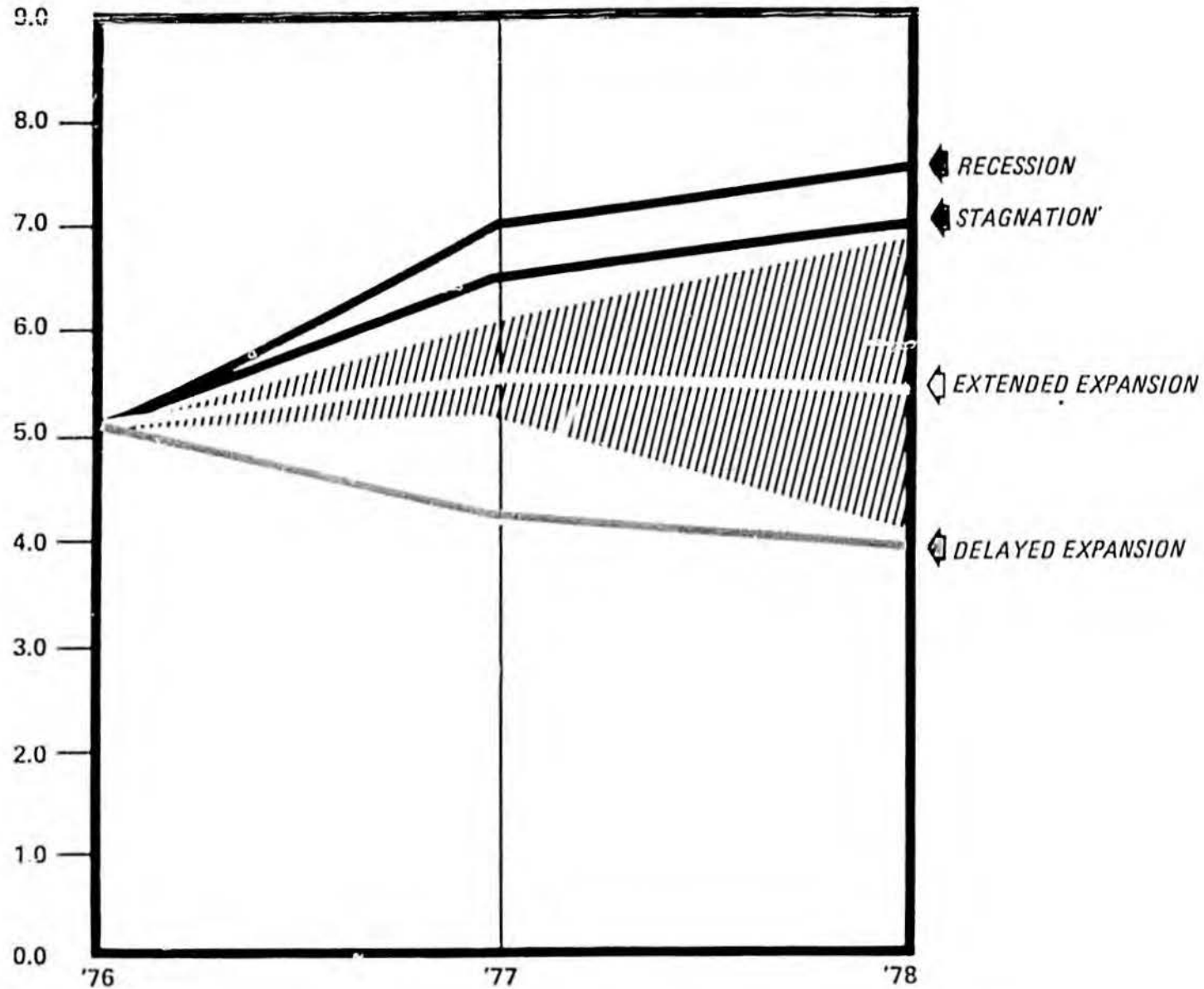
	#1 Extended Expansion				#2 Delayed Expansion				#3 Stagnation/Recession				#4 Recession			
	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979	Actual 1976	1977	1978	1979
GNP	11.3	10.5	10.0	10.0	11.3	8.5	10.0	8.5	11.3	10.5	8.0	5.5	11.3	12.5	10.5	6.0
GNP 72 Deflator	6.1 5.1	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



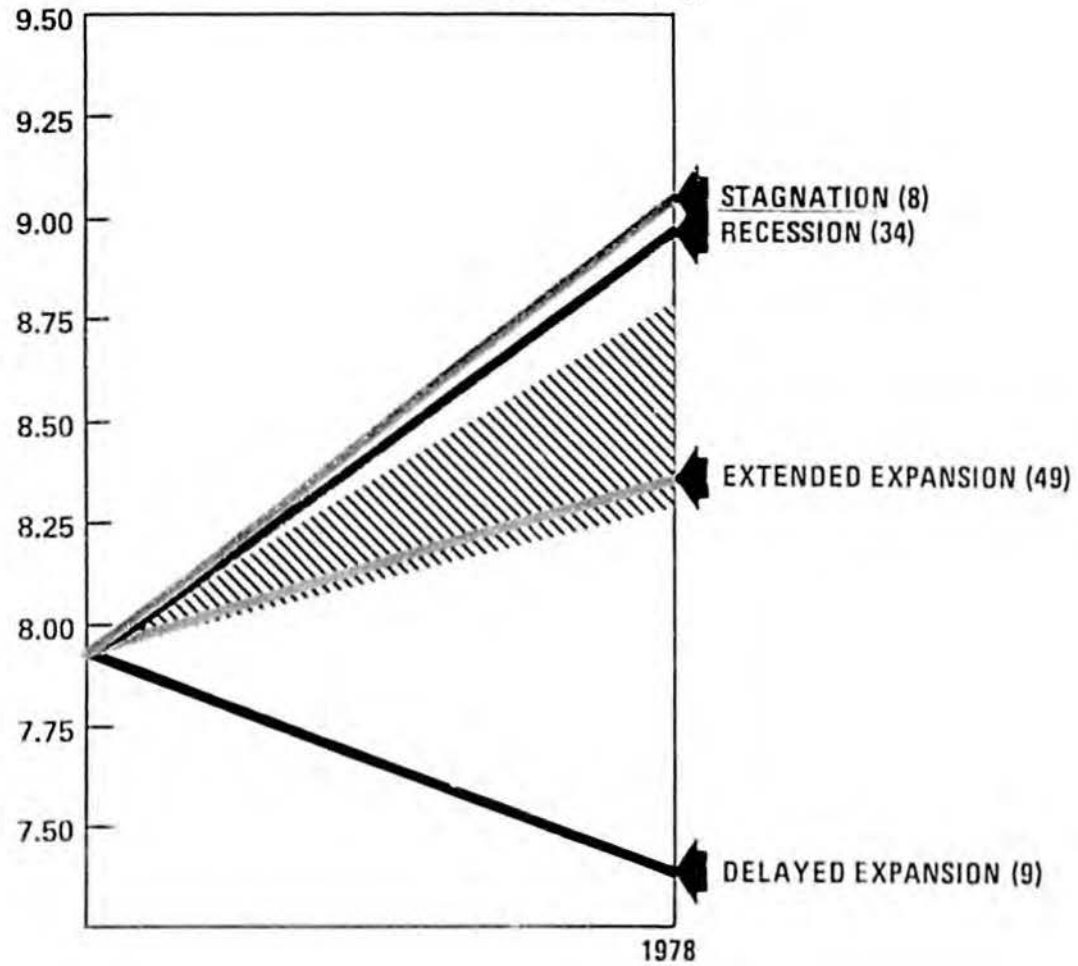
GNP DEFLATOR: Forecasts vs Model





MANUFACTURERS HANOVER TRUST

BOND MARKET FORECASTS
(LONG AA CORP.)

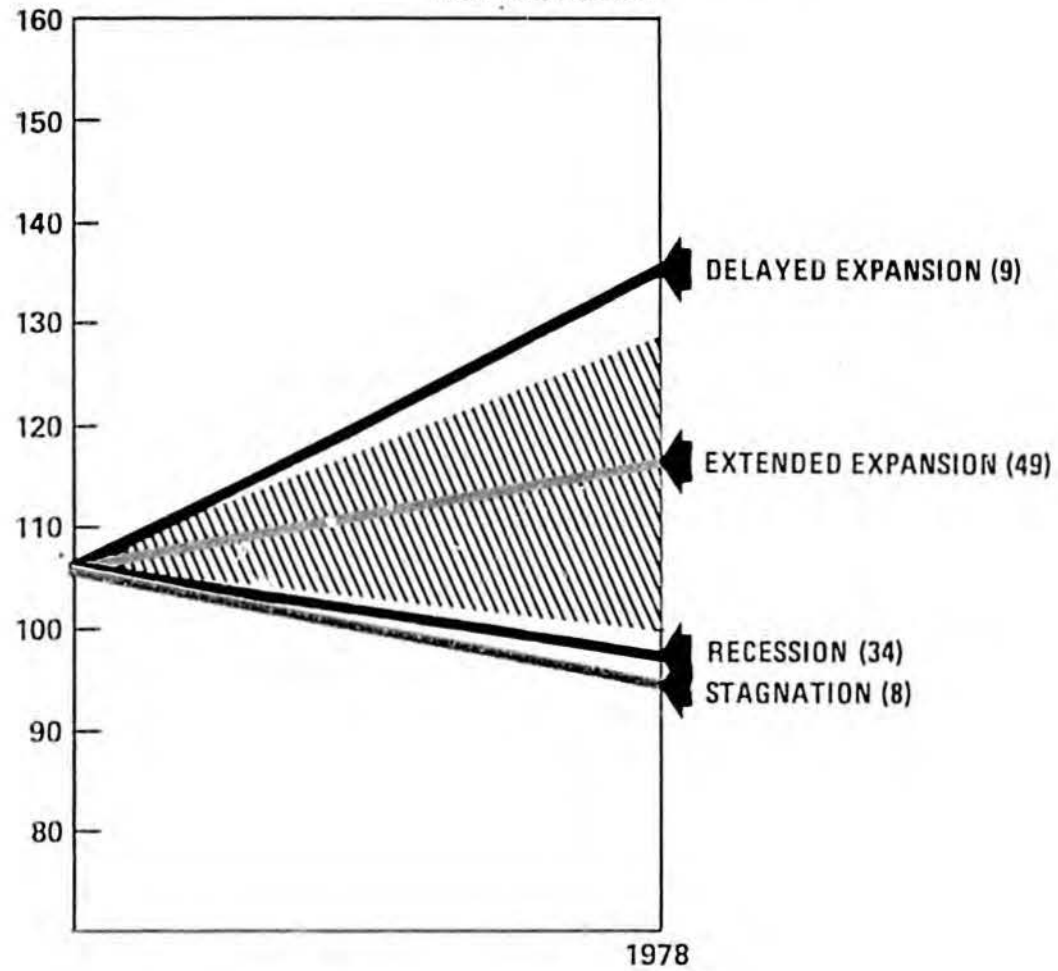




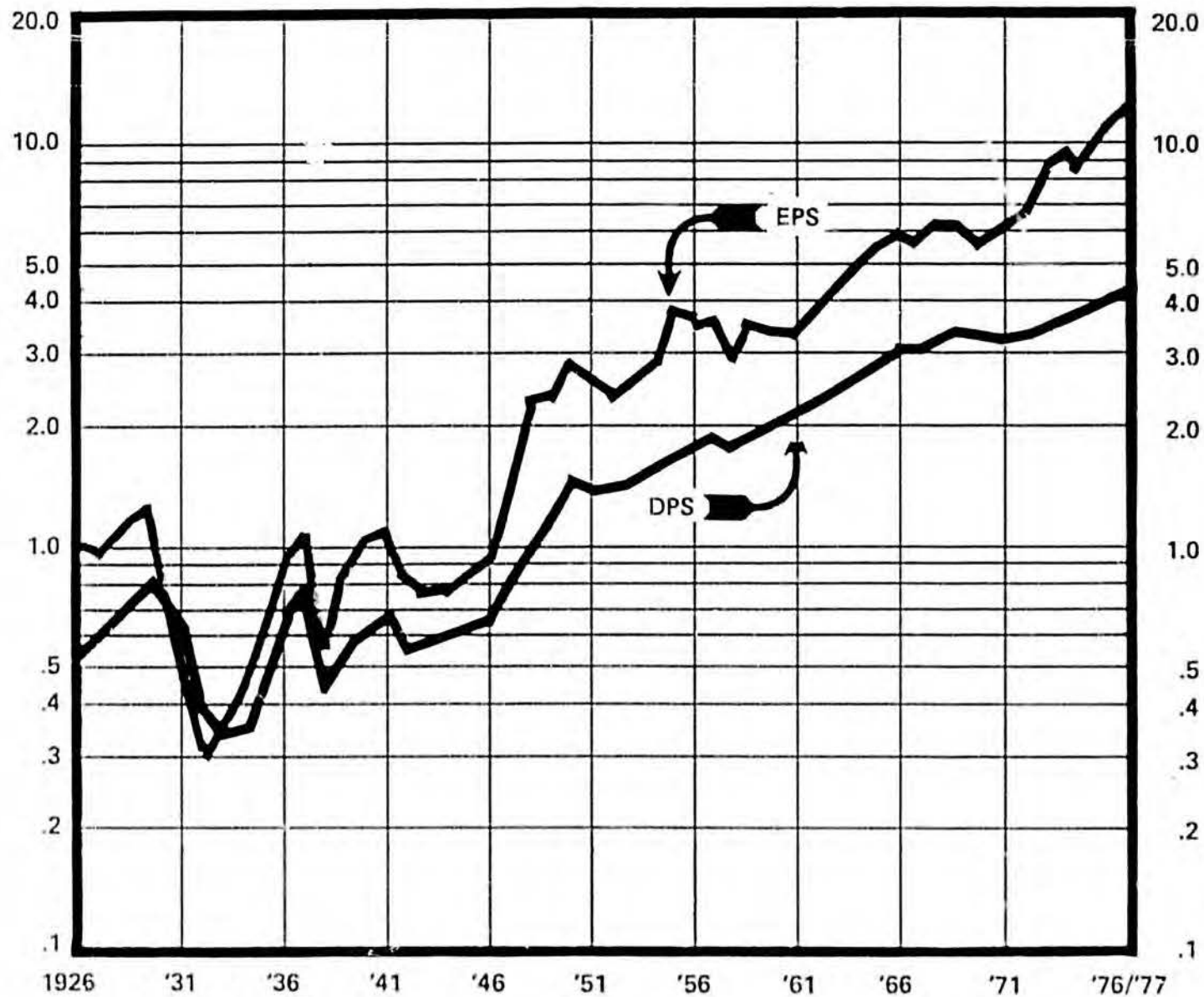
MANUFACTURERS HANOVER TRUST

STOCK MARKET FORECASTS

S&P 400 INDEX

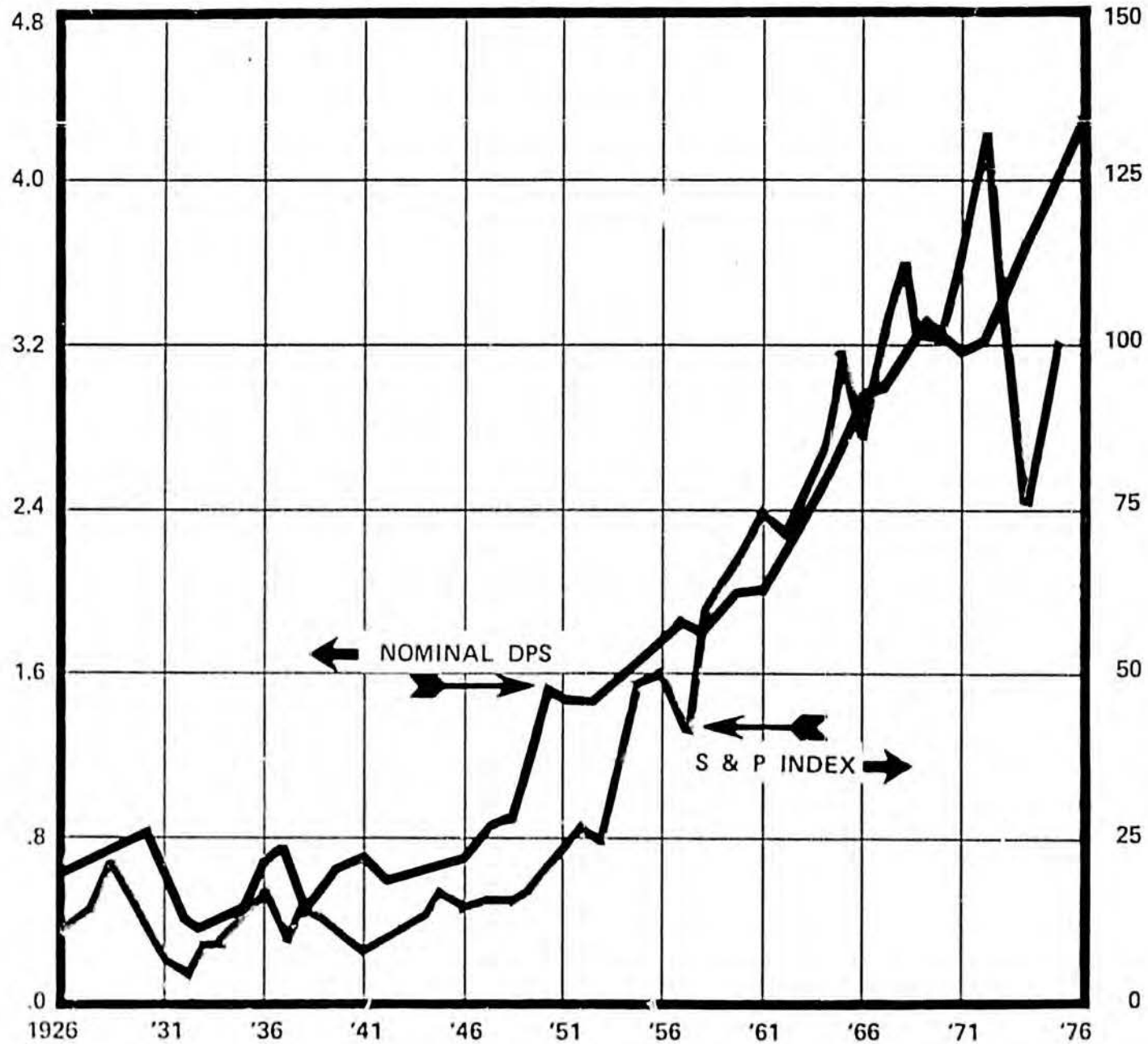


Dividends Per Share (DPS) & Earnings Per Share (EPS) 1926 - 1976



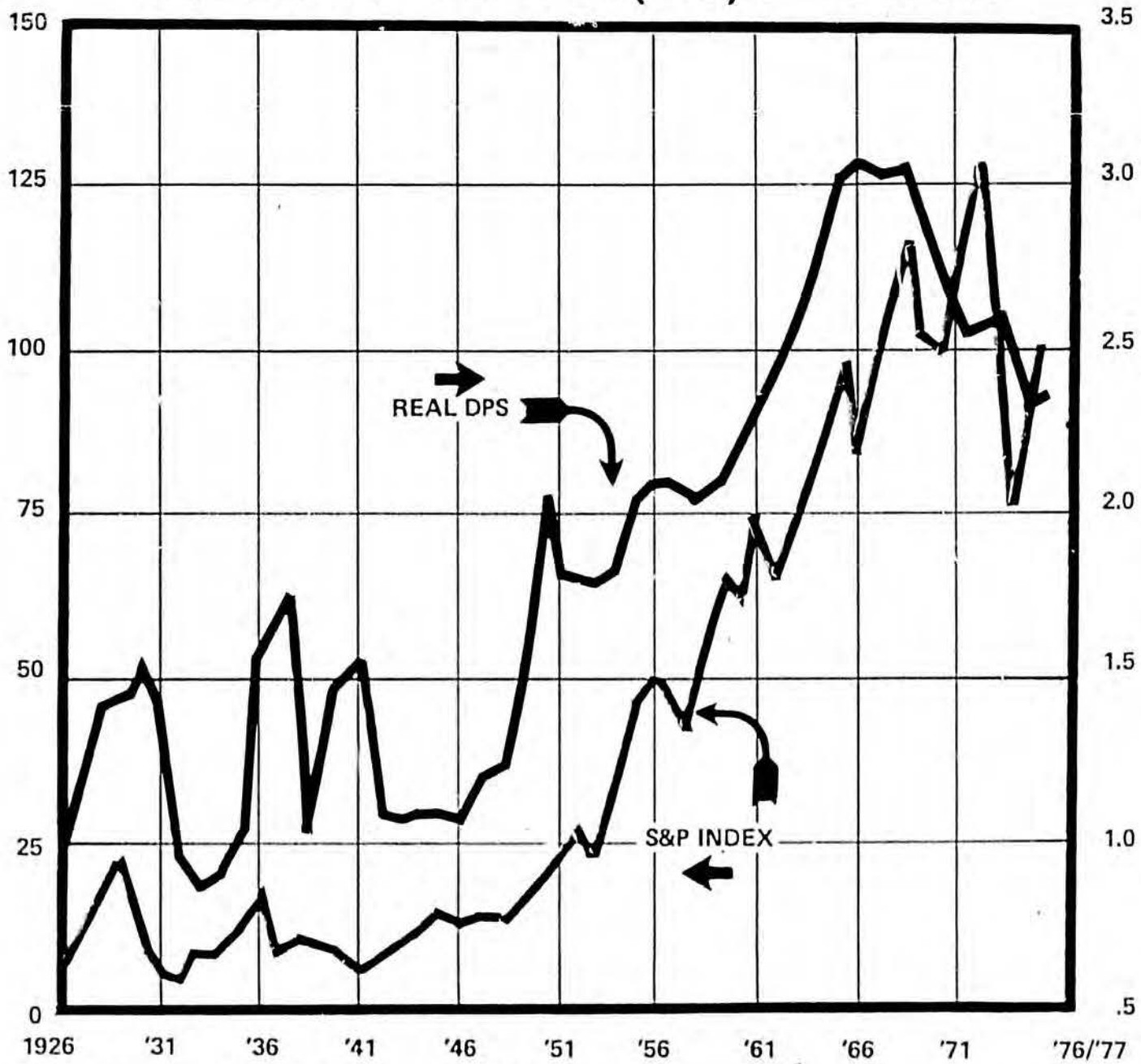
SOURCE: S & P INDEX

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



SOURCE: STANDARD & POOR'S

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

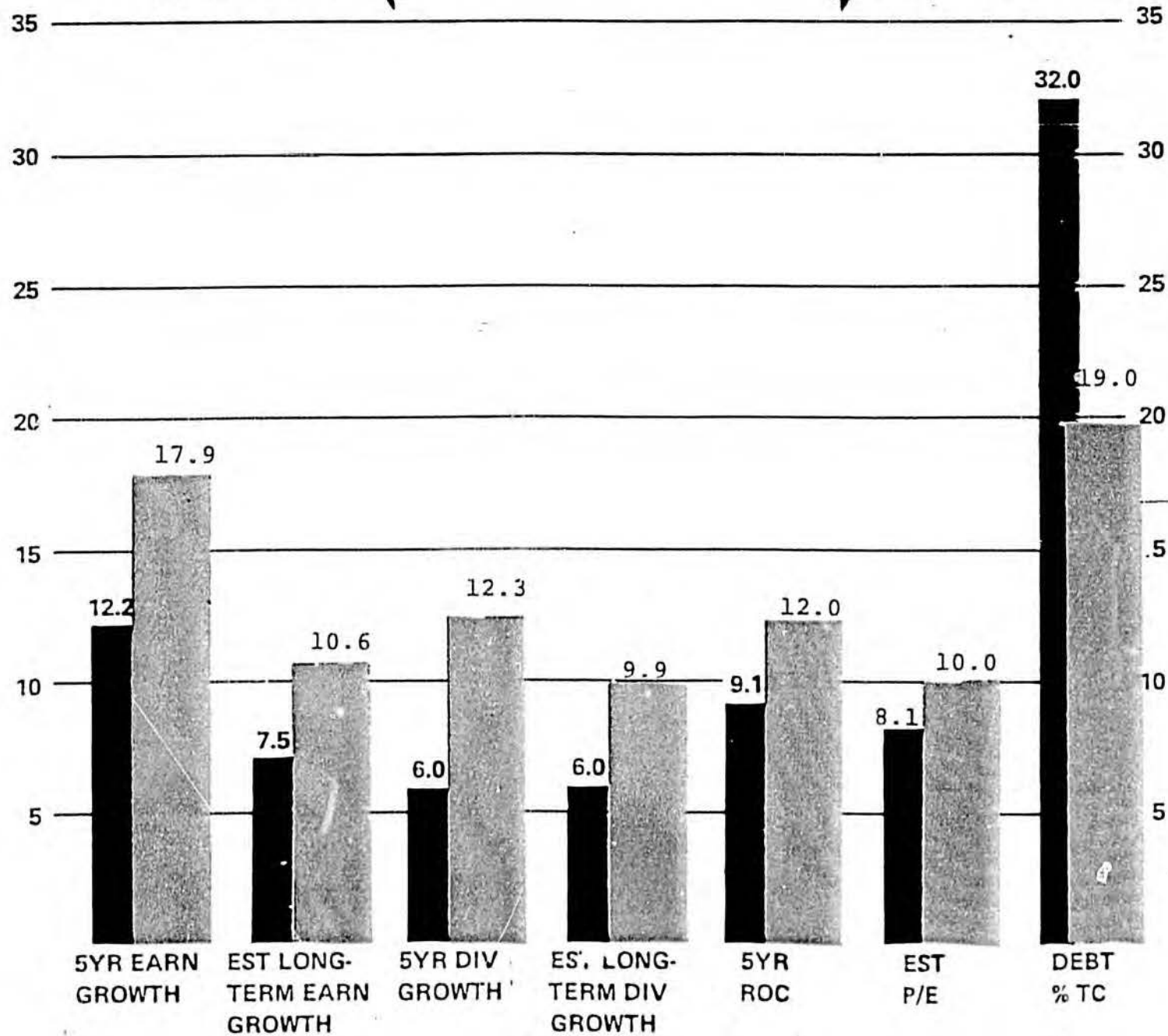


SOURCE: STANDARD & POOR'S & MHTCO

COMPARATIVE ANALYSIS

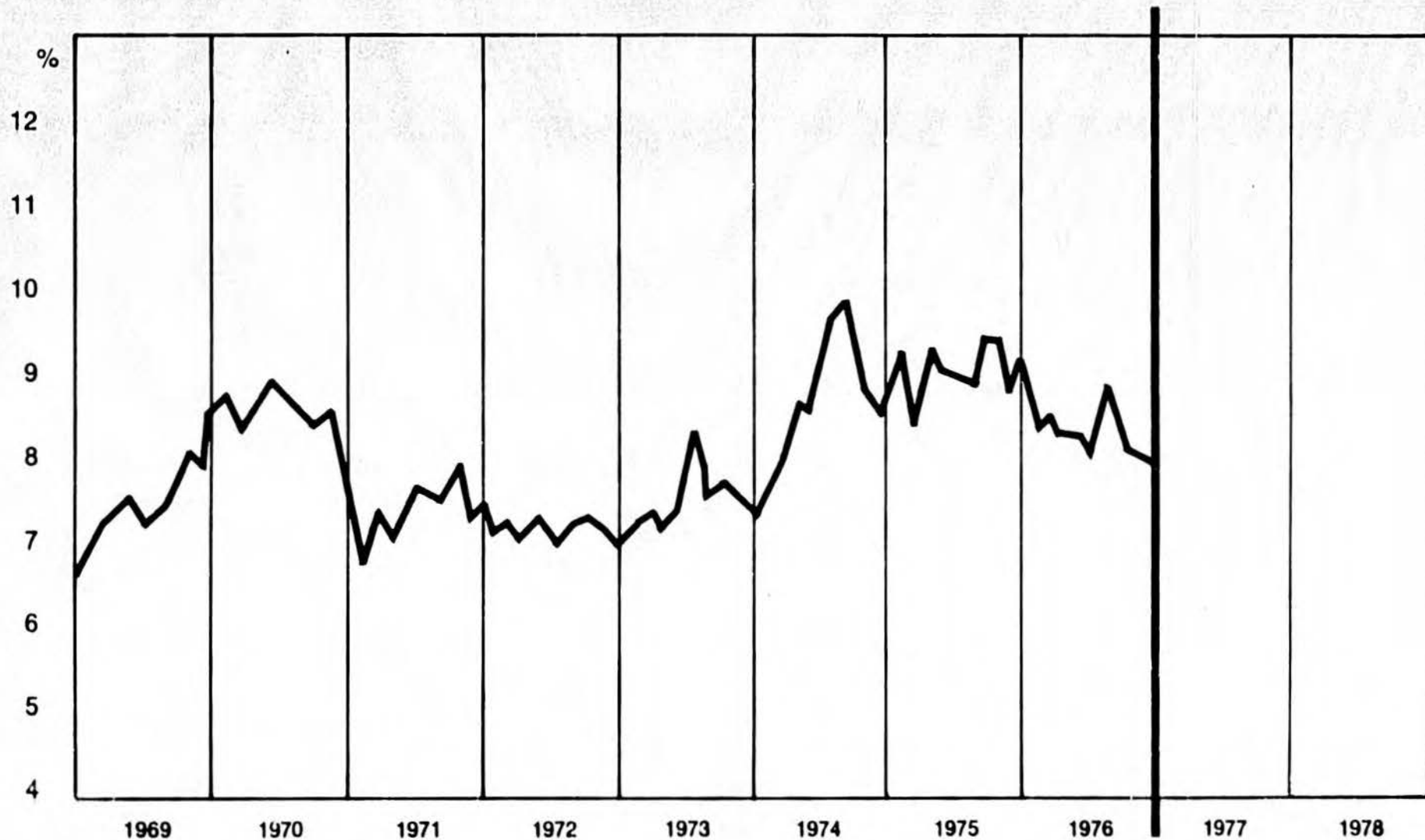
S & P 400 ◀

▶ ACC'T



YIELDS OF NEW AA INDUSTRIALS* 1969 through 1976

M MANUFACTURERS HANOVER TRUST



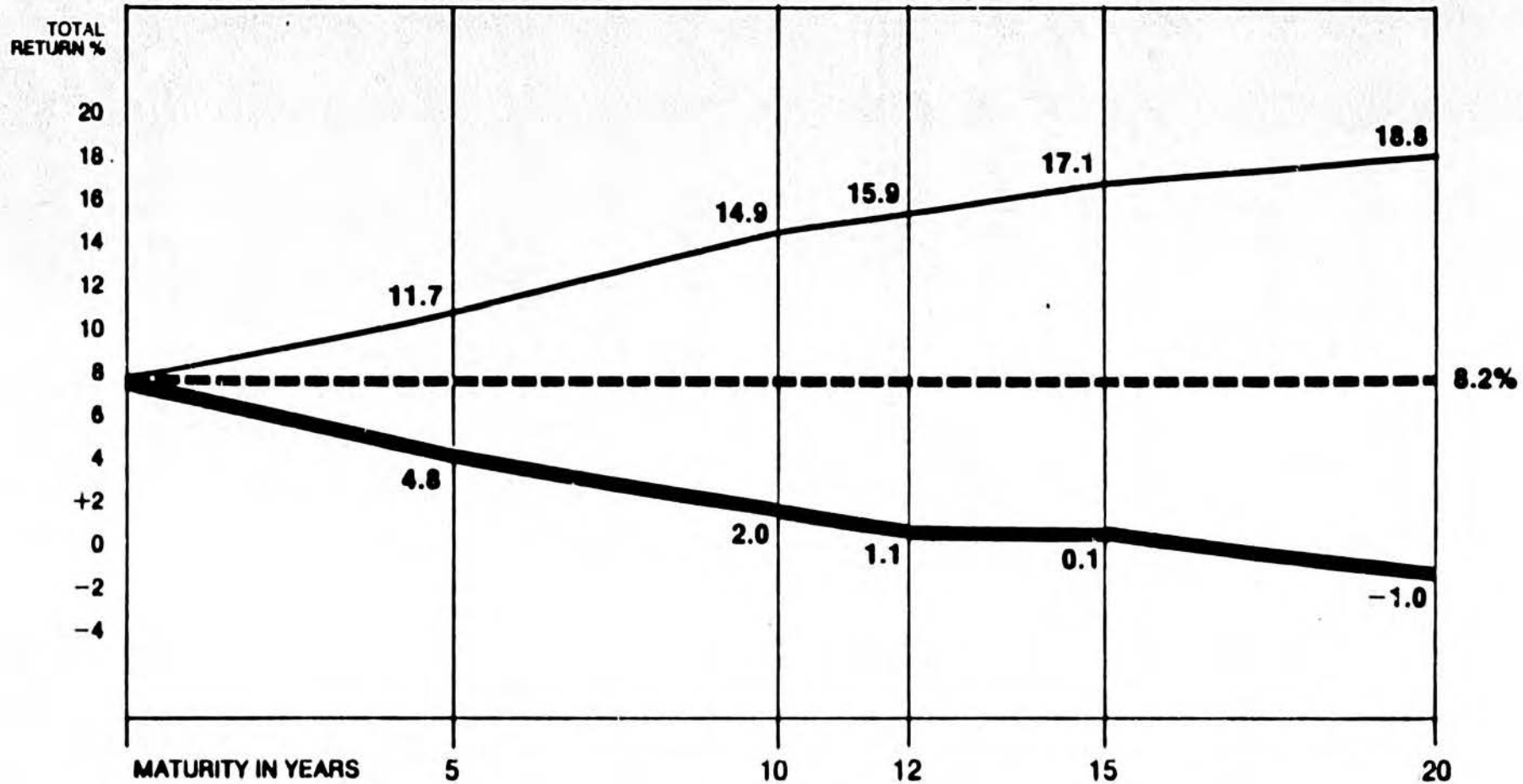
* call protected

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.



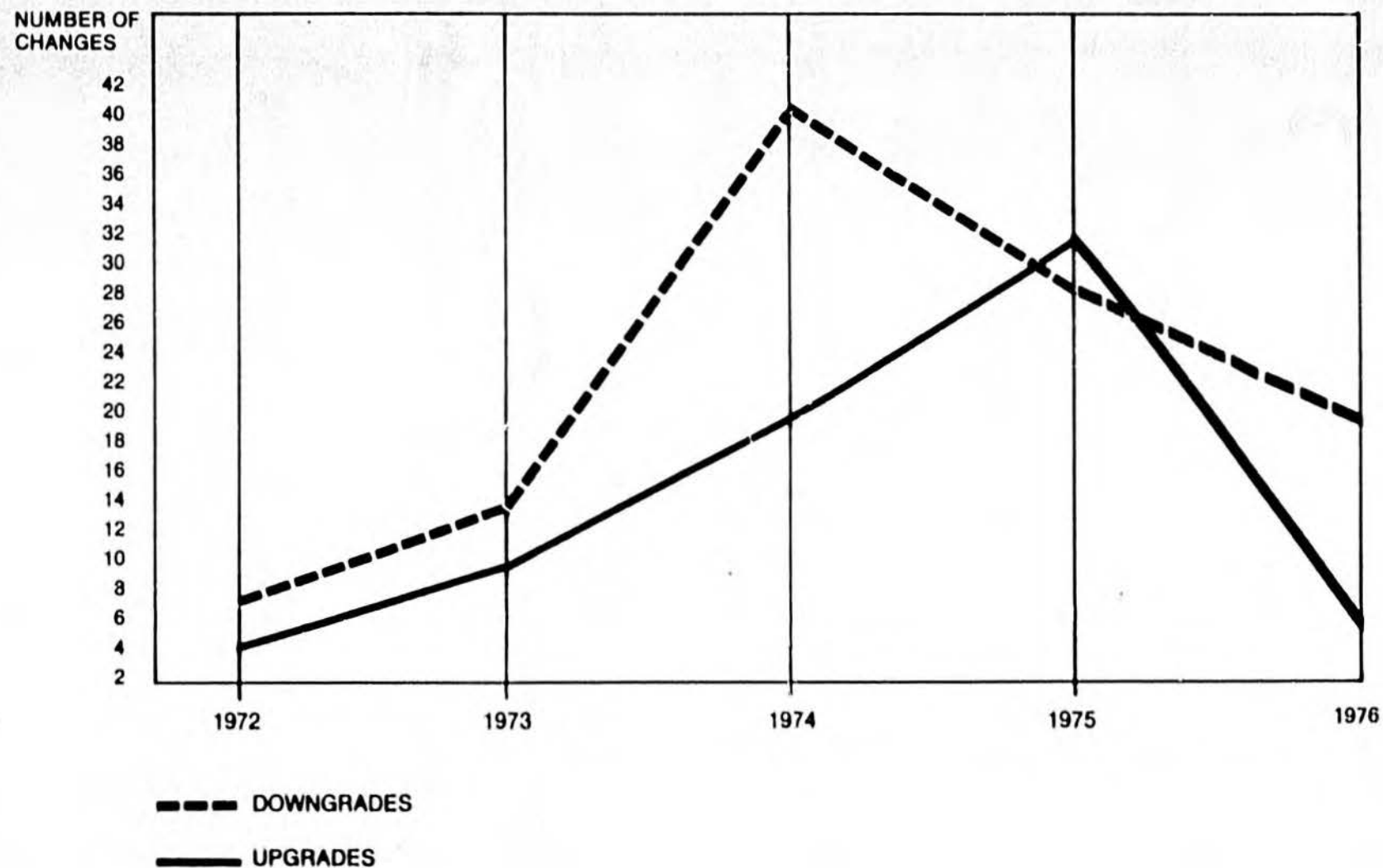
NOTE: STARTING POINT IS A BOND
WITH AN 8% YIELD TO MATURITY.

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**

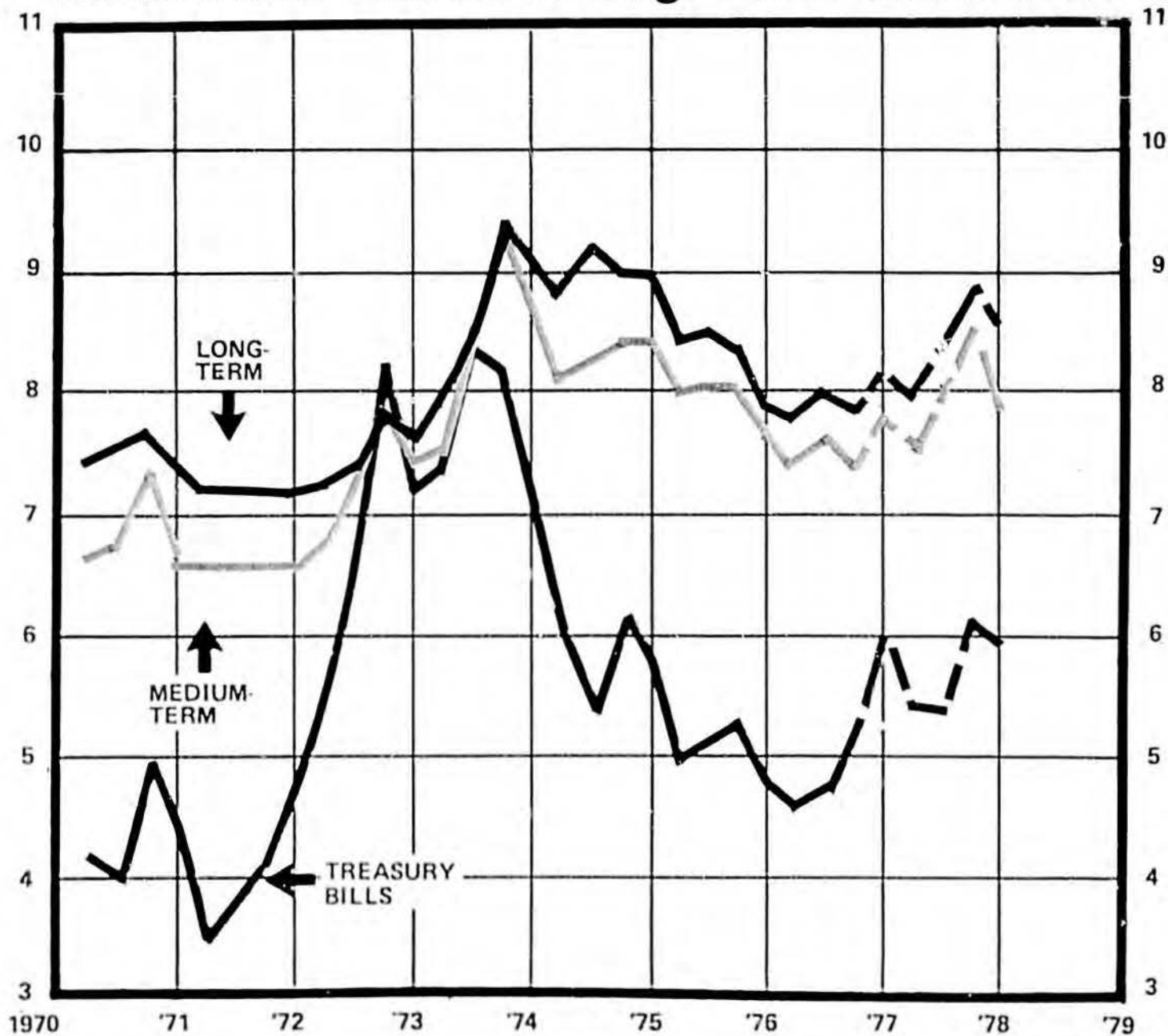
- By Quality**

- By Sector**

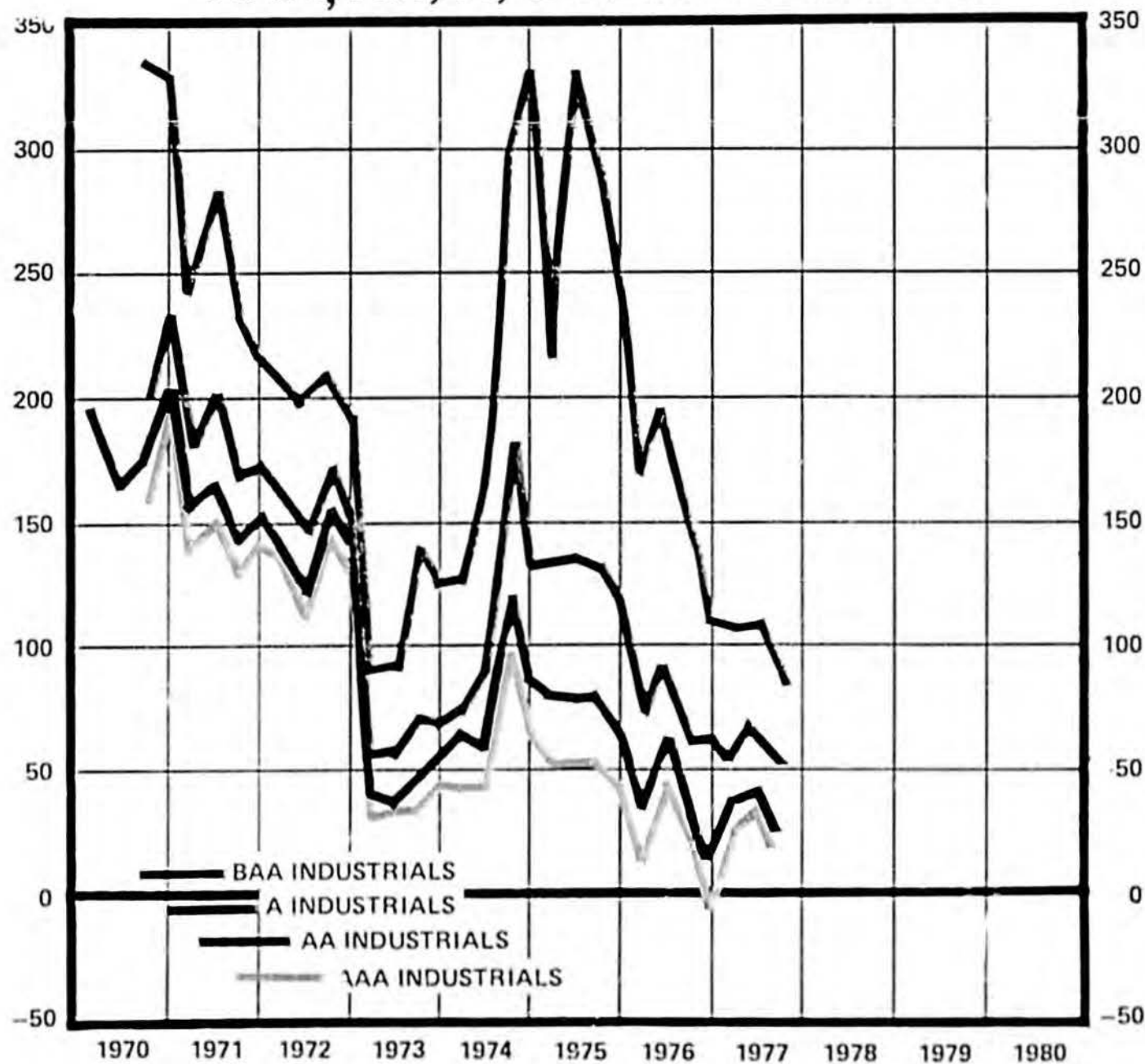
- **Swapping to improve quality or add incremental returns**

- **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

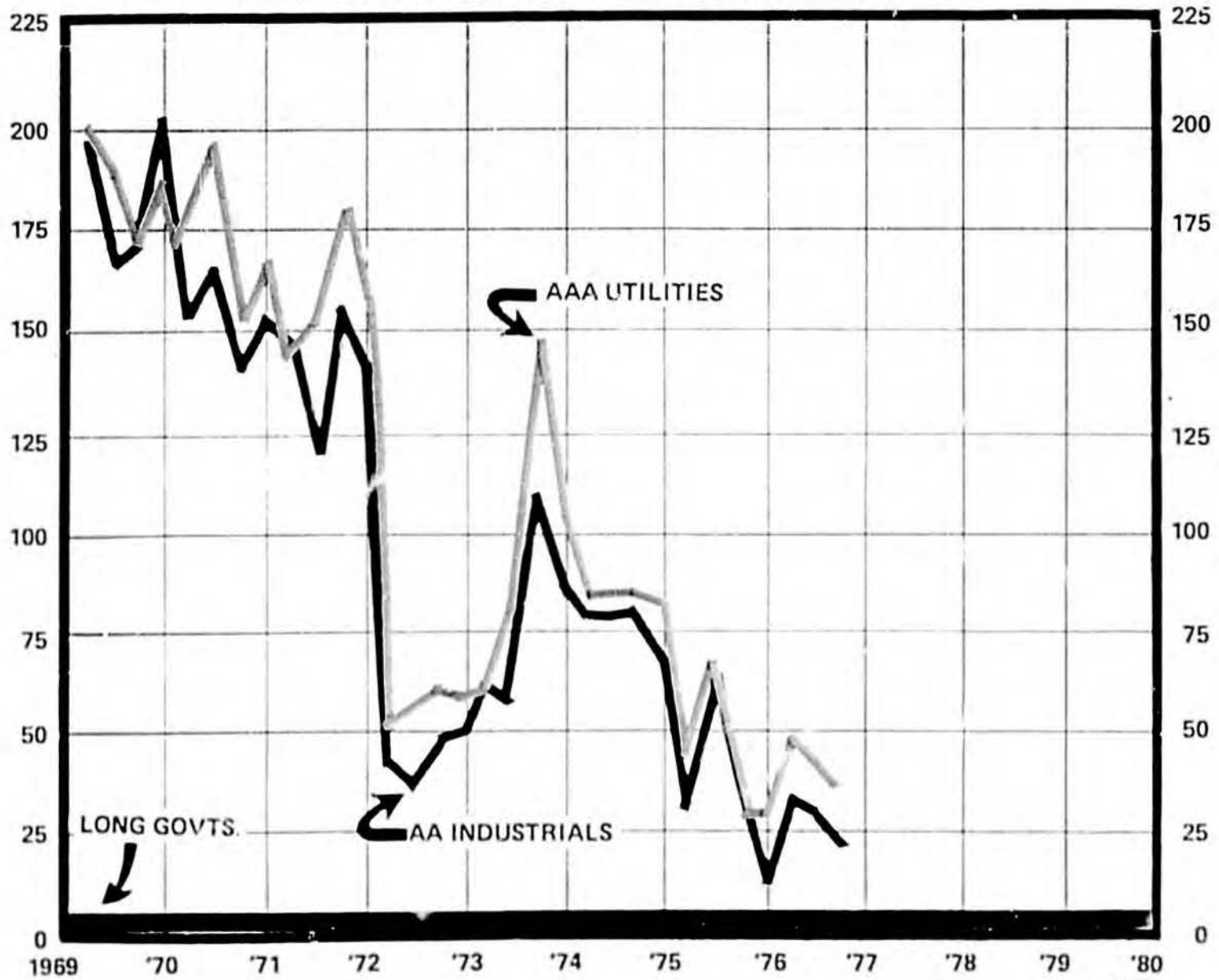


ILLUSTRATION OF REPRESENTATIVE BOND LIST ANALYSIS

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	8	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

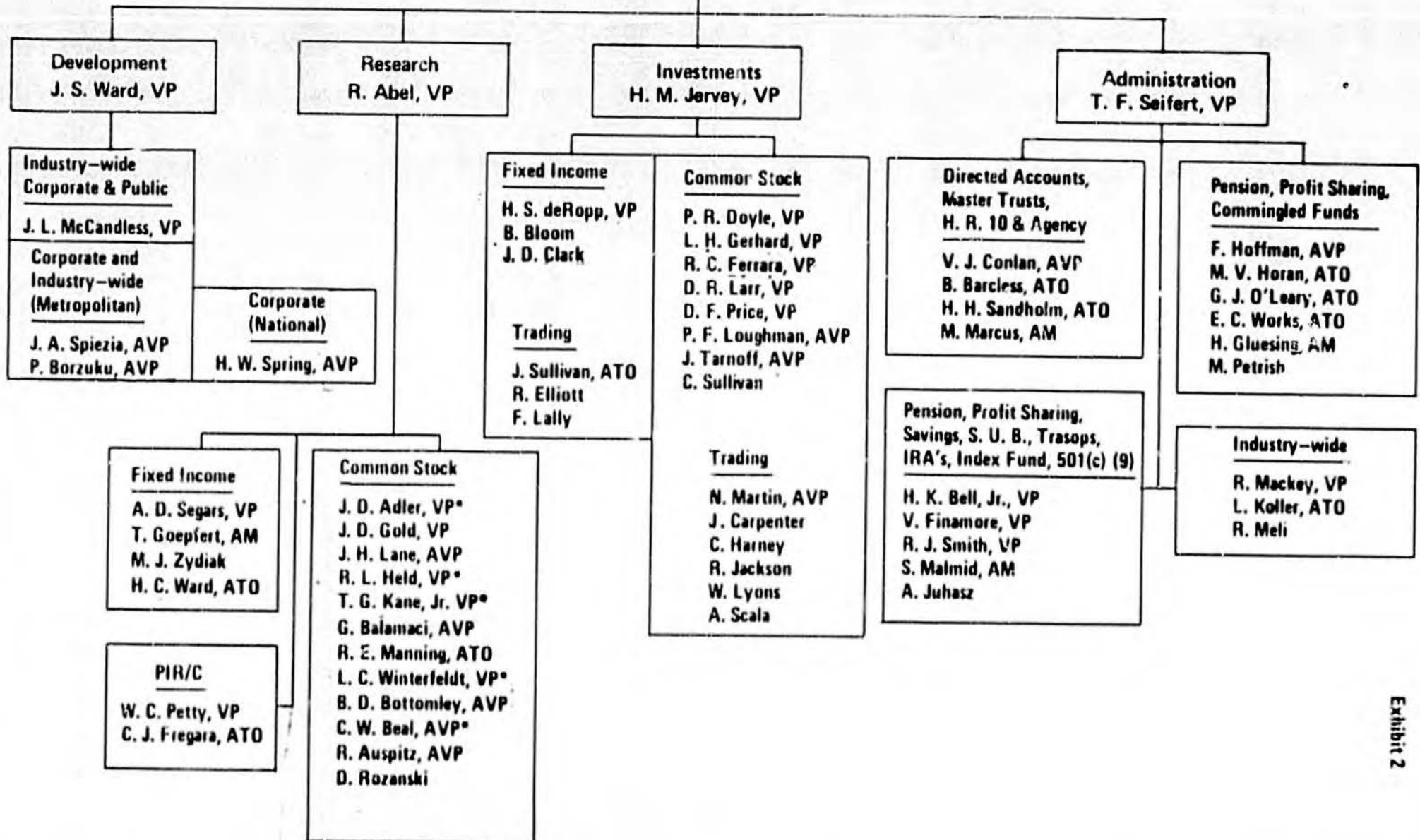
December 31, 1976

	<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%

Exhibit 1

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.

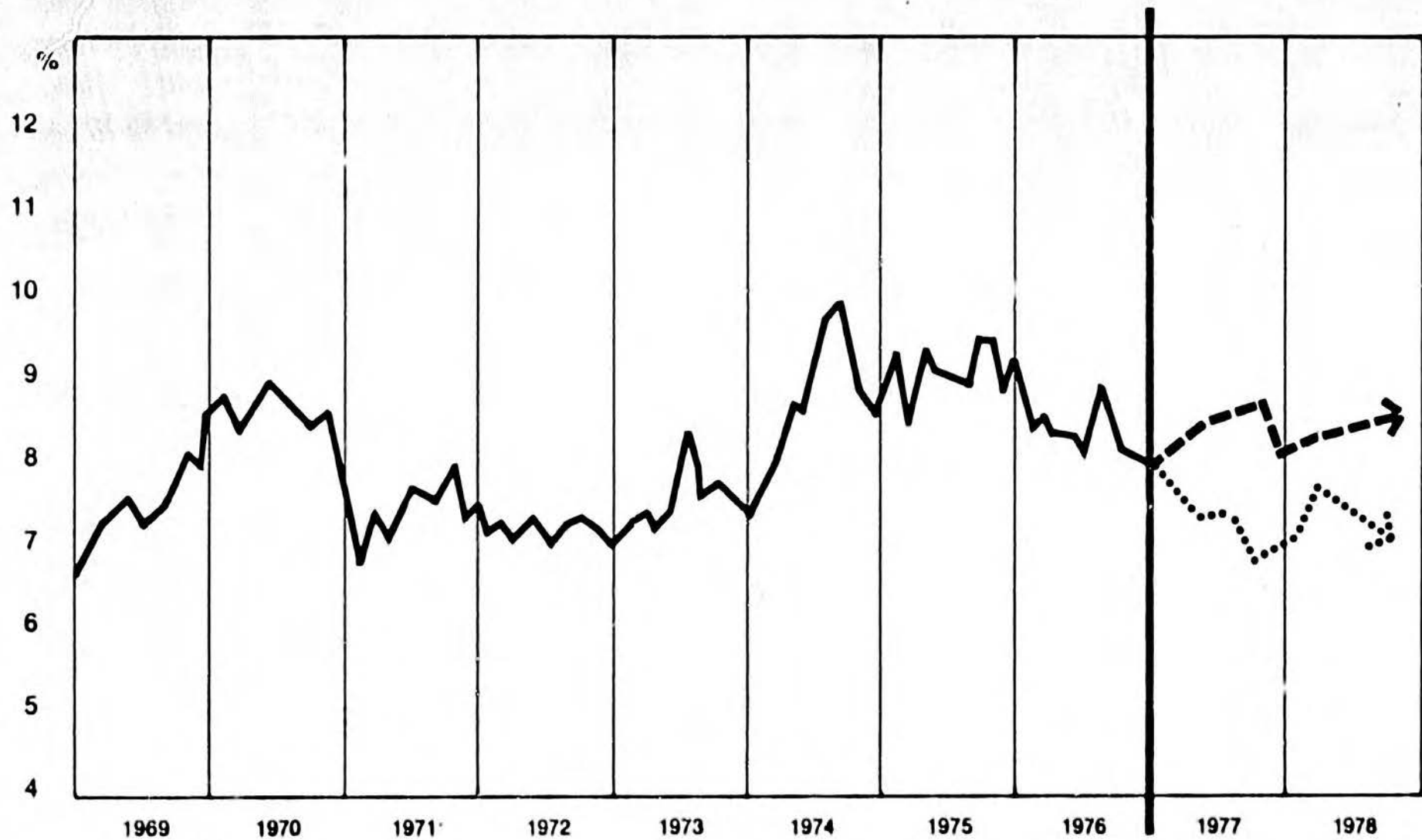
Exhibit 5, The Importance of Maturity Decisions, shows the impact of a 100 basis point (1%) change in interest rates, in either direction, on the total return of bonds with maturities of 5, 10, 12, 15 and 20 years. The starting point has interest rates at eight percent and indicates changes in one-year 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

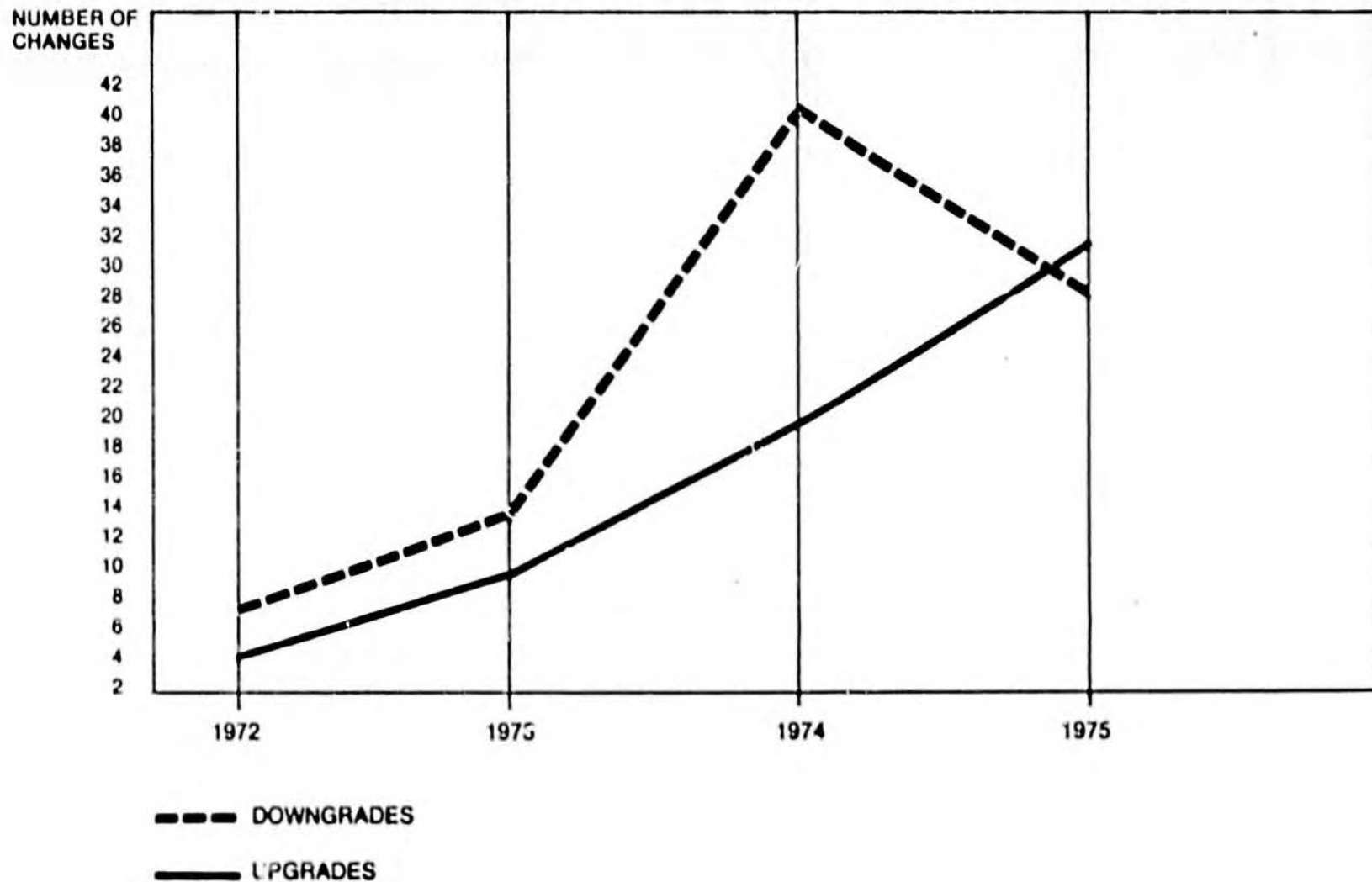
b) Rating System

- ++ = 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
	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
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- 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

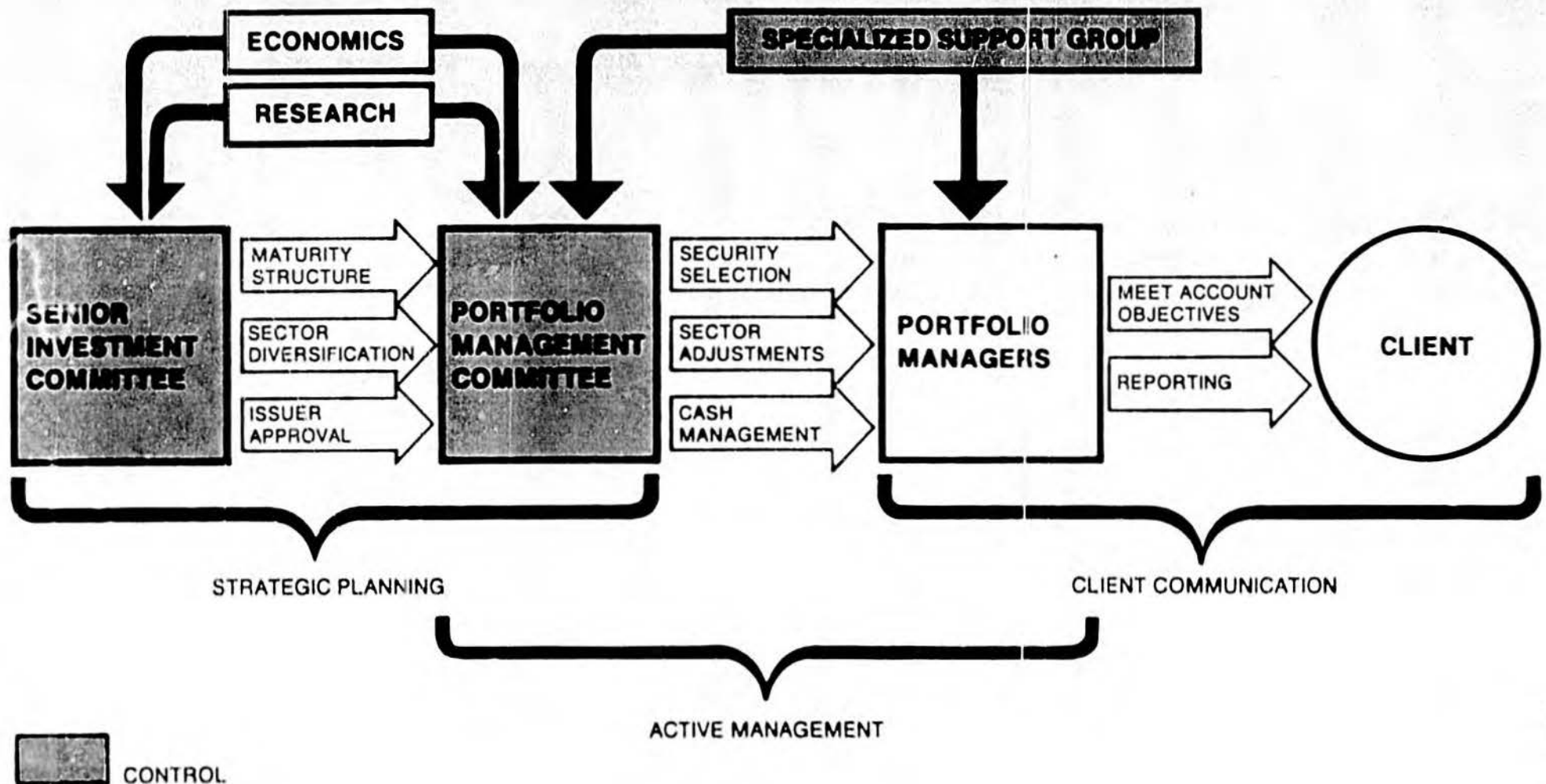
Once a client understands our investment philosophy and principles of fixed income management, the next factor to consider is the decision-making process. The structure of our investment organization is oriented to decision-making so that each segment contributes to the planning, implementation or control 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.

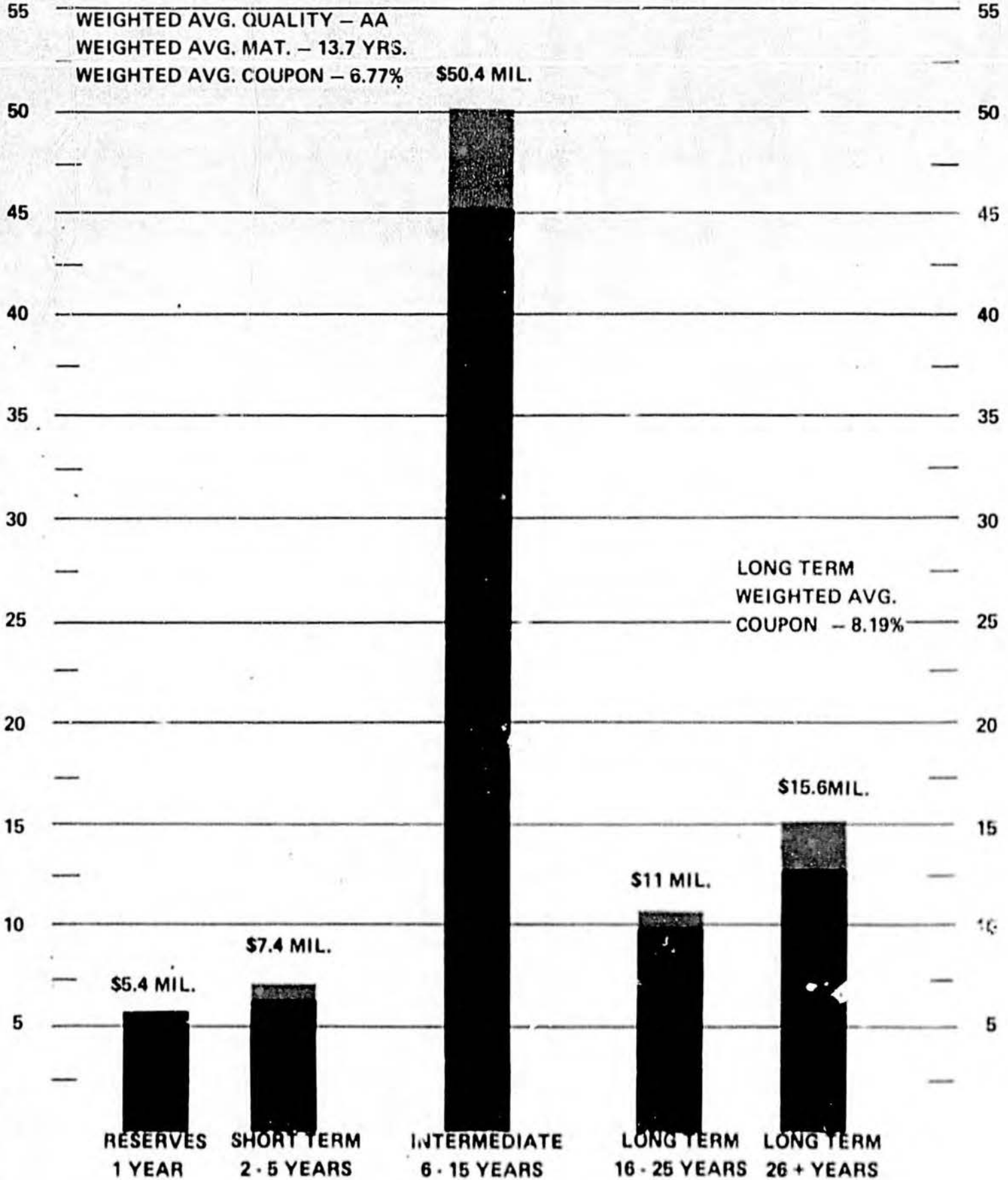
Group Trust Fixed Income Fund

DISTRIBUTION OF ASSETS BY MATURITY AND SECTOR

MARCH 31, 1977

\$ MIL.

\$ MIL.



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