

# J. L. BAINBRIDGE & COMPANY, INC.

◆PROFESSIONAL MONEY MANAGEMENT◆

## 1999 MID-YEAR REPORT

### INVESTMENT RESULTS

For the first half of 1999, J. L. Bainbridge & Company, Inc. achieved a 12.3% rate of return on all money under management. In conjunction with 1994, 1995, 1996, 1997 and 1998 returns of 10.2%, 38.4%, 20.3%, 23.2% and 30.2% respectively, a January 1, 1994 investment of \$100,000 has grown to a June 30, 1999 value of \$331,194 which equates to an increase of 231% over the past five and one half years. The annually compounded return over the past five and one half years is 24.3%. These results assume reinvestment of dividends and are after transaction costs and J. L. Bainbridge & Company, Inc.'s management fee.

### INVESTMENT REVIEW

The first half of 1999 was a period marked by a somewhat subdued stock market with the S&P 500 and NYSE composite indexes increasing 11.7% and 8.8% respectively. As stated repeatedly over the past year and one half, we are expecting a significant slowdown for the overall market with single digit market returns over the next five years. However, when compared to other more speculative investment programs, our program is at its best when the market is less frothy. When the market is racing ahead our program usually achieves a return in-line with the overall market but achieves a much greater relative return when the market slows down. Thus we remain totally confident our returns will meet our 15% objective compounded annually in an environment of much slower growth.

### INVESTMENT STRATEGY

As presented on the last page of each years annual report our mission is to "ENHANCE CLIENT'S

LIVES". Five years ago a new discipline was added to our investment strategy that has paid handsome dividends. This entails the calculation of the full value of each company's stock one year into the future and making new purchases only when the potential return from the current price to the full value price in twelve months is at least 35%. This discipline coupled with our policy of owning only exceptional companies with long records of success achieved a return of 231% over the past five years. More importantly this strategy produced a return of 10.2% in 1994 when the overall market declined slightly. Based on these results and our current portfolio of modestly priced high quality growth companies, we have never felt better about our ability to fulfill our mission to clients.

In addition to using the calculation of full value as a discipline for the timing of new purchases, it is also invaluable in setting sell points. Both buying too high and holding stocks that have become dangerously expensive, lead to higher risk and a mediocre return. Five years ago our largest holdings were Coca Cola, Gillette and Proctor & Gamble. When the price of these great companies became excessive, they were sold and replaced by Marriott, McGraw Hill and Walgreens, our current three largest holdings. If we had failed to sell these overpriced holdings, the annually compounded return from these holdings over the past three years would have been only 11% whereas the compounded return achieved over this period for Marriott, McGraw Hill and Walgreens was 32%. In addition because Marriott, McGraw Hill and Walgreens were purchased at bargain prices and their growth has exceeded expectations, they remain attractively priced today with the potential to return 43% over the next twelve months and 22% annually compounded over the next five years.

While as indicated at the beginning of this report we expect a market slowdown, we do not believe there is much danger of a prolonged decline in the

stock market because of the strong demand for investments from the immense accumulation of retirement assets coupled with a favorable economic outlook. This does not mean short term declines, such as the almost 20% decline last July through early October, will not occur from time to time. In fact declines will inevitably occur, but because there is no rational reason for such declines, they will be unpredictable. Accordingly we will not waste time trying in vain to predict the short term direction of the market. However, because these declines are excellent buying opportunities, we will take full advantage and purchase aggressively.

While patience is an important key to the success of any investment program, if we are correct in expecting a slow stock market patience will be more important than ever. In this environment market declines may be more frequent and there will likely be periods where our results will fall short of a 15% return. The decline of last autumn occurred due to groundless concern that economic problems in Asia would engulf the world economy. The absurdity of this line of thinking is pointed out by the fact that all of the economies of Southeast Asia less China and Japan makeup an economy equal to the economy of Massachusetts. The fact this decline was unfounded did not alter the fact that a large dose of patience and confidence in our long term investment program was required to stay the course. The next decline will be equally as unpleasant and require the same level of confidence. However, the experience gained from the last decline should help cushion the shock and therefore lest we forget enclosed is a copy of our letter sent to clients last October during the height of the storm.

In addition periods of stagnation in the market and our portfolio may occur. A period where our results trail 15% will require confidence that periods of high growth will follow and long term results will meet 15% compounded annually over the next five years. Patience is also required when individual stocks languish. For example Allied Signal was flat from late 1997 through early 1999.

This was not due to slower earnings growth as earnings grew at a strong mid-teens rate each quarter during this period. The cause of this prolonged stagnation is unclear as is the cause of sudden change that has occurred in the past four months where their stock has appreciated by more than 45%. The realization that any company will likely encounter periods of disinterest by investors and that this does not reflect an underlying problem with the company's performance, provides the will to endure with confidence any period where a company's stock price does not correspond with its substantial earnings growth.

Another reason we have never felt better about the current portfolio of truly outstanding companies is the diversification represented by these holdings. The portfolio includes investments in healthcare covering pharmaceutical, retail drug store and senior living center industries, aerospace and avionics, communications, lodging, cosmetics, publishing, investor information services and real estate investment trusts with a healthy 7% dividend yield. Current holdings also offer wide geographic diversity. For example Avon Products derives over four fifths of its business internationally where the opportunity for rapid growth is much greater than the mature United States market. Similarly, McDonalds derives most of its growth overseas while Allied Signal, McGraw Hill and Marriott have smaller but rapidly expanding international units.

## CONCLUSION

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The prevailing media hype of high stock prices and the need "to keep a close eye on the fire exits" is as irrelevant today as it has been for the past decade. With the economy in good shape and the demand for investments strong, we will adhere to our program confident in achieving our 15% annually compounded long term objective with minimal risk. Do not interpret this as complacency as we will be closely monitoring the progress of both the companies currently owned as well as those being evaluated as candidates for future purchase.

**J. L. BAINBRIDGE**

**& COMPANY, INC.**

Managing more than \$120 million for over 500 clients nationwide.

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