

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

SEMI-ANNUAL REPORT - JUNE 1996

COMMENTARY

Group rotation continued to be relentless, and in some cases quite dramatic. The overall market, however, continued to confound the pundits by not correcting. Holding cash in anticipation of an intermediate-term correction definitely hurt a lot of investors. Good stock selection, on the other hand, paid off handsomely.

Economic commentary during the period was tedious and unhelpful. The "problem" was that the economy muddled along, fluctuating between announcements of slower growth or accelerating growth. Despite these confusing and contradictory signals the economy has, on balance, been slowing slightly. The empirical evidence, moreover, offered no consistent validation that inflation was accelerating.

The big worry has been the possibility of wage inflation due to a relatively tight and improving labour market in the U.S. While it seems to be common sense that a tight labour market should lead to upward pressure on wages, economic data supplied by a leading U.S. economic research organization shows a rather weak correlation between these two sets of data. Also, current empirical data suggests that wage rates are currently rising by under 3%. A leading salary budget survey covering 3000 companies in the U.S., representing a broad cross section of industry, points to a rise of just under 3% again in 1997.

It would be logical if earnings disappointments, not rising interest rates and inflation fears, turn out to be the spoiler later in the year. There is evidence that earnings expectations are being brought down, and that while earnings are meeting these revised levels, there are fewer upside earnings surprises than was the case in 1995 and the first quarter of 1996.

So, is this just waffle or does it have a bearing on the Fund's strategy for the remainder of the year? Definitely! If interest rates do go up, the Fund's cash will be raised quickly. If the rate of economic growth slows and earnings expectations and reported earnings come in lower than earlier expected, the Fund thinks it had better rely on stock selection. If economic growth and earnings come in better than anticipated, without increased inflation and higher interest rates, stocks could be very good indeed, and there will probably be a speculative blow-off in the market. The Fund would rather enjoy that, provided of course, that it is smart enough to lighten up at the top.

CONCLUSION

We probably don't know what the economy will do, or how the market will react to it, but selection will really make the difference (just being facetious - sort of).

If interest rates go up, which the Fund does not expect, cash will be raised quickly - likely to the 20% level. Because of the continuous rotation of performing and underperforming groups over the past few years, there are still interesting opportunities in the equity market despite the fact that the economic cycle is very old - but not extended in terms of speculative excesses and production bottlenecks. This leads us back to the importance and possible potential of careful stock selection.

PERFORMANCE RESULTS

The fund did very well during the six months ended June 30, 1996. The net asset value per share on that date was \$16.12 (Cdn), a 17.4% increase from the beginning of the year. There was no currency effect during the period. The Fund outperformed all of the market indexes that we follow by a respectable margin.

NAVPS: June 30, 1996

\$16.12 (Canadian)

PERFORMANCE COMPARISONS*

	Dec 31/95 to Mar 29/96	Mar 29/96 to June 30/96	May 31/96 to June 30/96	Year to Date
U.S. Special Equity Fund \$Cdn	+10.3%	+6.4%	-1.5%	+17.4%
U.S. Special Equity Fund \$U.S.	+10.7%	+6.0%	-1.2%	+17.4%
S&P 500 \$U.S.	+5.4%	+4.5%	+0.4%	+10.1%
S&P Midcap \$U.S.	+6.4%	+2.8%	-1.4%	+9.3%
Russell 2000 \$U.S.	+5.1%	+5.0%	-4.1%	+10.4%
NASDAQ Composite \$U.S.	+4.9%	+7.8%	-4.6%	+13.1%

* Including income in all cases.

PORTFOLIO FUND VALUATION - June 30, 1996 (as a %)

Allied Healthcare (AHPI)	0.47
Amerilink Corp. (ALNK)	1.05
AMR Corporation (AMR)	2.75
Applied Materials Inc. (AMAT)	0.15
APS Holdings (APSI)	0.55
Astec Inds Inc. (ASTE)	0.70
Bay Networks (BAY)	0.10
Biowittaker Inc. (BWI)	0.64
BMC West Corp (BMCW)	1.46
Carnival Corp (CCL)	1.74
Chesapeake Energy (CHK)	7.24
Clayton Homes, Inc. (CMH)	3.30
Columbia/HCA Healthcare (COL)	5.63
CompUSA Inc. (CPU)	1.72
Covenant Transportation (CVTI)	1.28
Diamond Offshore Drilling (DO)	1.44
Deere & Company (DE)	3.02
Destec Energy (ENG)	0.32
Digital Equipment (DEC)	2.26
Dress Barn Inc. (DBRN)	2.06
DSG International (DSGIF)	1.51
EMC Corp. (EMC)	1.03
Falcon Building Prod. (FB)	1.51
Fleet Financial Group, Inc. (FLT)	3.28
Fred Meyer Inc. (FMY)	0.74
Gap, Inc. (GPS)	3.23
Greyhound Lines Inc. (BUS)	0.83
Harnischfeger Inds. (HPH)	1.21
Hi-Lo Automotive (HLO)	0.24
Intel Corp. Common (INTC)	0.37
Jones Apparel Group, Inc. (JNY)	4.33
Kellwood Co. (KWD)	1.16
Kemet Corporation (KMET)	0.50
Linear Technology (LLTC)	0.15
Mascotech Inc. (MSX)	0.69
Maverick Tube Corp. (MAVK)	0.89
Mesa Airlines Inc. (MESA)	1.20
Michaels Stores (MIKE)	0.43
Microsoft Corp. (MSFT)	0.30
Mississippi Chemical (MISS)	1.81
Mohawk Industries (MOHK)	0.71
Nike, Inc. (NKE)	5.17
Nine West Group (NIN)	2.57
Nucor Corp. (NUE)	0.38
O'Sullivan Industries (OSU)	0.56
Owosso Corp. (OWOS)	0.84
Pier 1 Imports Inc. (PIR)	1.34
Pope & Talbot (POP)	1.33
Praxair Inc. (PX)	4.25
Price/Costco Inc. (PCCW)	3.32
Singer Co. (SEW)	1.73
Texas Instruments Inc. (TXN)	0.25
Top Source Tech (TPS)	0.17
Vishay Intertechnology Inc. (VSH)	0.25
Wellpoint Health Networks (WLP)	1.68
Total Equities	87.86
Cash and Short Term Notes	12.14
TOTAL ASSETS	100.00%