



BANYAN CAPITAL MANAGEMENT

May 1998

Dear Client:

Since Banyan has now been in business for ten years, it seems an appropriate time to reflect on where we have been and where we are going. While many aspects of the investment landscape have been altered, our basic investment philosophy remains consistent.

The Investment Environment - Then and Now

Banyan Capital Management was born on November 1, 1987 - just eight business days after the historic market crash. In one very important respect there couldn't have been a worse time to launch a new investment counseling firm - investor psychology was at an incredibly low ebb. From its peak in late summer that year the stock market declined about thirty percent, culminating in the biggest one day decline in history on October 19, 1987. At a time when most investors were acting like deer caught in head lights, the environment for making new commitments to the equities markets could not have been more inviting. Those were the days of single digit P/E ratios, when dividend yields of 4 ½% were common; and one could make a long list of companies with stock prices at or below book value. The stocks of truly outstanding companies could be purchased at bargain prices.

Today, however, the S&P 500 sells at perhaps an all time high P/E ratio of 29, a dividend yield of a scant 1 ½%, and a price to book value relationship somewhere in the stratosphere. It is in this environment that investors are actually expecting returns of twenty percent per annum going forward and are tripping over one another to get new money invested in the stock market. At this point bargains are rare and investors should consider themselves fortunate to find shares of an outstanding company selling at a fair price.

Another interesting contrast was documented in a recent Wall Street Journal article which shows that the impact of news events is being absorbed by the market almost instantaneously. In the past it could take weeks for news to be fully reflected in the price of a stock. Today, with faxes and the internet, new information can be reflected in stock prices in only minutes. And, of course, you don't want to be on the wrong side of one of these sledge hammer shots to the forehead. Even one such occurrence can give a portfolio a migraine for months. Thus far, we have been fortunate in avoiding such mishaps.

There has been a marked improvement in how we view American industry. Throughout most of the decade of the 80's the majority of publicly held businesses were seen as bureaucratic, lethargic monoliths where management acted mostly to enrich themselves. The Germans and the Japanese were thought to have superior business intellect. Today, U.S. business enterprise is the envy of the entire world. It is amazing how efficient we have become. Apparently all the heavy investment we have made in technology has finally begun to pay off. Weak, ineffective managements have for the most part been winnowed out through corporate restructuring and industry consolidations to be replaced by executives bent on increasing shareholder value while still being true to their various other constituencies. It's good to see us in a much improved condition and getting better every day.

Let Us Give Thanks

For the ten years ending December 31, 1997, composite equity performance for Banyan clients was 18.5% per year. ([Explanation of how composite is compiled](#)) We are indebted to many for our good fortune.

First, thanks is due to our staff - most of all Don Bundy, our portfolio administrator of the past four years. Without his dedicated efforts over a full range of administrative responsibilities, returns would certainly have suffered. Likewise, we are thankful to his two predecessors, Marcia Kass and Margaret Sutton.

We could not have accomplished what we have without the outstanding stewardship of the senior managers of the companies in which we are invested. May each of these gentlemen continue in excellent health.

A heavy dose of thanks goes to each of our clients. We are fortunate at Banyan to work for a patient group of investors who are willing to share our long-term approach to the management of their investment portfolios. Evidence of their commitment to our approach is that we almost never receive a concerned phone call when the market goes through its inevitable periods of stress. Such patience and trust enables us to do our job - produce attractive investment results over time.

The Future

What will the future hold for interest rates, the economy and the markets? Answers to these questions are unclear. In fact there has never been a time when the future was perfectly clear. In what continues to be an uncertain environment, our investment methods are going to remain the same. We'll only invest in those companies whose stock prices provide a reasonable margin of safety to prevent the permanent loss of capital. Rather than spending time attempting to predict the future, we are going to further hone our skills at determining what businesses are worth and understanding the motivations and skills of those individuals managing those businesses. This is the focus that has allowed us to grow from \$1 million under management in 1987 to over \$33 million today.

In fact, we can see ourselves growing to \$100 million in assets within the confines of our existing infrastructure and staff. A warm welcome is due to our new office manager Debra Watson. Debra will be running Banyan "the business" and taking primary responsibility for client service. More of my time can now be spent on the investment process rather than administrative duties.

Looking down the road a bit further, we continue to explore the possibility of one day offering the alternative of a mutual fund and/or an investment partnership managed by Banyan. Should either of these possibilities become a reality, we will continue to offer the same level of service to our existing private accounts.

The past decade has been a prosperous one for our clients and Banyan, and therefore we are thankful. The investment process continues to be stimulating and rewarding and we look forward to the challenges and opportunities that the next ten years are certain to bring.

Sincerely,

Gary L. Watkins
President