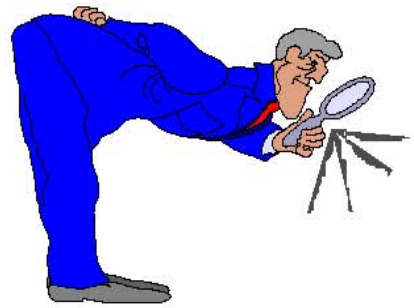
GSI Market View



4th Quarter 1994

- The U.S. financial markets are struggling with higher interest rates and a declining dollar relative to the Japanese Yen and German Deutschmark. In part this is due to a ***wide trade deficit*** and ***stronger economic activity***.
- The Federal Reserve has increased short-term interest rates from 3% earlier this year to a current 4.75%. It appears as if this trend will continue until our economy *slows down to less than 3% growth*.
- ***Gradualism was the approach used by the Fed in lowering interest rates and this is the approach being followed in raising interest rates.*** At some point, higher rates will bite into economic growth, and there will be a slowdown or a recession. The two unknowns are the *peak in rates* and the *severity of the slowdown.*
- The objective of the Federal Reserve is to ***achieve a smooth landing*** while ***containing domestic inflation***. This is a possible achievement, but long term interest rates have gone higher than most market analysts expected. An 8% long-term U.S. Treasury Bond rate was breached intraday, in early October. Even with a 4% rate of inflation, ***4% real returns should be attractive long-term.***
- However, ***market psychology often overshoots rational valuations***, and that may be the case today.
- The reality of the marketplace is that as *interest rates rise*, the discount rate for the stock market also increases resulting in *reduced stock valuations*.
- The offsetting factor is *corporate earnings which for some companies are increasing dramatically*. It is hard to say at this point whether rising corporate earnings will win over rising interest rates.
- Our strategy will continue to be one of ***careful selection of common stocks*** and ***emphasis on U.S. Government bonds***, maintaining fully invested positions on balanced accounts. So far, this approach has produced *superior performance results*, and we are optimistic that it will be successful as we move into 1995. Current sector overweightings for common stocks are:
    - Technology
    - Healthcare
    - Basic Industries

GS Investments, Inc
920 Second Avenue South,Suite 600
Kinnard Financial Center
Minneapolis, MN 55402
(612) 371-0590