

October 1987

To Our GAMCO Clients:

We have shared with you our comments about the market at our May Annual Meetings as well as in our year-end letters. As we write to you, the markets are being hit by sharp declines. We have most, but not all, of the issues in focus. Nonetheless, we thought we should touch base with you now.

8.1 On The Richter Scale

The market has been hit by the equivalent of a major earthquake. We anticipated a decline but not with the quickness, volume, or devastation of this downturn. We now await the aftershock. The stock market is currently undergoing what we believe is a classic "down leg" in a previous bull market. As equity investors, we have witnessed sharp declines in 1961-1962; following the assassination of President Kennedy in November 1963; during the break in 1969-1970; the 1973-1974 debacle; and most recently after Volker's so called "Saturday Night Massacre" in October 1979. This one is the most severe. There is no single event we are able to point to which triggered this broadbased decline. Rather, and simply stated, the U.S. equity market is responding to both its own overvaluation and to the earlier erosion in the bond market. For example, stocks were up 35% through mid-August, while bonds were down 20%. We might also add a dose of rising frustration with the Administration's perceived inability to govern.

From a technical viewpoint, we have maintained that the U.S. equity market will exhibit increased volatility and instability, partly because stocks are likely to return to historical trading patterns and partly because the new, financial instruments and widespread use of computerized trading techniques exacerbate trends and are not yet fully understood.

Having said the above, we must again reaffirm to you the basics to our fundamental approach: we are stock pickers, not market forecasters... yet, we do not function in a vacuum. We are conscious of broad market trends to the extent that they impact our stocks.

The Solution

Our approach has been and continues to be to identify and invest in stocks of domestic, cash generating franchise businesses selling at a discount to their private market value, which is defined as the price an informed industrialist would be likely to pay to acquire the company's assets. We continue to be alert for the "catalyst", our own special ingredient, in our quest for a rate of return.

We have to fight the deficit both domestic and foreign; we have to increase investment to stimulate productivity and enhance both the quality of our product and the services offered. This recent financial trauma will galvanize political factions and, hopefully, depoliticize solutions. The solution is not a weaker dollar, but a free flow of capital to new ideas and more efficient output! We need international cooperation.

With the collapse in so called "deal" stocks, and with tax and other legislative efforts to permit entrenchment of management, both good and bad, in the limelight, how will the spread between the public and private market value narrow? While we see forces are at work to thwart abuses inherent in the free market auction process, such as street sweeps and greenmail, we believe that our system will continue to function. That is, sellers will be able to sell their businesses, and buyers will be able to diversify and be opportunistic. Rhetoric about the non-deductibility of interest and other tax changes, will continue to unfold but will not preclude restructuring from taking place.

Back to Basics

We started out in business in January 1977 just before the Dow tumbled twenty-five percent, so making investment decisions against an uninspiring backdrop has been part of our day to day modern social structure and we must anticipate these elements as permanent characteristics of the capital markets. In previous decades, investors demanded and received premium returns for investing in stocks versus investing in bonds for various reasons, one of which was greater volatility. This element is returning.

GAMCO Investors, Inc.

What are we doing today

Right now, we continue to seek out companies with value, while allowing the market to stabilize. For example, Warner Communications has dropped 40%. Yet, WCI has no debt on a "net basis", is a cash generator, and is in businesses that should do relatively well, whatever the economic scenario.

From today through the balance of this year there will be more "pot holes" in the market, driven by a broad range of uncertainties and the aftershock, but we look on these as buying opportunities. Values of the underlying businesses did not rise as dramatically as the market earlier in the year, which is why we were not 100% invested in stocks, as is our stated policy. Conversely, values are not going down. We are again in better balance. Our investments in Adams Russell, Bundy and Rogers Cable are unfolding in a fashion similar to that of Stewart Warner and Taft. We believe holdings in Piedmont and Storer will work out providing both profits and liquidity.

Patience is difficult. We will continue to monitor your portfolios closely, and be ready when opportunities arise. You hired us to manage your money and make tough decisions. Please do not challenge us. Let us manage. Our returns were not achieved by "following the crowd"- buying stocks when capital is in the air. We need your support in order to enhance our mutual objectives.

As usual we welcome your comments and questions at all times.

Sincerely,

GAMCO Investors, Inc.