

# 1998 Semi-Annual Report

## Commentary

It would be a great time to be retired and in the process of writing a definitive book on successful high-growth investing based on our experience up to October 13, 1997. I find, however, that managing a portfolio is really a lot more interesting and rewarding. Moreover, despite the short-term frustration of seeing good small- and mid-cap stocks being outperformed by a narrow list of extremely over priced large-cap stocks, the current market environment is developing into an exciting investment outlook for our investment style.

**This report is going to be quite long, not because we feel it is necessary to rationalize lagging the current performance of the large-cap dominated indexes, but because we feel a major investment opportunity in small- and mid-cap stocks is beginning to shape up.**

Although we are investing for high potential long-term growth, we really hate being beaten by the market over the short-term. At the same time, we want to avoid becoming so caught up in the short-term that we fail to recognize major long-term opportunities.

I have been around long enough to know that the wisest business strategy is generally not to state one's views too strongly. To do so will either be construed as rationalization when you are under-performing the market, or be used to reinforce unrealistic expectations if you are beating the market. Nevertheless, despite these risks, we feel that now is the time to stand up and be counted.

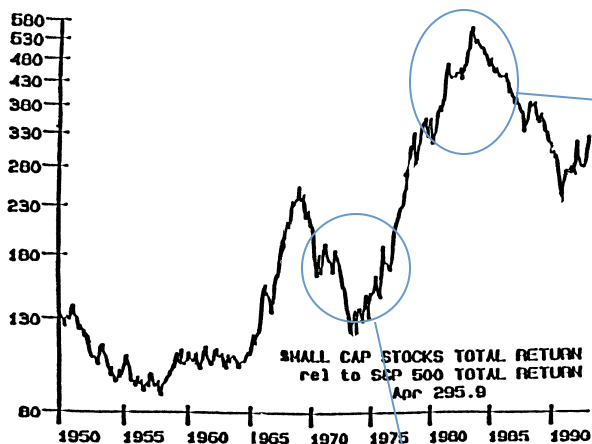
Sometimes after a period of good performance we get the hollow feeling that the good times are all over and there will be a lot of pain before any good values develop. At other times, things get so bad that we get excited because we know that new bull markets start when the current news seems irrecoverably disastrous.

**Currently, neither of these generalizations really seems to apply, however, we are feeling increasingly positive about the appreciation potential of small- and mid-cap stocks. There are some very significant points backing up this positive view:**

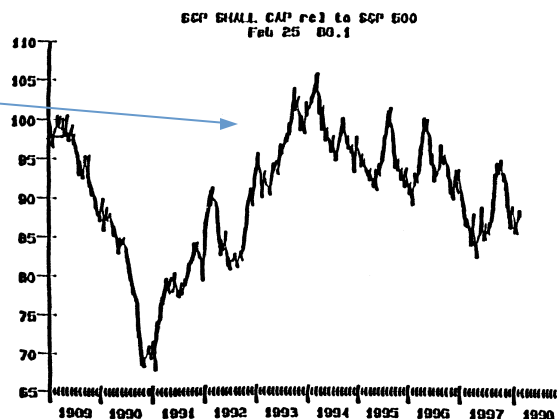
- Common stocks are the best long-term investment available to portfolio investors and small-cap stocks are better than large-cap stocks over the long-term.
- There are extended periods when small-cap stocks under-perform large-cap stocks. The current period of under-performance of small-cap stocks has been taking place since early 1993. The 1990-93 period of superior small-cap performance was shorter than usual, but rewarding.
- The P/E ratios of small-cap stocks have fallen to the low-end of their historic relationship to the P/E ratios of large cap-stocks as represented by the S&P 500 index.
- On a fundamental basis, small-cap stocks have higher long-term growth rates than those of the more mature companies making up the S&P 500 index.

The strength of small-cap stocks and large-cap stocks go through alternating periods of relative strength. All of the preceding points are consistent with the belief that small-cap stocks are due for a period of out-performing large-cap stocks.

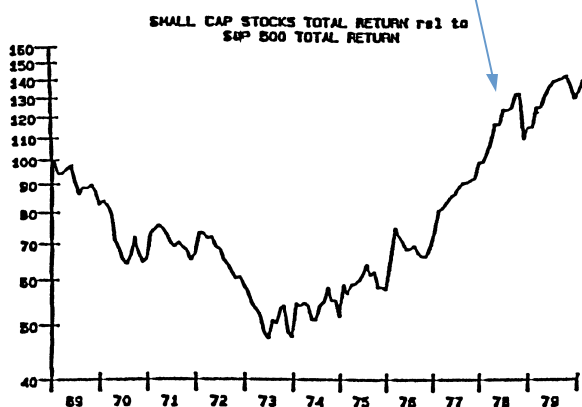
These points are dramatically illustrated in the following charts:



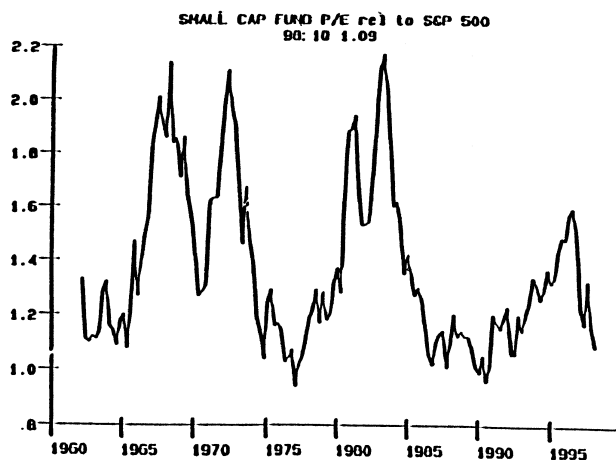
Source: ISI



Source: ISI



Source: ISI



Source: ISI

## Mature Market Cycle

Concern about the age of the current bull market (maybe we can now say “recent bull market”) and the high current level of stock valuations relative to earnings is well founded.

This bull market is eight years old with only a pause in the 1994. The past four years have seen a remarkably uninterrupted advance producing above-average annual gains especially for large-cap stocks. Market corrections are a normal, re-occurring fact of life. A correction from the most recent market highs would be both rational and healthy for the longer-term.

The US market cycle is not only extended in terms of time, but also in terms of being at the high- end of the historic range of price/earnings ratios. Price earnings multiples have just this year exceeded the peak levels reached back in 1961. As well, the super bull market of the last 4 years in large-cap stocks also seems reminiscent of the “nifty fifty” experience of 1971-72 to many market observers. The bear market that followed in 1973-74 was the worst bear market of the post World War II era.

These observations warrant careful consideration. A sense of history is useful in the interpretation of current events as long as we realize, certainly in the case of the stock market, that an exact repeat of history is not going to occur. The implications of past events are never absolutely clear and can be misleading if based on superficial observations or selective recall.

## Market Valuation & Performance during the 1960s

The 1961 multiple peak did not prevent the remainder of the 1960s from being very rewarding to investors. That doesn't mean that investors weren't faced by unnerving markets during the decade. There was a scary bear market in 1962 which produced rapid declines on high volumes and which, at the time, was thought by many investors to be the beginning of another 1929.

The S&P 500 dropped 19.5% between the end of March and the end of October 1962, nevertheless, the market was on its way up again by the end of the year. The only lasting damage from that bear market was to investors who panicked out of the market during the decline or who did not use their buying reserves near the bottom of the new bull market. The peak multiples of 1961 were largely the result of extreme valuations being placed on “reliable growth stocks” such as food stocks. These stocks did not lead the following bull market. By the mid-60s small-cap stocks were leading the market and posted a major advance which became over done by the end of 1968.

Despite the significant bear markets in 1962 and 1969 plus a modest bear market in 1966, the S&P 500 produce a return of 7.8% per annum during the decade. Small-cap stocks delivered a 15.5% annual compound rate of gain during the 60s. The best way to miss these results was to get hung up on market timing which, incidentally, was approved of back then.

## Market Valuation & Performance during the 70s

The claim that the terrible market of 1973-74 was the direct result of the “nifty fifty” overvaluation of 1971-72 might well be another misleading reading of history. There were fundamental economic developments taking place in the early 1970s that could have been much more significant. The most obvious events being the Vietnam conflict, the energy crisis, rising rates of inflation, increasing government spending, growing government deficits and rising interest rates.

The “nifty fifty” was a group of fifty very large, well-managed, high-growth companies. At the peak of the “nifty fifty” phenomenon the average multiple of these leading stocks was over 50 times earnings. At the same time, the average multiple of the S&P 500 on trailing earnings was fluctuating around 18 times for most months of the year, with a high of 19 times being reached for November. Not surprisingly, small-cap stocks under-performed during the 1971-72 bull market. Early into the 1973-74 bear market the relative performance of small-cap stocks began to stabilize and actually performed slightly better than large-cap stocks for the remainder of the bear market.

**Once the 1975 bull market began, small-cap stocks took off and continued to strongly outperform the S&P 500 index up until the middle of 1983. This rotation between the relative strength of large-cap and small-cap stocks has been a repeating phenomenon since the late 1920s.**

Despite starting the decade with a bear market in 1970 and the enduring 1973-74 bear market (the worst since 1929-32), the S&P 500 index grew at an average annual rate of 5.9% during the 70s. Small-cap stocks grew at 11.5% during the decade.

## Economic Background

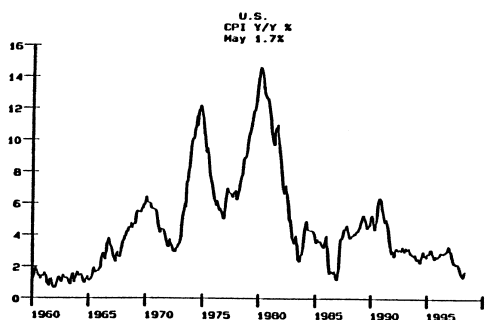
Back as far as 1993 commentators were beginning to focus on the fact that in the U.S. a “too good to believe” set of economic conditions had developed. They were: steady economic growth with improving corporate earnings, moderate inflation and the lowest level of interest rates in 30 years.

There was a great deal of nervousness that these conditions couldn't last and that higher rates of growth would develop which would set off the old “boom – bust” cycle that had been repeated so many times in the past. Alan Greenspan's preemptive interest rate hikes in 1994 at first added fuel to this concern and then appears to have broken the cycle, resulting in a continuation of moderate growth and low inflation.

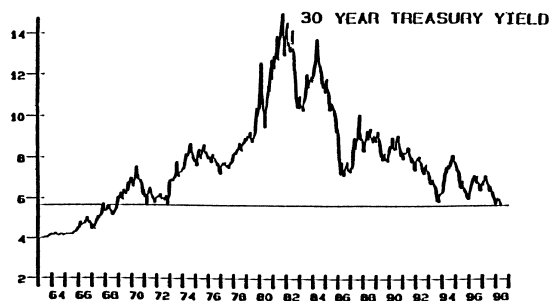
*Continued on page 5...*

## Economic Background cont...

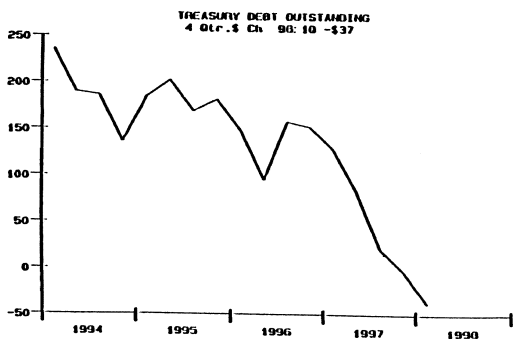
The low inflation, low interest rate, modest growth scenario has been supported by other macro economic factors that have led to a continuation of the 8 year bull market and rising price/earning multiples. Some of these factors are illustrated in the following charts. Please note that some of the charts only show the improvement of recent years.



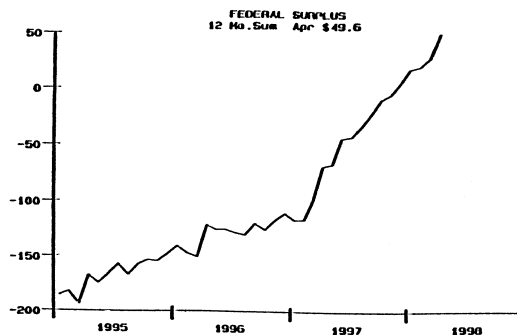
Source: ISI



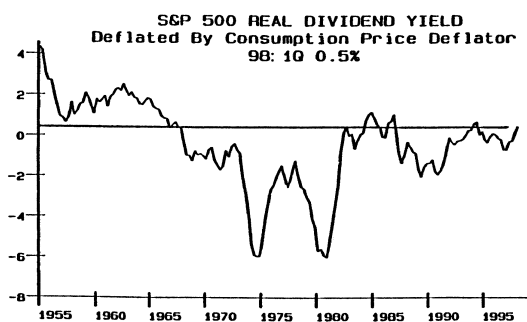
Source: ISI



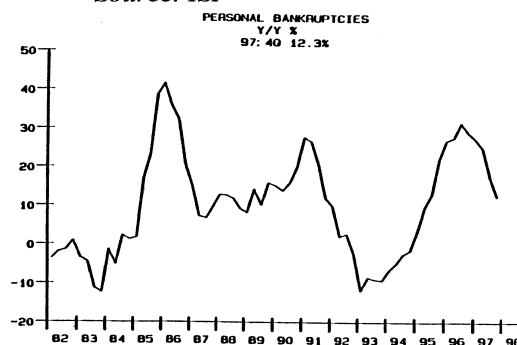
Source: ISI



Source: ISI



Source: ISI



Source: ISI

To us this economic background implies that P/E multiples should currently be expected to be at the high-end of their historic range for all stocks. Ironically, these positive economic factors are being used to rationalize excessive big-cap valuations while smaller-cap stocks are not seeing similar multiple expansions. A number of rather dubious reasons are being used to explain this phenomenon:

- Asian investors who flee to the US are familiar only with large-cap stocks;
- Large amounts of money are going into Index Funds, reinforcing the trend of large-cap stocks;
- As many small-cap stocks have overreacted to disappointments, managers are worried about investing in **any** small-cap stocks;
- Investors don't want to have the marketability problems of small-cap stocks during uncertain times (this reason is justified, at least in the short-term).

This type of thinking can affect market actions for a period but over the longer-term more fundamental factors prevail.

## Portfolio Outlook

This report is beginning to sound as if we feel our job is to be commentators and you should know not to pay much attention to those folks. Stock selection is what will determine the Fund's long-term growth.

**Stock selection must be more than just riding stocks that are outperforming the market regardless of value considerations. Consider the following:**

### 10 Largest US Equities

Company	Market Cap. (06/30/98) billions \$	P/E Multiple		Expected 1 yr EPS Growth**
		12 months to Dec 31 97	12 months to Dec 31 98*	
General Electric	\$295.68	36.9 x	32.3 x	14.2%
Microsoft	\$267.06	65.3 x	54.2 x	20.5%
Coca-Cola	\$211.13	52.1 x	53.1 x	-1.8%
Exxon	\$174.05	24.2 x	25.1 x	-3.7%
Merck & Co	\$159.29	34.9 x	31.1 x	12.3%
Pfizer Inc	\$152.19	63.9 x	51.3 x	24.7%
Wal-Mart Stores	\$135.82	38.9 x	33.0 x	17.9%
Intel	\$124.54	19.2 x	23.9 x	-19.9%
Lucent	\$109.14	61.2 x	46.0 x	33.1%
IBM	\$107.01	19.1 x	17.6 x	8.3%
Unweighted Average		41.6 x	36.8 x	10.6%

\* based on IBES forecasts and reported earnings YTD

\*\* expected 1 year EPS growth rate between 12 month periods ending Dec 31 ,1997 and Dec 31, 1998

### Select North Growth US Equity Fund Holdings

Company	Market Cap. (06/30/98) billions \$	P/E Multiple		Expected 1 yr EPS Growth**
		12 months to Dec 31 97	12 months to Dec 31 98*	
Int'l Specialty Products	\$1.79	19.4 x	16.3 x	18.8%
Integrated Health Services	\$1.71	14.7 x	12.3 x	19.6%
Symantec	\$1.50	19.5 x	15.7 x	23.9%
Alaska Airlines	\$1.43	15.5 x	11.2 x	38.0%
Precision Cast Parts	\$1.30	17.5 x	13.1 x	33.1%
Toll Brothers	\$0.79	15.0 x	12.5 x	20.4%
Kellwood	\$0.77	18.7 x	17.4 x	7.3%
Dress Barn	\$0.58	15.6 x	13.3 x	17.6%
Inacom	\$0.49	14.6 x	12.5 x	17.5%
Greenbrier Companies	\$0.25	14.9 x	12.7 x	17.2%
M/I Scholttenstein Homes	\$0.19	10.1 x	7.5 x	34.0%
SBS Technologies	\$0.17	20.8 x	16.3 x	27.6%
Northwest Pipe	\$0.15	14.0 x	11.8 x	19.0%
Unweighted Average		16.2 x	13.3 x	22.6%

\* based on IBES forecasts and reported earnings YTD

\*\* expected 1 year EPS growth rate between 12 month periods ending Dec 31, 1997 and Dec 31, 1998

We believe that the next important gain in stock prices will be lead by small- and mid-cap stocks. A significant correction in the overall market will likely be necessary to cause a breakdown in the large-cap market leadership. It is very important that we are well positioned in smaller, reasonably-priced growth stocks when this switch in leadership takes place. The potential gains from this policy dwarf the frustration of not performing as well as the current over-priced stocks that are providing the final excesses of an eight-year-old bull market.

We have not dwelled on the problems in Asia. They are significant and they will continue to affect world markets including the US market. Complicated scenarios as to how this issue will resolve itself have little chance of success. Our approach will be to try to anticipate the effect of the Asian problems on individual companies.

*Continued on page 8...*

## Summary

This market cycle is in its eighth year and is at the higher-end of the historic P/E range of the S&P 500 Index. Many important economic factors such as low interest rates suggest that P/E multiples should rationally be at above average levels. Nevertheless, the strong performance of the largest-cap stocks over the past 4 years has resulted in excessive valuations for that group of stocks.

There has already been a considerable shakeout in the broad market since the US market first reacted to serious problems in Asia in mid October of 1997. This is well illustrated by observations of a Salomon Smith Barney analyst based on prices of August 7, 1998:

“As of Friday close, the biggest stocks in the market ... those with a market capitalization of at least \$20 billion... are off 15% from their 1998 highs. The losses suffered by small stocks: three times greater ...down 45.5%...”

“...[W]hile the S&P 500 index is still ahead 11.6% for the year, the average S&P stock – on an equally weighted basis - is just up 0.85% for the year.”

In other words, we are well into a corrective phase in the market. On an individual stock basis we have been able to find smaller growth stocks that are getting good current earnings and that sell at attractive multiples.

We continue to concentrate on stock selection. Our analysis of values relative to long-term growth potential is consistent with the historic pattern of relative strength rotating from large- to small-cap stocks. All the relevant factors are in place, and we expect smaller-cap stocks to lead the market during the next significant uptrend in the US Equity Market.

Yours truly,



Rudy North

## Performance Results

### SEMI-ANNUAL RESULTS

	Dec. 31/97 To Mar 31/98	Mar 31/98 To June 30/98	May 31/98 To June 30/98	Year To Date
<b>North Growth US Equity Fund \$CDN</b>	<b>10.9%</b>	<b>0.5%</b>	<b>1.2%</b>	<b>11.4%</b>
<b>North Growth US Equity Fund \$ US</b>	<b>11.8%</b>	<b>-2.9%</b>	<b>0.4%</b>	<b>8.5%</b>
S&P 500 \$US	13.9%	3.3%	4.1%	17.7%
S&P Midcap \$US	11.0%	-2.2%	0.6%	8.6%
Russell 2000 \$US	10.3%	-4.6%	0.3%	5.3%
NASDAQ Composite \$US	17.0%	3.3%	6.6%	20.9%

*\*Source: Bloomberg "Total Return Analysis" as of July 16, 1998*

*Note - Including income in all cases*

### AVERAGE ANNUAL COMPOUND RATE OF RETURN as of June 30/98

	1 Year	2 Years	3 Years	4 Years	5 Years
<b>North Growth U.S. Equity Fund \$CDN</b>	<b>22.7%</b>	<b>26.0%</b>	<b>26.8%</b>	<b>25.3%</b>	<b>21.6%</b>
Average U.S. Equity Fund \$CDN **	28.0%	26.3%	23.7%	-	19.1%
Median U.S. Equity Fund \$CDN **	28.4%	26.3%	24.7%	-	19.8%

*-Results after all management fees and other expenses*

*\*\* as measured by the Globe & Mail*

NAVPS: JUNE 30/98:

\$17.55 CDN

The North Growth US Equity Fund gained 11.4% during the first six months of 1998. While this performance was greater than expected at the beginning of the year, it fell significantly short of the performance of the Large-Cap Indexes. The weak Canadian dollar produced 2.9% of the 11.4% gain.

## North Growth U.S. Equity Fund

Portfolio Valuation – June 30, 1998 ( as a %)

Xerox Corp (XRX)	4.48	Percentage of Holdings
Inacom Corp (ICO)	4.05	
Whirlpool Corp (WHR)	3.94	Large Capitalization (over \$5 billion) 29.65%
Compaq Computer Corp (CPQ)	3.93	
AMR Corp (AMR)	3.90	Mid Capitalization (\$1 to \$5 billion) 27.05%
Kellwood Co (KWD)	3.35	
BJ's Wholesale Club (BJ)	3.18	Small Capitalization (less than \$1 billion) 37.67%
Greyhound Lines Inc (BUS)	3.11	
Northwest Pipe Co (NWPX)	3.09	
Greenbrier Companies Inc (GBX)	3.01	
Tommy Hilfiger Corp (TOM)	2.75	
Toll Brothers Inc (TOL)	2.73	
Clayton Homes Inc (CMH)	2.63	
Dress Barn Inc (DBRN)	2.60	
Precision Castparts (PCP)	2.55	
Sun Microsystems Inc (SUNW)	2.45	
Mesa Airlines Inc (MESA)	2.28	
CompUSA Inc (CPU)	2.20	
The Limited Inc (LTD)	2.19	
Integrated Health Services (IHS)	2.18	
Barrett Business Services (BBSI)	2.07	
Dillard's (DDS)	2.04	
Symantec Corp (SYMC)	1.88	
Costco Companies (COST)	1.87	
SBS Technologies Inc (SBSE)	1.80	
Pier 1 Imports Inc (PIR)	1.70	
Carnival Corp (CCL)	1.61	
Owosso Corp (OWOS)	1.53	
Costilla Energy (COSE)	1.44	
Praxair Inc (PX)	1.43	
O'Sullivan Industries (OSU)	1.42	
M/I Schottenstein Homes (MHO)	1.07	
Alaska Air Group (ALK)	1.03	
Diamond Offshore Drilling (DO)	1.02	
International Specialty Products (ISP)	1.00	
Nextel Communications Inc (NXTL)	0.89	
Paul Harris Stores (PAUH)	0.78	
Axent Technologies (AXNT)	0.75	
Fred Meyer Inc (FMY)	0.52	
Cisco Systems (CSCO)	0.28	
Ford Motor (F)	0.27	
Cox Communications (COX)	0.24	
Texas Instruments Inc (TXN)	0.22	
Nucor Corp (NUE)	0.21	
Adobe Systems (ADBE)	0.21	
FDX Corp (FDX)	0.21	
Aluminum Company of America (AA)	0.20	
Analog Devices (ADI)	0.20	
National Data Corp (NDC)	0.20	
Chesapeake Energy Corp (CHK)	0.20	
US Filter Corp (USF)	0.18	
LSI Logic (LSI)	0.18	
APS Holding (APSIQ)	<u>0.12</u>	
<b>Total Equities</b>	<b>89.40</b>	
<b>Cash and Short Term Notes</b>	<b>10.60</b>	
<b>TOTAL ASSETS</b>	<b><u>100.00%</u></b>	