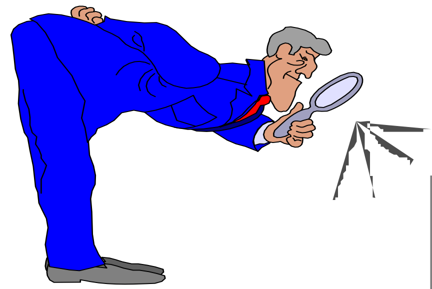
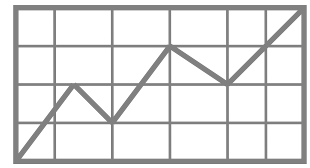
GSI Market View



2nd Quarter 1997



Tiger Woods is a champion at 21. His victory at the Masters golf tournament was nothing less than spectacular. As each set of 18 holes was played from Thursday to Sunday, observers waited to see if he could handle the extreme tension associated with the tournament. Tiger played each day steady as a rock and finished setting a tournament record in the process.

He did not let the psychology of the game distract his play. Interestingly, his father trained him to deal with the psychology of the game. As Tiger learned to play, his father set up distracting circumstances. He talked in the middle of Tiger's backswing; he dumped a full set of clubs on the green as Tiger was putting and he cheated by moving his ball to a different putting location when on the green. Each act was intended to upset Tiger and take his mind off his game. This turned out to be excellent training for what was to come. *Distractions at the Masters did not keep Tiger from focusing on his game.*

One of the forces that drive the financial markets over the short-term is psychology. Many factors contribute to investor psychology, none more important than the pronouncements made by Federal Reserve officials. Late last year Chairman Greenspan warned about "irrational exuberance" when referring to the high level of the stock market. Last month Vice Chairman Rivlin commented that inflation would be fought with higher interest rates, if necessary. As first quarter economic data became available, a hike in short-term interest rates soon followed. *Immediately the media and pundits sent shivers throughout the marketplace by announcing that successive interest rate increases would likely occur in the future.* According to one CNBC broadcaster … "interest rate hikes are like cockroaches, when you see one, you know there are always more behind it." Each of these pronouncements and the corresponding hike in short-term interest rates encouraged nervous traders and some long-term investors to sell bonds and stocks. A sharp decline in stock prices ensued.

As the first quarter of 1997 began, the stock market rose smartly. This was a reflection of strong corporate earnings reported for the final quarter of 1996. As the first quarter of 1997 developed however, unemployment rates dropped and hourly labor rates rose. Correspondingly, long-term interest rates rose and inflationary fears spread. *The stock market nearly erased higher prices achieved early in the quarter.* Market psychology changed from exuberance to fear in three short months. *The focus turned to the potential for higher interest rates and higher inflation.*

Inflation, however, remained tame and corporate earnings again exceeded expectations. Specifically, technology company earnings, lead by Intel and Microsoft, increased dramatically, surprising the market. *This was after numerous predictions by major publications in addition to well-known analysts that these companies would not do as well as expected.* In fact, Business Week featured an article in its March 31, 1997 issue, suggesting that a slow down in the high-tech industry was likely. In the author's opinion, this would affect the whole economy and drive the stock market down. This has not proved to be the case.

It is our view that market psychology took over in both periods while basic fundamentals were ignored. It seems to us that we have a strong economy providing a firm base for the marketplace. It is interesting that we are now experiencing the fruits of past economic strength with a $65 billion pay down of Federal debt. This is due to higher tax collections from corporations and individuals and more responsible fiscal management at the Federal level. *According to the Wall Street Journal, this is "only the second cut in the outstanding debt since 1981 and the biggest ever."*

If the economy shows too much strength however, the Federal Reserve is likely to act by raising short-term interest rates. The purpose of this action is to allow our economy to grow at a reasonable rate that will not spark a rise in inflation. It is our view that the economy has already begun to slow, lessening the need for a series of interest rate increases. *In other words, interest rates are not necessarily akin to cockroaches.* They are however, nearly impossible to forecast over the near-term. We believe that if inflation remains around 3%, a 7% Treasury bond would provide an excellent real return.

Therefore, the bond market might be considered attractive at these price levels. Daily news reports, reacting to economic statistics could cause the bond market to fluctuate above and below current levels.

We also expect that some corporations will experience slower growth in earnings. Many however, will continue to grow earnings at high rates because they are well positioned within their respective industries. *Technology, health care and financial stocks fit this mold.* Many have dropped in price to make them appear very attractive for purchase.

The big issue investors have is dealing with market psychology. With current uncertainties, it is likely that market volatility will test the nerves of the most sensitive investors. But if we can set our minds to avoid daily distractions, we will end up like Tiger Woods. *We will end up being champions!*

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