

PHILLIPS, HAGER & NORTH U.S. SPECIAL EQUITY FUND

1ST FIVE YEAR REPORT – OCTOBER 13, 1997

COMMENTARY

We issued our first anniversary report on October 13, 1993 and have been waiting ever since for our fifth anniversary. The five years since the fund started has been an above average period for U.S. equity investments. The Fund was able to capitalize on this favourable environment and we are pleased to announce that on October 13, 1997, the unit value of the Fund was \$21.86 (\$Cdn). **This represents an annual rate of growth of 25.5% (\$Cdn) for our unit holders.**

As has been repeated time and time again in our monthly reports, low inflation rates, low interest rates and moderate economic growth is a powerful setting for equity markets. This has been the prevailing environment during the past five years with the exception of 1994 when interest rates rose partially on the preemptive actions of Alan Greenspan to head off a possible acceleration in economic growth and, probably more significantly, to strengthen the U.S. dollar that was weak at that time. This “hiccup” in interest rates resulted in a restrained equity market in 1994 including an end to the small cap bull market of 1993, and the beginning of the big cap market leadership for the next three years.

Apart from the generally favourable economic conditions supporting the market over the past five years, the other dominant theme was a constant rotation of market interest to different industry groups. This rotation, we believe, resulted in the avoidance of the excessive optimism and market valuations that lead to significant market corrections—sometimes even in the face of good economic conditions. Nevertheless, it must be acknowledged that despite this healthy rotation, stock valuations are currently high.

The Fund’s main strategy of concentrating on stock selection was crucial to obtaining above average results during this period of rotation in market leadership. **While it would be unrealistic to expect a continuation of 25% compound growth, we continue to believe that the U.S. equity market offers excellent long term growth potential.**

The market was very accommodating in allowing the PH&N U.S. Special Equity Fund to complete its first five year period just days before the problems in the South East Asian markets finally resulted in a collapse of the Hong Kong market which quickly developed into a world wide market correction. Predicting short term market direction is always a hazardous and usually unrewarding pastime, so we will not pretend to know what the market will do short term. Our policy will be to continue to concentrate on stock selection.

Getting back to a subject more relevant to a five year anniversary report: whether compared in Canadian dollars or U.S. dollars, the Fund performed a **full** 1% per annum above the S&P 500 Index over the five year period. This is **after** a 1% per annum management fee and other necessary expenses such as auditing fees and custodian fees. All these costs make up a **total** management expense ratio (MER) which has ranged between a high of 1.19% for 1993 to a low of 1.09% for 1996. We believe the Funds MER is one of the lowest in the industry.

To summarize, our Fund holders' financial results over the five year period were due to a very favourable equity market (21.9% \$U.S. per annum as measured by the S&P 500 Index), and favourable relative performance of over 2% per annum above the performance of the S&P 500 Index due to active management, which resulted in a 1% per annum **net** gain. PH&N U.S. Special Equity unit holders also received the benefit of a 2.6% per year** gain due to the strong U.S. dollar relative to the Canadian dollar. The total gain of 25.5% (\$Cdn) per annum has been a satisfying achievement, but is definitely above any realistic long term expectation of investment results.

It is impossible to predict how the next five years will unfold for investors. The most important year, as always, will be the current year. The most important five year period will always be the latest five year period. After over 30 years of picking stocks which appear to have significant growth potential and that are believed to be trading at reasonable valuations, your senior manager continues to feel that this investment strategy offers a most logical approach for seeking superior long term growth of capital.

** As a matter of interest, the Canadian dollar was 80.4 cents U.S. on Oct 13/92 and 72.6 cents U.S. on Oct 10/97.

PERFORMANCE RESULTS

NAVPS: October 13, 1997

\$21.86 (\$Cdn)

In the Fund business, a five year record is the equivalent of coming of age. Any five year record is better than not having a five year record.

FIVE YEAR RECORD * (Oct. 13, 1992 - Oct. 13, 1997)

PH&N U.S. Special Equity Fund \$Cdn	25.5%
S&P 500 Index \$Cdn	24.4%
PH&N U.S. Special Equity Fund \$U.S.	22.9%
S&P 500 Index \$U.S.	21.9%

* *average annual compound rate*