Investment Policy

PaineWebber

Medical Megamorphosis

Healthcare reform: The Good, The Bad or The Ugly?

Highlights

■ **The Good:** *Sweeping reform plan does not pass* because it is too costly to be financed without huge taxes. But, healthcare disinflation continues; drug companies keep their pricing increases to CPI or CPI + 1%. Health supply/device stocks unit growth flattens, but best companies still achieve 12-15% growth. Firms withdraw from marginal businesses, trim sales forces/product lines and emphasize cost controls and manufacturing strategies. Growth rates of drug companies stay about where they are now—i.e., *after* being adjusted downward in 1992-93 to reflect the reality of disinflation—mid- to high-teens for the premier companies.

■ **The Bad:** *Healthcare prices are frozen for a while, and then Clinton's health care plan of managed competition goes into effect but without onerous features such as global budgets.* Pricing power of health supply/devices virtually disappears for most products, and unit growth is weak because of utilization review. A rash of restructuring and acquisitions commence. However, major firms that are able to survive still grow 10-12%. Drug companies with strong patents, good unit growth, rich R&D pipelines and strong global franchises grow 11-14%.

■ **The Ugly:** *A deflationary disaster scenario*. Plan calls for a *price rollback* for drugs and devices. Most products in the hospital supply/devices sector become commodity products, and average selling prices fall 20-30%. Hospital inpatient activity falls dramatically because of utilization review. *Small* medical device and HMOs either go out of business or are acquired. The growth rates of well-established players fall to the 5-7% range. Growth rates of HMOs go to zero. For drugs, somewhat less grim: unit demand goes up, growth slows to 8-10% range because volume growth is better and the firms more exposed to foreign markets.

■ Politically weakened Clinton may be forced to accept "good"/"bad" mix — "ugly" unlikely. Focus: large multi-national healthcare stocks with strong balance sheets and cash flows and that sell *non-durable* products that patients need every day, rather than capital goods (such as CAT scanners) whose demand depends on building or expanding hospitals. Diversified, multi-national healthcare firms such as Abbott Labs, Bristol-Myers Squibb, Johnson & Johnson, Merck and Pfizer offer the best risk/reward tradeoff. They are survivors, if "ugly" scenario unfolds, but will participate strongly in any rally that may occur.

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Oil, banking and healthcare: Three problem industries for Washington and Wall Street

With just a few weeks left until the Clintons' healthcare reform plan is unveiled, investors are feverishly scrutinizing every utterance of Hillary Rodham Clinton, much as Kremlinologists used to decipher speeches printed in *Pravda*. In this overheated environment, it is useful to step back and see how healthcare stocks compare with two other "crisis" industries that preoccupied Wall Street and Washington: Energy in the early 1980s and banks in 1990.

Just as with these previous crises, it is governmental decisions that will largely determine how the current "healthcare crisis" is resolved. And as in those previous instances, the *rational* approach for Washington to take is to recognize that the industry is part of the solution, not part of the problem and, accordingly, to permit it to function effectively and profitably.

Will the Clinton Administration and Congress, in this tradition, recognize that you cannot improve the healthcare system if you financially cripple the drug and medical supply industries? *There is a definite risk that they will not, which is a major reason why the stocks have sold off so sharply.* But a punitive approach toward the healthcare industry today would be a classic case of "cutting off your nose to spite your face." Oil companies helped end the oil crisis by finding more oil. And in 1990, the Fed recognized that you cannot have a recovery with a decimated banking system.

What is so worrisome for investors today is that this is shaping up to be a "political" and not an "economic" healthcare reform effort. From what we can gather, the President's proposals are beginning to look like the traditional Democratic blueprint for nationalized healthcare with a few new wrinkles, namely, broadening coverage to include the uninsured, as well as the untested concept of managed competition (i.e., the establishment of buying groups like HMOs, which would have power to negotiate with healthcare service providers).

Furthermore, it appears unlikely that the reform plan will include any proposals for making the healthcare infrastructure more efficient. Net net, it appears that the President hopes to achieve his objectives by redefining healthcare benefits for everyone via adoption of a managed competition model, *rather than removing the inefficiencies in the system*. In other words, healthcare "reform" appears likely only in a political versus an economic sense, *with the healthcare industry being viewed by Washington as the problem and not part of the solution.*

Oil 1982 vs. healthcare 1993

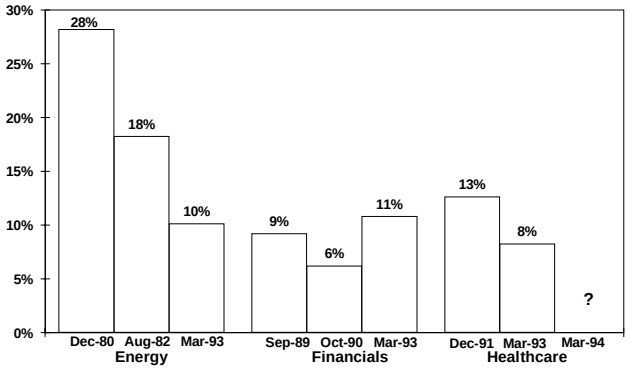
Some observers call healthcare companies the oil stocks of the 1990s—destined to underperform for an extended period as their pricing power evaporates. Certainly, there are cogent similarities. In both cases, the sector had too much pricing power, grew faster than the economy and grabbed an excessive share of GDP. Eventually there was a political and economic reaction against this trend, pricing power declined and overpriced stocks corrected sharply.

There are, however, several differences between oil in mid-1982 (by which time the stocks had declined 40-60% from their 1980 highs) and healthcare today. First, there is pricing. In July 1982, oil prices were $31.50 per barrel, down 13% from their 1980 highs, but over the next four years they would drop another 56%. For drugs and hospital supplies, however, it is not yet clear whether healthcare reform will cause prices to decline drastically over the next few years or merely to rise more slowly or stabilize.

Here's another difference between healthcare and oil. What investors forgot during the energy mania of the 1970s is that oil is *just another commodity*. As with aluminum, newsprint, ethylene and steel, when the price of oil rises, more is produced, less is used, and the price tends to decline. By contrast, healthcare in general is *not* just another commodity.

Chart 1

Percent of S&P 500 accounted for by energy, healthcare, financials at different times



Banks 1990 vs. healthcare 1993

This is a tricky comparison between two very different industries, but the bottom line is that healthcare stocks are *not* likely to bounce back as dramatically as banks did in the two years after October 1990. Bank stocks were more oversold in 1990 than healthcare is today because their

financial results were much worse. Indeed, many observers doubted that the banking industry would survive the violent unwinding of the 1980s' debt mania. Instead of merely reporting disappointing earnings *increases* (as Bristol-Myers, Merck and others have done lately) many solid banks in 1990 took huge write-offs, reported losses and cut or eliminated dividends. A few, such as Bank of New England, disappeared.

Not only was banks' future earnings growth apparently bleak, it was also *unanalyzable*, because everything depended on whether banks would have to take round after round of loan charge-offs, and it was impossible for investors to know the true state of their real estate loan portfolios. But after seeing every Texas bank disappear during the 1980s and watching one earnings disaster after another in 1990, investors feared the worst.

As it turned out, banks' fundamentals were better than they seemed because bad news in 1990 was not a harbinger of more bad news but rather a *natural precursor of good news*. A key cause of all the red ink and dividend cuts was a tougher stance by regulators who had been villified for the S&L debacle. Because regulators forced banks to accelerate loan charge-offs during 1990, trends on asset quality were *surprisingly good in 1991*. There is no comparable dynamic at work in healthcare today.

Bank stocks had a couple of other advantages that healthcare firms lack. Sometime in the autumn of 1990, regulators in Washington figured out that—however much you might hate bankers for making all those stupid loans for LBOs and vacant office buildings—you cannot run an economic recovery without a viable banking system. So regulators eased up on the industry and encouraged its profitability. Not necessarily so with healthcare. If misguided regulation reduces the financial strength of healthcare firms, this will certainly impede the development of new products that would save lives and money. But that cost is hard to measure and far less noticeable than a recession, prolonged by a credit crunch, that could cost politicians their jobs. *Misguided regulation is a very real risk for the healthcare industry*.

On the positive side, healthcare firms, unlike banks, have relatively high long-term unit growth potential and good business opportunities overseas. And, like banks, healthcare firms have plenty of room to improve profitability by cutting costs and streamlining their marketing divisions. Historically, healthcare firms have not needed to be cost conscious because they had pricing flexibility.

Table 1

Overview of energy in 1982, banks in 1990, healthcare in 1993

	Energy in 1982	Banks in 1990	Healthcare in 1993
Unit growth	Getting worse	Poor	Good
Future pricing	Getting worse	Improving as spreads widen	Getting worse
Major uncertainty for investors	How far will oil price drop?	Will real estate portfolios be a Texas style disaster?	Will Clinton impose price freeze or rollback?
Opportunities for overseas growth	Fair	Poor	Good
Cost trends	Plenty of room to cut	Plenty of room to cut	Plenty of room to cut as marketing is streamlined
Investor Psychology	Negative	Terrified	Frightened
Recent earnings trends	Poor	Terrible	Deteriorating but not a disaster
Balance sheets	Strong	Sharp deterioration	Excellent

Healthcare will likely continue to be a unit growth industry . . .

With investors fixated on the Clintons' reform plan and its implication for pricing, it is easy to forget that, unlike banking and energy, healthcare will, in all likelihood, continue to be a long-term *unit* growth industry. For anyone who has the basics—food, shelter, transportation, recreation—nothing is more important than avoiding the pain and high cost of being sick or having a loved one who is sick. This is why, rather than looking for ways to *cut back* on consumption of healthcare, Hillary Rodham Clinton wants to raise taxes to *expand* consumption.

Favorable demographics too are a potent factor boosting long-term unit demand for healthcare, both domestically and worldwide. The developed world is getting older. The United Nations forecasts that between 1990 and 2000 the *total* population of developed countries will rise 6.3%. However, the number of people aged 45-64 will increase more than *twice as fast* (13.6%) and the number of people aged 65 or older will rise *three times as fast* (18.8%). Fundamental demand for drugs and medical supplies will grow faster than demand for just about any other broad category of consumer product you can think of—be it food, beverages, autos, housing, entertainment or whatever.

. . . but hospital inpatient activity could drop . . .

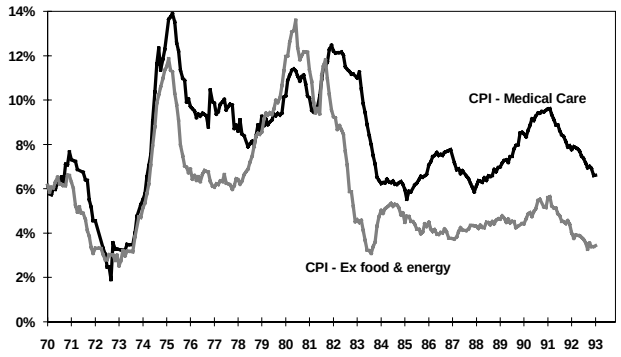
While the Clintons' desire to provide healthcare coverage to the 35 million Americans without insurance is widely expected to provide a stimulus to hospital activity, some observers believe that hospital activity could *drop*, not increase. PaineWebber analyst David Lothson argues that the majority of the uninsured are children and young adults in relatively good health and for whom emergency hospital care is currently provided. In David's opinion, a significant impact on hospital utilization rates would be the movement of individuals into Health Insurance Purchasing Cooperatives, or HIPCs, which are expected to perform similarly to HMOs by using hospitals more efficiently. If the more than 200 million Americans not currently enrolled in HMOs were forced to join them, hospital patient activity (measured in terms of inpatient days) would fall nearly 30% by David's estimates.

Assuming that the industry's current 62% occupancy rate were maintained, hospital capacity could shrink by over 250,000 beds (29%), triggering the closure of over 1,400 of the nation's 4,900 acute care hospitals. While such an action could save nearly $60 billion annually, it would come at the expense of 1 million jobs of both part- and full-time hospital employees, not to mention those jobs lost in companies that supply hospitals with products and services.

. . . and pricing is likely to be regulated

The most immediate concern for investors today is, however, the outlook for pricing. While drugs and medical supplies represent a small part of the healthcare puzzle and are a minor cause of the healthcare "crisis," the industry raised prices very aggressively during the 1980s. The Clinton Administration has insisted that *as a first step* these rapid price increases end, and in the face of this populist barrage drug firms have beaten a tactical retreat by promising to hold price increases to the general rate of inflation.

Chart 2
CPI inflation and medical inflation



The key issue now is not *if* but *how* prices will be regulated under the new reform bill. Will Washington adopt a punitive approach to medical companies, or will there be a relatively non-punitive approach, e.g., letting drug prices rise at the rate of the CPI?

Arguing for a punitive approach: "High" drug prices are a very visible issue, because many consumers (including Medicare recipients when not in the hospital) have to pay for drugs out of their own pocket. Several Congressmen, as well as President Clinton's Arkansas colleague, Senator David Pryor, are severe critics of the drug manufacturers. Furthermore, prices for many drugs are higher in the U.S. than overseas, which raises an obvious question: "Why should the same drug cost much more in Buffalo than Toronto? Why not close the gap by lowering U.S. drug prices?" Then, too, the drug industry and medical device industry have limited political power because—in contrast to hospitals—they do not employ many workers.

Arguing for a non-punitive approach of letting drug prices rise at the rate of the CPI: If the matter is decided in

terms of good public policy rather than politics and ideology, the non-punitive approach should prevail for this reason: There is little upside and steep downside to freezing drug prices and financially damaging the industry. The *upside* is limited because drugs and medical supplies are only 10% of America's healthcare bill, and their prices are rising more slowly than other categories of healthcare spending. So the direct payoff from a drug freeze would be modest.

On the other hand, the *downside* of a price freeze is steep, because medical innovation offers the best opportunity to reduce healthcare costs by, in effect, substituting science and manufacturing for high-cost services. Then, too, there are "industrial policy" considerations. The President has pronounced himself a friend of dynamic high-tech companies, financed with venture capital, that produce world-class products for export while creating high-paid jobs for American workers. That describes the biotechnology industry to a tee. Unfortunately, when Merck and Bristol-Myers stub their toes, the biotech industry gets cancer. Most small biotech firms depend on regular infusions of capital. If industry profitability is decimated, dozens of biotech firms will disappear.

Obviously, we don't know exactly what form of price regulation will be proposed by Clinton and passed by Congress or how punitive it will be, but it is worthwhile to consider the risks/opportunities based on three posssible scenarios. For the purposes of this analysis, we asked PaineWebber's health supply/devices analyst, David Lothson, and pharmaceuticals analyst, Ronald Nordmann, their opinions of how key companies in their respective industries would fare under these different scenarios.

Three price regulation scenarios: The good, the bad and the ugly

Scenario 1 is a deflationary disaster scenario—every healthcare investor's nightmare. To pay for generous benefits, the reform plan calls for a *price rollback* for drugs and devices. Hospitals are forced to provide more care to patients under stringent "global budgets" that starve them for funds. The hospitals, not unlike big city public school systems, protect jobs while skimping on drugs and devices (just as schools raise teachers' salaries while using antiquated schoolbooks). The package is passed in 1994 and goes into effect rather quickly in 1995.

Under this scenario, most products in the hospital supply/devices sector become commodity products, and average selling prices fall 20-30%. Hospital activity falls dramatically because of utilization review (i.e., the more efficient use of hospitals by HIPCs, as discussed above). Smaller focused players without sufficient diversification (i.e., selected medical device and HMO companies) either go out of business or are acquired. The growth rates of well-established players such as Johnson & Johnson, Abbott, U.S. Surgical and Medtronic fall to the 5-7% range, but growth rates of HMOs go to zero because of a premium freeze and because they must successfully attract HIPC members by offering competitive bids.

The situation for drugs is somewhat less grim, because unit demand goes up. Generics are mandated, as is "therapeutic substitution" (i.e., the lowest price drug is utilized in each therapeutic class, even if no generic is available). Companies cut way back on SG&A but also trim high risk R&D projects. Strong near-term cash flows are used to diversify into other areas, such as consumer products, OTC drugs and foreign ventures, and there is also backward integration into generics or raw materials. This diversification raises the risks for drug companies, and their growth slows to the 8-10% range—slightly higher than for device companies, because volume growth is better and the firms are more exposed to foreign markets.

Under *Scenario 2, the Clintons' plan passes with some significant modifications* by Congress. Healthcare prices are frozen for a while, and then Clinton's healthcare plan of managed competition goes into effect but without onerous features such as global budgets. It is passed in 1994 and is phased in over three years starting in 1994.

Under this scenario, the pricing power of health supply/devices virtually disappears for most products, and unit growth is weak because of utilization review. Buying power moves to groups, versus individual hospitals, so the hospitals squeeze their suppliers. The result: A rash of restructuring and acquisitions commence. However, the major firms that are able to survive (such as JNJ, MDT and ABT) are still able to grow 10-12%. Drug companies with strong patents, good unit growth, rich R&D pipelines and strong global franchises (e.g., BMY, MRK, PFE) achieve 11-14% growth.

In *Scenario 3, the plan does not pass* because it is too grandiose and costly to be financed without huge taxes that kill the tenuous U.S. economic expansion, not to mention Bill Clinton's chances for reelection. However, the healthcare disinflation that has already clobbered the growth rates of many firms continues; drug companies pledge to keep their pricing increases to CPI or CPI + 1%, and mostly keep their promise.

In this scenario, health supply/device stocks can only raise prices modestly, and unit growth flattens, but the best

companies still achieve 12-15% growth. Firms withdraw from marginal businesses, trim sales forces and product lines and emphasize cost controls and manufacturing strategies. Cash-rich companies buy back stock or diversify—a risky move, especially for managements accustomed to having pricing flexibility. The growth rates of drug companies would stay about where they are now—i.e., *after* being adjusted downward in 1992-93 to reflect the reality of disinflation—which is mid- to high-teens for the premier companies.

Healthcare stocks' valuation: Cheap but getting cheaper?

Regardless of the exact form of price regulation that is finally decided upon, the earnings growth rates of the major healthcare companies are *already* significantly lower than they were just a few years ago. Nevertheless, many of these stocks still show up at the top of most "value" models—of the 20 cheapest stocks in the PaineWebber Equity Valuation Model, no less than 15 are healthcare stocks. *Unfortunately, cheap stocks have been known to get much cheaper as fundamentals deteriorate and consensus inputs for growth rates and normal earnings decline*. For example, in July 1982, 13 of the 20 cheapest stocks in the Equity Valuation Model were energy stocks, mostly oil service stocks such as Hughes Tool, Halliburton, Parker Drilling, etc. Most of these stocks underperformed over the next few years because their consensus growth rates, which were in the 12-16% range in 1982 and high teens to low twenties in the heyday of energy just a few years earlier, continued to slide (see Table 2). In fact, over the next five years oil service earnings fell dramatically.

Table 2

Consensus Growth Rates of Selected Energy Stocks*, July 1982 and July 1985

	1982	1985
N L Indus.	14.0%	NA
Dresser	13.0	9.0%
Hughes Tool	13.0	11.0
Cooper Indus.	13.5	10.0
McDermott	12.0	10.0
Halliburton	14.0	10.5
Smith Int'l	12.0	NA
Standard of Ohio	9.0	7.0
Parker Drilling	13.0	NA
Helmerich & Payne	16.0	13.0
Exxon	6.5	6.5
Mobil	8.0	7.0
Standard of Calif.	9.0	8.0
Baker Int'l	15.0	10.0
Texaco	6.0	5.5

*15 cheapest energy stocks in Equity Valuation Model July 1982

In this regard, a key point for investors to bear in mind is that *even before healthcare reform has taken effect* there have been profound structural changes in the way products are distributed and priced in the healthcare sector. These changes, which will continue over the next year or two, create risks for investors in healthcare stocks—risks that are not necessarily reflected in current stock prices.

Consider the terrifying tale of U.S. Surgical. This company would seem to be well insulated from healthcare reform because its products have strong unit growth, and its laparoscopic surgical supplies save healthcare dollars by making surgery less invasive, so that patients can get in and out of the hospital more quickly. A couple of weeks ago the stock looked totally "washed out," trading in the mid-$50s, down from $134 in early 1991. At a price of $55, USS (which PaineWebber then rated neutral) looked ridiculously cheap, a company with a growth rate of 25%—four times the growth rate of the S&P 500—trading at a market multiple on 1992 earnings. But this dirt-cheap stock quickly became a lot cheaper, plunging to a price of $30 after management announced that earnings would fall well below Wall Street's expectations because the company was shifting to a new and more efficient distribution system that would occasion an inventory correction.

Significantly—and ominously—it appears that unit demand growth may be slowing as hospitals try to save money by purchasing more re-usable supplies, rather than disposables. The point is that, when your customers make a concerted effort to save money, it is hard to avoid nasty earnings shocks.

Bank stock performance: High quality stocks provided big returns

For the purposes of our analysis, it is instructive to look back at the performance of specific oil and bank stocks from their respective bottoms. Table 3 shows the performance of 20 financial stocks from the dark days of October 1990 to February 1993. All 20 stocks outperformed the S&P 500, most by huge margins. The very well-managed, high-quality institutions that were "safe havens" during the bank stock massacre appreciated the least—e.g., J.P. Morgan, Republic National Bank and Wachovia. At the other end of the spectrum, the best performers tended to be weak, northeastern institutions that had troubled real estate portfolios—Shawmut, Bank of Boston, Chemical, First Fidelity, MNC, etc. With the benefit of hindsight, we know that the best thing to do was to hold your nose and buy these super-risky stocks. However, *you did not have to take the risk of buying banks with big problems to*

make big money in banks stocks. Well-managed firms with limited exposure to Northeastern real estate—such as State Street, Golden West, Fannie Mae, BancOne and Nations Bank—offered superb returns. These stocks arguably offered the best risk/reward in the bank stock universe.

Table 3

Price change of Selected Financials and S&P 500
October 1990 – February, 1993

S&P 500	*+45.8%*
JP Morgan	+79.2
Republic New York	+86.1
Wachovia Corp	+93.2
Wells Fargo	+129.1
Citicorp	+135.6
Amsouth Bancorp	+151.4
Golden West	+165.0
Fannie Mae	+178.2
Bank America	+181.3
BancOne Corp	+185.2
Midlantic	+185.5
Nations Bank	+210.1
Chase Manhattan	+215.0
Fleet Norstar	+255.4
MNC Financial	+259.4
First Fidelity	+267.9
Chemical Bank	+300.0
State Street	+310.9
Bank of Boston	+324.5
Shawmut National	+338.5

Oil stock performance: Oil service got cheaper, but large integrated producers did well

As for the oils, Table 4 shows the performance of 16 energy stocks from July 1982 to July 1985. The S&P 500 rose 78.3% in this period, yet three energy stocks—Amoco, Royal Dutch and Exxon—actually managed to outperform it! Several other large oil integrated producers—Arco, British Petroleum and Amerada Hess—came fairly close to matching the strong price performance of the S&P 500. Furthermore, they offered higher dividend yields than the S&P 500. The significant conclusion: If in 1982, you incorrectly believed that the worst was over for the energy sector and bought a group of multi-national energy stocks, you would have kept pace with a powerful bull market. The reasons for the decent performance of these stocks were: a) some firms such as Exxon and Amoco bought back shares; b) the oil price decline was not as steep as investors feared; and c) many stocks traded up on takeover expectations, after such firms as Getty and Gulf were acquired.

Table 4

Price change of Selected Energy Stocks and S&P 500
July 1982 – July, 1985

Western Co. of No. Amer.	-58.3%
Smith Int'l	-57.2
Parker Drilling	-46.8
Baker Hughes	-4.0
Rowan Cos	+1.4
Schlumberger Ltd	+8.4
Unocal Corp	+21.1
Helmerich & Payne	+25.8
Mobil Corp	+42.8
Chevron Corp	+45.5
Arco	+63.1
British Petroleum	+63.9
Amerada Hess	+67.2
S&P 500	*+78.3*
Amoco	+79.9
Royal Dutch	+98.8
Exxon	+101.9

On the other hand, if you took a more aggressive stance and bought the "high fliers" of the oil patch—service firms such as Western Cos., Smith International, Baker Hughes and Helmerich & Payne—you would have *dramatically underperformed* the S&P 500 and very likely lost money while the S&P 500 was rising about 80%. Even Schlumberger only appreciated 8%. Why the difference between the multi-nationals and the service firms? Oil firms produced a non-durable product that motorists, airlines and electric utilities need to buy every day of the week. Unit demand was rising during an economic expansion—even if the growth in demand and the price of the product were disappointing. Service firms, on the other hand, served the market for oil exploration, which collapsed with the decline in oil prices. The revenues of six large oil service firms dropped 15% between 1982 and 1985 while their earnings dropped 67%.

Implications for healthcare stocks: Selective opportunities in large, diversified, multi-national non-durables

The moral would seem to be that it is much safer to own large multi-national healthcare stocks that have strong balance sheets and cash flows and that sell non-durable products that patients need every day, rather than capital goods (such as CAT scanners) whose demand depends on building or expanding hospitals. That's where the biggest crunch will come. As various health cost-containment schemes wrestle with controlling costs, the big ticket health durables will, at least during the transition phase, be the first victims. It is even possible that low-cost *disposable* hospital products could lose to *reusables* over the short

term. The labor cost of processing reusables is more difficult to cut than the recurring bill for the disposables.

It is the large healthcare companies that have the financial and operational flexibility to buy back shares, cut costs, and reconfigure their operations for a changed environment--provided they are well managed. Furthermore, more than 40% of the revenue (but a smaller share of earnings) of multi-national healthcare firms are generated overseas and are not directly impacted by healthcare reform in the U.S. Finally, many such stocks have dividend yields that nearly match that of the market. Such companies are much safer investments than small healthcare firms, such as biotechs, although some biotechs may trade up in the next couple of years as they are bought out.

To be sure, the stocks of large firms such as Merck and Abbott would not perform as well as small healthcare firms if the fundamentals of the healthcare sector suddenly brightened, as occurred with the banks. Unfortunately, that seems exceedingly unlikely. Furthermore, the performance of bank stocks shows that even high-quality firms such as BancOne, Golden West, Fannie Mae and State Street produced excellent returns for investors who bought them in 1990, without the substantial risk attached to buying weaker institutions.

Too cheap to ignore, but . . .

Healthcare remains too cheap to ignore, but probably still a little too uncertain to make a big bet. Continue to "market weight" the sector. These may be cheap stocks, but cheap stocks in "crisis industries" have been known to get cheaper and cheaper.

Net net, politically weakened Clinton may be forced to accept a"good"/"bad" mix — "ugly" scenario unlikely. Large, diversified, multi-national healthcare firms such as Abbott Labs , Bristol-Myers Squibb, Johnson & Johnson, Merck and Pfizer probably offer the best risk/reward trade-off. They are survivors if the worst industry scenario unfolds, but will participate strongly in any rally that may occur.

Appendix A

Implications of Clinton's reform for non-healthcare firms

Clinton's reforms could also significantly increase labor costs for non-healthcare firms with large numbers of workers. Areas that appear most vulnerable to any legislation requiring minimum healthcare coverage for employees include retailers, restaurants, hotels, nursing homes and labor-intensive manufacturers. A screen of S&P 500 companies reveals that a disproportionately large number of companies in those industries generate a relatively small amount of revenue per employee, implying that any federally mandated increase in healthcare benefits could cut into margins in a non-trivial way (see tables 5 and 6).

Table 5

Top 50 companies in S&P 500 with lowest revenues per employee, sorted by revenue per employee

	Revenues per employee ($000's)
Block H&R	$15.0
Beverly Enterprises	24.7
Wendy's International	29.1
Ryan's Family Steak Houses	29.3
Hilton Hotels	30.1
Shoney's	36.5
Ogden Corp	37.3
Luby's Cafeterias	37.6
Manor Care	39.7
McDonald's Corp	39.9
Bally Manufacturing	41.2
Community Psychiatric Centers	43.1
Marriott Corp	44.7
Oshkosh B'Gosh	45.0
Promus Cos	48.4
Zenith Electronics	49.7
American Greetings	49.8
Russell Corp	54.2
Service Corp International	55.6
PepsiCo	58.0
Blockbuster Entertainment	59.6
Bassett Furniture	60.7
National Semiconductor	63.1
VF Corp	67.1
Brown Group	67.8
Woolworth Corp	68.8
General Mills	69.8
Charming Shoppes	70.4
Harland John H	71.8
Galen Health Care	72.3
Limited	74.9
National Medical Enterprises	76.1
Genesco	76.7
Westinghouse Electric	77.5
EG&G Inc	78.3
Toys R Us	78.5
Masco Corp	78.5
Gap	78.7
Federal Express	79.5
Computer Sciences Corp	79.7
Hartmarx Corp	81.1
Dun & Bradstreet	81.2
National Service Industries	81.3
National Education Corp	83.3
Pep Boys	83.7
Deluxe Corp	84.0
Yellow Freight System	84.4
Alexander & Alexander	87.8
Parker-Hannifin	89.1
M/A-Com Inc	89.2

Table 6

Top 50 companies in S&P 500 with lowest revenues per employee, sorted by industry

Apparel	Healthcare	Hotel/Gambling	Restaurants	Retailing	Misc. Manufacturing	Misc. Services
Genesco	Beverly Enterprises	Bally Mfg	General Mills	Brown Group	American Greetings	Alexander & Alex
Hartmarx Corp	Community Psych	Hilton Hotels	Luby's Cafeterias	Charming Shoppes	Bassett Furniture	Block H&R
Oshkosh B'Gosh	Galen Health Care	Marriott Corp	McDonalds Corp	Gap	Deluxe Corp	Blockbuster Ent'mt
Russell Corp	Manor Care	Promus Cos	PepsiCo	Limited	EG&G Inc	Computer Sciences
VF Corp	National Med Ent.		Ryan's Family	Pep Boys	Harland John H	Dun & Bradstreet
			Shoney's	Toys R Us	Masco Corp	Federal Express
			Wendy's	Woolworth Corp	National Semiconductor	M/A-Com Inc
					Parker-Hannifin	Nat'l Education Corp
					Westinghouse Electric	Nat'l Service Inds
					Zenith Electronics	Ogden Corp
						Service Corp Int'l
						Yellow Freight Sys

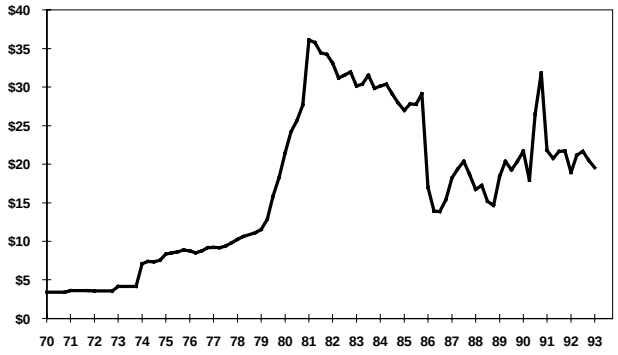
Appendix B

A look back at the oil mania and the bank stock bear market

Oil: The one-way commodity

Crude oil prices began the 1970s at $3.40 per barrel and by early 1981 were at $36.12 per barrel. Most of this huge price rise occurred in two leaps connected to upheaval in the Mideast. Crude prices rose 150% in 1973-74, after OPEC imposed an oil embargo during the Yom Kippur War of 1973. Then crude prices tripled in 1979-80 during the Iranian Revolution that replaced the Shah with the Ayatollah.

Chart 3
Price of oil (West Texas Intermediate)



Skyrocketing oil prices led to an oil mania on Wall Street. By the end of 1979 general inflation was running at double-digit rates and oil stocks were widely viewed as the best game in town for investors who wanted to own equities rather than direct inflation hedges such as art, diamonds, gold coins and farm land. It was widely assumed that oil prices would be above $60 per barrel in a few years. The hot stocks of the day were names like Helmerich & Payne (which rose 380% between December 1978 and December 1980), Reading and Bates (up 502%), Rowan (up 350%) and Tosco (up 488%). Never ones to miss a mania, investment bankers put together some big deals involving "inflation hedges." Fluor bought St. Joe Minerals, GE bought Utah International, DuPont bought Conoco, Sohio acquired Kennecott Copper. Investment publications were full of ads with such headlines as "Oil & Gas—Better than Gold!" In fact, Barron's carried four special advertising supplements during 1980 devoted to energy investments.

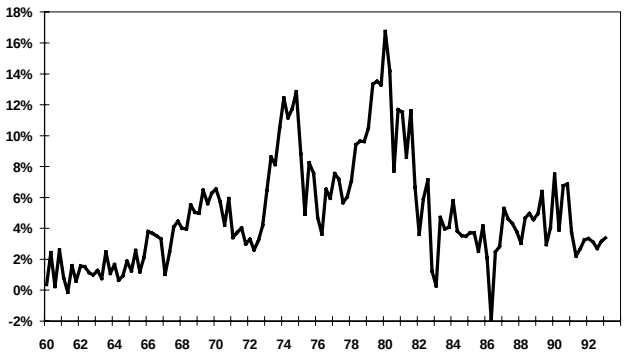
One investor observed in 1980, "The almost morbid obsession with anything connected with energy has created a situation in which a large number of good stocks with good outlooks have been allowed to drift down to ridiculously low levels." With inflation accelerating, it was obvious to many investors that consumer stocks would underperform for quite a while. A highly respected Boston portfolio manager said, "The major concerns of the eighties will be energy, defense and making our plants more efficient. That's where the money will be going. I don't think the world of the future will be built on Cokes, hamburgers and leisure time products." In point of fact, a portfolio comprised of CocaCola, McDonald's and Disney was just the ticket for the 1980s, beating the S&P 500 by 498 percentage points while oil service stocks underperformed by 210 percentage points.

Oil stocks in 1980: The knowable and unknowable

It is easy and rather pleasurable to look back on the energy mania of 1979-1980 and smugly say, "How dumb could they be?" But this approach does not teach us very much. A better question is, what did investors overlook that they should have seen?

What was unknowable in 1980 was that Paul Volcker, like George Washington or Winston Churchill, would perform as a "great man" on the stage of history by doing the "impossible" deed of killing inflation in three years. Inflation had been accelerating in the U.S. more or less continuously since 1965. No Fed Chairman between 1965 and 1979 dared to impose a recession long enough and severe enough to short-circuit the inflationary spiral. However, Paul Volcker had the courage to do just that.

Chart 4
CPI (quarterly change at annual rate)



There was no way for investors to know in advance that Paul Volcker would be the hero who slayed the inflationary dragon. However, what most investors should have recognized but did not was that oil was, after all, just another commodity that was subject to the law of supply and demand: When the price went up, consumers used less, producers produced more, and prices tended to decline. It is remarkable that investors ignored this axiom because most of the glamour stocks of the 1970s were

involved in expanding the supply of oil. For example, in 1979, *Fortune* published a glowing portrait of "Bob Fluor, Global Superbuilder," who jetted around the world overseeing Fluor's big construction projects. The firm's two biggest projects were a $5 billion complex in Saudi Arabia that gathered "five billion cubic feet of sour gas now being flared daily from oil wells as waste and refined it into fuel" and "a $2 billion-plus coal-conversion plant for the Republic of South Africa in the Transvaal." Hundreds of other projects around the globe were also expanding the supply of oil.

Three misconceptions about oil

OPEC Power—This frenetic expansion of oil production capacity was very well known to investors, yet it did not occur to them that this could lead to an oil glut. Why not? Aside from the overall inflationary mentality of the time, there were three main reasons. Most important by far was faith in the ability of the OPEC oil cartel to keep prices high by restricting supply if necessary. After all, OPEC did it in 1973 and again in 1979, and it was hard to argue with success. Few observers pointed out that the two oil price spikes, in 1973 and 1979, occurred at the peak of the business cycle, when demand was strong. In addition, both were the result of completely unexpected supply interruptions rather than demand increasing faster than the resource base.

Running on empty by 1995—Another reason why oil prices supposedly could "only go higher" despite the step-up in oil production during the 1970s was the conviction that mankind was destined to run out of oil in a few decades. This was not just the opinion of Malthusian cassandras in universities and think tanks. In a 1977 article called "When We'll Start Running Out of Oil," *Fortune* explained why "experts" were in general agreement that "If world demand increased by even 2.5 percent a year—well below the pace of the past—it will outrun the rate of production sometime between 1990 and 2010." Belief that oil supplies would soon be exhausted sparked intense interest in "alternative energy sources" including oil shale, wind, geo-thermal and solar. In 1980, Congress, with impeccable timing, created the Synthetic Fuels Corporation to produce oil from shale oil. In a few years, Synfuel Plants in Colorado were producing oil for $46 per barrel when the market price was approximately $20 per barrel.

Government interference in energy market—The third reason why belief in $60 oil was so strong by 1980 was that energy demand was slow to shrink, and domestic output was slow to expand, in response to higher worldwide energy prices. A key reason was *interference by the Federal government in the workings of the energy market*. To investors accustomed to the laissez faire approach of Presidents Reagan and Bush, it is an eye-opener to see how the Federal bureaucracy attempted to manipulate the oil market in the 1970s, in a vain effort to encourage more production and less consumption of energy *without exposing voters to the harsh reality of higher prices*. "Energy policy" in the 1970s was a labyrinth of rules, legislation, plans and boards created by politicians with one eye on economic performance and one eye on the next election. The result was bizarre distortions in the market that call to mind the late and unlamented U.S.S.R. A *Wall Street Journal* article written early in 1977, at the height of a natural gas shortage during a particularly cold winter, described how many natural gas wells in the U.S. were not producing because the gas price set by Uncle Sam on *inter*state gas shipments was only one quarter of the free market price on *intra*state shipments.

The White House reforms an industry plagued by runaway costs

Much as Hillary Clinton is now devising a scheme to reform the healthcare industry, during Jimmy Carter's first few months in office, James Schlesinger and a group of experts was concocting a new plan to solve the "energy crisis." Then, as now, the buzz word was "sacrifice," but mainly for corporations, not voters. A typical trial balloon of the energy plan floated in April 1977 was that the plan would "contain some stiff conservation measures that will require new sacrifices by Americans. [Federal Energy Administration Chief] O'Leary said yesterday the government may tax industrial use of natural gas to prod some plants to switch to other fuels. He said that the administration is committed to *keeping down natural gas costs to homeowners and that it would rather raise prices for industrial users* who can switch to other energy sources, such as coal or oil." (Italics ours.)

When James Schlesinger finally unveiled his 256-page proposal, it was almost as detailed as a Soviet Five-Year Plan. According to *The Wall Street Journal*, "The Carter Administration also disclosed a target for gasoline consumption of 7.35 million barrels a day in 1978. But after that, gasoline consumption would have to drop each year to 6.6 million barrels a day in 1985, or drivers would face a tax increase." The plan tried to make distinctions between various classes of oil: "The President will use existing authority to raise the price of so-called new-new oil to about $15 a barrel by 1980. New-new oil, according the White House, would be oil produced after April 20, 1977, at a site at least two and a half miles from an existing well and more than 1,000 feet deeper than an existing

well." Mr. Schlesinger's attempt to guide the behavior of consumers and manipulate the oil market faced controversy in Congress. Oil state senators complained that it did not do enough to encourage production; northern liberals complained that it enriched energy producers who were already prospering.

Although Schlesinger's "Energy Plan" was not well received, the Carter Administration continued to try to control the oil industry with a variety of taxes and regulations. When the President finally decontrolled domestic oil prices, he also imposed a "windfall profits tax." The White House also concocted a couple of gasoline rationing plans, one of which would cost $600 million just to prepare, and another $2 billion per year to operate.

Oil vs. healthcare

The Carter Administration's ill-fated attempts to regulate the energy market, like the disastrous experience with wage and price controls in 1971-72, illustrate the danger of Washington setting healthcare prices. When politicians try to micro-regulate markets, they are tempted to shield voters from price increases. But when producers do not receive an economic price for their goods and services, they *produce less,* which raises underlying price pressures. And once politicians freeze prices, it is difficult to decontrol them because they will be vulnerable to the charge that they have rewarded this or that "special interest" at the expense of consumers at large.

Also, the maze of boards, councils and guidelines used to regulate an industry tend to expand over time, and the process of creating this temporary regulatory mechanism absorbs resources—time, money, political capital—that are better expended on fundamental reform. In short, price controls don't work.

Explaining away the energy glut

By 1980, some thoughtful investors wondered whether high oil prices might start to curb demand for energy. A participant at the *Barron's* roundtable observed, "Whether it's wood in Vermont, Con Ed converting to coal, electric cars, shale or 26 other things that take a while to permeate the system, maybe we're finally setting up some of the self-correcting forces that will mean that energy costs will not be running away with us over the next five to eight years." As the economy weakened in 1981, oil prices softened and headlines began to talk about an "oil glut."

But as oil stocks plunged in 1981 most Wall Street analysts continued to believe that the price of oil would be set in the Middle East. In October 1981, one analyst liked the domestic oil stocks because of recent unrest in the Mideast; Iran and Iraq were fighting and bombing oil installations, while the Saudis might cut production if they did not get AWACs from the U.S. There still was little appreciation that the energy market had changed fundamentally as worldwide energy demand growth slowed while production capacity expanded.

Banks in 1990: Is Chicken Little an optimist?

Between mid-1989 and the end of 1990, bank stocks declined 39%, and over the next two years they rose 100-200%. At the end of 1990 investors had an extraordinary opportunity to buy high-quality bank stocks and double or triple their money in two years. In comparison to the oils, the problem investors had in seizing this opportunity was informational rather than conceptual. Whereas investors had misconceptualized the oil industry—falsely believing it to be impervious to the law of supply and demand—for bank stocks it was difficult to know just how troubled their real estate loans were.

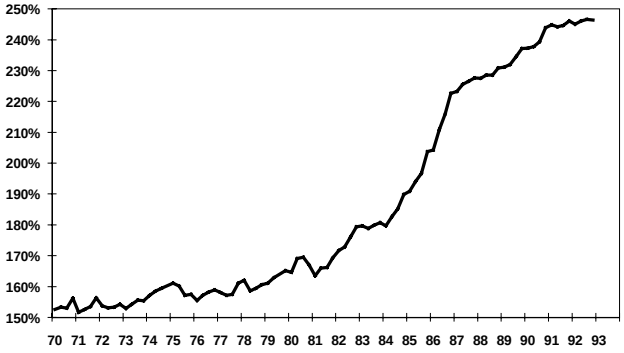
Unwinding the debt spiral

Although there were many surprising and spectacular twists and turns along the way, the debt mania of the 1980s ended pretty much as many investors expected. Throughout the 80s, financial cassandras were warning about the dangers of debt—LDC debt, Federal debt, credit card debt, corporate debt, household debt. This long-standing debt phobia gained credibility in 1989 when the incoming Bush Administration addressed a problem that Congress and President Reagan had ignored—the S&L debacle. A bill was passed that shut down the Federal Home Loan Bank Board, created the Resolution Trust Company, issued $50 billion in bonds to finance the shutdown of bankrupt thrifts, and sharply raised federal insurance premiums paid by thrifts and banks. Fed Chairman Paul Volcker warned that this increase in insurance premiums would hammer the profitability of the banks, which did not have the market power to pass on these higher costs to borrowers.

Despite this steep tax increase, the anticipated cost to the U.S. treasury of the S&L crisis rose from $50 billion to $500 billion in a year. Hypocritical Congressmen, who for years had been taking campaign contributions from S&L operators, grilled hapless S&L regulators in highly publicized hearings. Like Casablanca's Captain Renault, they were shocked (shocked!) that S&Ls had been permitted to make high-risk loans funded with Federally insured deposits.

Chart 5

Total credit market debt outstanding as a % of GDP



Though a harbinger of trouble ahead, the S&L crisis was merely a sideshow for Wall Street during 1989. With stock prices rising nicely and the economy apparently headed for a "soft landing," investment bankers continued to put together new deals, many financed with Japanese capital. In October, while bankers labored to finish up the leveraged buyout of UAL Corp., billionaire developer Donald Trump made a bid to acquire AMR, owner of American Airlines.

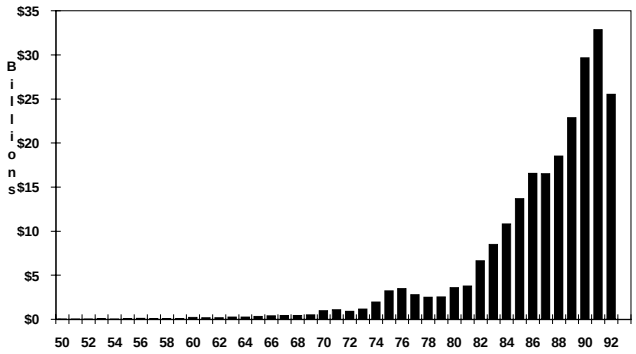
Then on a crisp Friday the thirteenth in October, at 2:54 p.m., an announcement appeared on trading screens that ended an era: The UAL buy-out group could not get bank financing for its $6.79 billion deal. The arbs ran for cover, the DJIA plunged 190 points in a little over an hour, and bond dealers dumped junk bonds in favor of Treasuries. Though stock prices traded up sharply on Monday, "deal stocks" continued to be hammered. Over the next few months, the junk bond market continued to be weak, in part because regulators forced S&Ls to liquidate their junk bond portfolios. In just two days in January, the price of RJR's PIK bonds of 2009—widely considered to be high-grade junk—fell 20%. Then, in one week in February 1990, the kingpin of the junk bond market, Drexel Burnham, got caught in a liquidity squeeze and abruptly decided to liquidate. Drexel's swift demise further imperiled thrifts with big junk holdings, including Columbia Savings and Loan, Imperial Savings, CenTrust and Charles Keating's Lincoln Savings. The debt deflation spiral was gaining momentum.

The bank bear market

With the collapse of the UAL deal, the bank stock bear market began. Bank shares underperformed the S&P 500 by about 18% in the last quarter of 1989 as the commercial real estate market weakened, the S&L crisis expanded, and overall confidence in the financial system waned. The demise of deal mania on Wall Street was a direct negative for the banks, particularly money centers, which generated lucrative fees and loans by financing "HLTs" (highly leveraged transactions). Overbuilt real estate markets, particularly in New England, were a still bigger worry. Nevertheless, some analysts considered the bearishness overdone and began 1990 urging investors to overweight the bank stocks. The stocks were cheap, they argued, and earnings would rise in 1990 if the economy achieved a "soft landing." Investors who feared big earnings declines in 1990 because of real estate problems were "Chicken Littles."

Chart 6

Net loan chargeoffs at FDIC banks



Unfortunately, the banking news in 1990 made Chicken Little look like an optimist. On the first trading day of the new year, Bank of Boston announced a higher-than-anticipated addition to loan losses reserves. During January, the Bank of New England, whose portfolio was being assessed by the Office of the Controller of the Currency, was struggling to survive. The giant bank attempted to sell off assets to Fleet Norstar, but negotiations were halted by the swift deterioration of Bank of New England's balance sheet. In just four months, the bank's stock dropped from $23 to $4, en route to zero. This financial meltdown was a shocker. With regulators getting tougher, the real estate depression spreading out from New England to other markets, and recession a distinct possibility, frightened investors wondered how many other Bank of New Englands might be in their portfolio.

The regulators strike back

Problems in the banking industry were a cause as well as a consequence of the weakening of the U.S. economy. In May, the Federal reserve admitted that, in response to pressure from regulators, banks were tightening their lending standards. Alan Greenspan admonished regulators not to create a "credit crunch," but the regulators—recently blamed for the S&L crisis—were more interested in keeping their own jobs than in fostering economic

growth. They pressured bank after bank to cut dividends and to reclassify loans as non-performers if the value of the loan exceeded the liquidation value of the collateral—even when interest payments were current. Consequently, bank bombs kept going off in investors' portfolios. On a single day in July 1990, investors received disappointing earnings results for Chase Manhattan, First Chicago, the Bank of New York and Midlantic.

The real estate depression and credit crunch made the U.S. economy highly vulnerable when Iraq invaded Kuwait on August 1. In a couple of months, oil prices soared, consumer confidence fell, and auto sales plunged. Investors—apparently facing an inflationary war or an economically debilitating standoff between the U.S. and Iraq—bailed out of stocks. Especially financial stocks, which seemed to be victims of just about every bearish trend you could think of—the end of the takeover mania, the depression in commercial real estate, tougher regulation of banks, higher inflation, and a coming recession that would clobber loan growth. On a fairly typical trading day, Golden West dropped $4 3/8 to $19 3/8, Great Western fell $1 1/2 to $9 1/4, and Fannie Mae dropped $1 3/4 to $27 despite raising its dividend. A precise measure of investors' declining confidence in the financial system was the rate that the country's biggest bank, Citicorp, had to pay on its floating rate preferred stock. In just a few weeks the rate rose from 7.8% to 12.5%.

The sell-off in bank stocks was indiscriminate. Along with northeastern regional banks and money centers that were heavily involved in financing HLTs and commercial real estate, investors also sold stocks with impeccable fundamentals. For example, State Street Bank, whose primary business was not lending but rather providing fiduciary services to mutual funds, saw its shares plunge 50% during 1990—even though earnings rose 12%. A similar victim was Fannie Mae. After trading as high as $44 1/2 at midyear, FNM plunged as low as $25 and traded for a few months in the $25-30 range. There was no good reason for investors to dump FNM. Its widely diversified portfolio of modest mortgage loans to middle-class homeowners—who were, after all, living in the buildings they had borrowed to buy—bore little relation to loans to commercial real estate operators. An investor who had bought FNM in October 1990 had a profit of about 150% by the end of 1991.

The banks in 1990: Bears vs. bulls

The bear case on bank stocks in the dark days of December 1990 was at least as compelling, if not more so, as is the bear case for healthcare stocks today. Some major banks faced a liquidity squeeze, similar to the one that had killed Drexel Burnham. Near-term earnings momentum was terrible. Many dividends had been slashed and several firms had imploded. The stocks seemed unanalyzable because investors did not know what loans were in each portfolio, let alone how the bean counters at the OCC would classify them. The downside risk was that, in the end, the banks' loan portfolios would have the same credit quality as those of the Texas banks in the 1980s—i.e., none. (All of the major Texas banks eventually disappeared.)

Furthermore, this was not exactly a world-class, cutting-edge industry. One of the main reasons why the banks got into so much trouble with commercial real estate and HLTs, after losing a ton of money in loans to LDCs and oil producers, was that their basic franchise of lending to large corporations had been lost to the commercial paper market. One of their few remaining attractive businesses, credit cards, was threatened by a consumer-led recession. Concluded one Wall Street commentator, "I don't know whether First Chicago or Wells Fargo or any other bank will be a survivor. With all due respect to Mr. Buffett and the others who have fabulous records, I don't think they do, either."

The bull case on bank stocks could be summarized with five observations: 1) The stocks were ridiculously cheap. 2) Not all firms were as badly managed as Bank of New England and other troubled institutions. 3) Real estate in most parts of the U.S. was not in nearly as poor shape as that of New England, an area that experienced a torrid real estate boom in the 1980s without much population growth. 4) You cannot run an economic recovery without bank lending, so Washington was not likely to let the industry die. 5) In any case, the draconian regulation that had forced banks to report huge increases in non-performers and loan loss reserves was not, in truth, a negative for bank fundamentals because the regulators merely forced banks to recognize loan problems more quickly than usual. The regulators, in other words, had *compressed the credit cycle*, so the bad news would end sooner than usual. This was bullish, not bearish.

The Fed responds

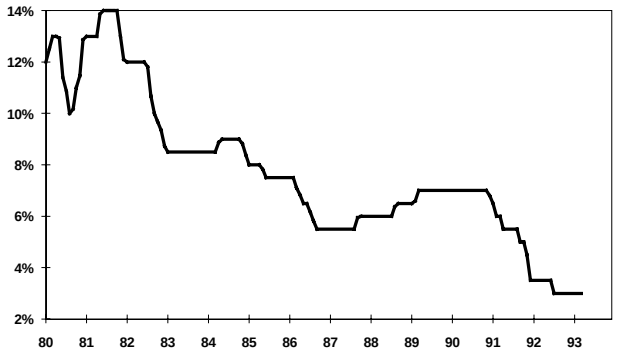
Of course, it was hard to believe the bank bulls in December 1990 because most had already been wrong for a year and a half, and the news was terrible. Citicorp pre-announced a fourth quarter loss of $300 million and slashed its dividend 44%. Security Pacific forecast a fourth quarter loss of $320-360 million and announced plans to

sell its merchant bank. But this was a case of bad news being good news, because the Fed swiftly changed course in the last two weeks of December by lowering banks' reserve requirements and cutting the discount rate from 7% to 6.5%. Bank bears dismissed the cut in reserve requirements as psychological window dressing. "It's like giving aspirin to someone who has cancer," said one.

In this case, the aspirin worked. With expectations driven into the floor, banks announced pleasantly surprising earnings during 1991 and the stocks soared. Five factors drove these good earnings: 1) Most important, credit quality was not as bad as feared; by October non-performers were even declining slightly. 2) Low short-term interest rates were improving lending spreads. 3) Banks had cut costs aggressively. 4) With the bond market rebounding, trading profits were strong. 5) The bank stock rally enabled firms to beef up balance sheets by issuing equity. Many analysts were slow to perceive these improvements and dismissed the initial rally as short-covering.

Chart 7

U.S. discount rate



Prices of companies mentioned as of 4/26/93:

Abbott Labs[1] ABT $26 5/8
Amerada Hess AHC $52 1/4
Amoco Corp AN $54 3/8
AMR Corp[1,2] AMR $66 7/8
Atlantic Richfield[1] ARC $121 3/8
Baker Hughes Inc BHI $25 7/8
Bank of Boston[1] BKB $21
Bank of New York BK $52 3/4
BancOne Corp[1] ONE $53 3/8
Bristol-Myers Squibb[1] BMY $59 1/8
British Petroleum BP $54 1/4
Chase Manhattan CMB $30 1/8
Chemical Banking Corp[1] CHL $37
Citicorp[1] CCI $25 3/4
Coca-Cola Co[1] KO $39 5/8
Disney (Walt) Co[1] DIS $40 5/8
duPont(El)deNemours[1] DD $52 7/8
Exxon Corp[1] XON $64 5/8
Federal Natl Mtge[2] FNM $75
First Chicago FNB $38
First Fidelity Bancorp FFB $43 1/8
Fluor Corp FLR $39 3/8
General Electric[1] GE $92
Golden West Fin'l[1] GDW $41 1/4
Great Western Fin'l GWF $16 1/4
Halliburton Co HAL $37 7/8
Helmerich & Payne HP $30 1/8
Hughes Supply HUG $13 7/8
Johnson & Johnson[1] JNJ $39 3/8
McDonald's Corp[1,2] MCD $46 1/8
Medtronic, Inc MDT $63 7/8
Merck & Co[1] MRK $36
Midlantic Corp[3] MIDL $20
MNC Financial MNC $14 1/8
Morgan(J.P.) JPM $66 3/8
NationsBank Corp NB $48 1/8
Parker Drilling PKD $6 3/4
Pfizer, Inc[1] PFE $63 7/8
Reading & Bates (New) RB $6 3/4
Republic New York RNB $47 1/8
RJR NabiscoHoldings[1,3] RN $5 3/4
Rowan Cos RDC $9 1/2
Royal Dutch Petrol RD $89 3/4
Schlumberger Ltd SLB $63 1/8
Shawmut Nat'l SNC $20
Smith Int'l[1] SII $10 1/4
State Street Boston[3] STBK $31 3/4
Tosco Corp TOS $23 3/8
UAL Corp[2] UAL $139 3/8
U.S. Surgical USS $28 3/4
Wachovia Corp WB $35 3/8
Wells Fargo WFC $102 5/8
Western Co N Amer[2] WSN $11 5/8

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