***FRONT BARNETT ASSOCIATES LLC***
***INVESTMENT COUNSEL***

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# Financial Market Update -- Favorable Outlook Continues

Recently released business statistics and anecdotal evidence suggest the slowdown in economic growth we have been expecting is underway. Among the visible signs of the economy's reversion to a more sustainable rate of expansion are weaker department store, auto and new home sales and the Federal Reserve's "Beige Book" which reported a slowdown in its most recent survey. These signs of deceleration come on top of a decline in the National Association Purchasing Manager's Index and a drop in hours worked in July. They are also consistent with David Bostian's Macroeconomic Index, a highly reliable leading indicator, which has for months been signaling caution. On another positive note, the second quarter inflation rate was less than 2%, according to the Commerce Department's estimate for the GDP deflator. We now expect third quarter real GDP growth to fall to 2.5% from the 4.2% pace reported for the second quarter and for inflation to remain muted. For the time being, these signs of moderating growth with little inflation have given investors cause for optimism that the Federal Reserve would not increase short-term interest rates in August and probably not until after the November election. We share this view. Between now and then, however, we anticipate there will be conflicting signs of both strength and weakness in the economy which will undoubtedly add to the heightened and, incidentally, more normal level of financial market volatility we have experienced since mid-year.

The above noted July and early August data was viewed as extremely good news by both the bond and stock markets. The bond market has rallied with interest rates on 30 year U.S. Treasury Bonds falling about 30 basis points (from 7.10% to 6.80%) in the past two weeks. The broad stock market indices have also moved up sharply, recovering most of the ground they gave up during the July "correction" of almost 10% (when measured from the S&P's intra-day high to its intra-day low). Many smaller cap stocks, which had shown spectacular gains through mid-year, have experienced huge declines over the past 45 days and remain mired at or below their lows for the year. **We are pleased that client accounts under our supervision have generally regained the ground they lost last month and now stand near their highs for 1996**.

While over the near term we would not be surprised to see both the bond and stock markets retrace a portion of their recent rebounds, we believe longer term economic fundamentals remain sound and we continue to recommend fully invested positions in client accounts.

Within clients' equity portfolios, where a blend of *growth* and *value* shares defines our investment approach, we continue to lean toward *growth* companies whose earnings are likely to remain in an uptrend despite the slower economic growth we see extending through year end. High quality technology companies, to which we added during earlier periods of market

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weakness, remain core holdings in this group. On the *value* side, selected financial stocks and economically sensitive issues represent areas of current buying interest.  Later in the year, as Iraq oil begins to flow, energy shares may weaken in response to the reality of an increased supply of crude.  This weakness could present a buying opportunity in oil company shares which are now underweighted in client portfolios and which would be included among our *value* stocks because of modest their valuations.

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