FRONT BARNETT ASSOCIATES LLC
INVESTMENT COUNSEL

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Current Investment Strategy-- Stay the Course

Our long-held expectation that economic activity would moderate, but not stall, as 1996 progressed has thus far been fulfilled. Recently released economic data confirm that GDP growth has slowed from 4.7% in the second quarter to just 2.2% in the quarter ended September 30th. Indeed, our consulting economist David Bostian's Econometric Index has been signaling this slowdown since early this year. Further moderation in domestic economic activity is likely in the current quarter and into 1997 as consumer spending, government outlays, and trade remain restrained. We now forecast fourth quarter GDP growth in the 1.75% to 2.0% range. The "centrist" majority vote which drove the outcome of the recent Presidential and Congressional elections, we believe, assures that further efforts to achieve a balanced budget will be undertaken in the new Congress, keeping a lid on government spending. Profit margins of U.S. businesses, which inevitably ebb and flow along with the business cycle, are probably at or near cyclical peaks. Accommodative central banks around the world, however, appear to be willing to provide liquidity sufficient to fuel further growth and extend the cycle. Therefore, based upon our forecast for continued moderate sustainable growth, low inflation and stable to lower interest rates, we believe **common stocks will remain a favored class of assets**.

Equities

Our firm continues to invest in a combination of *growth* and *value* stocks, the investment philosophy that defines our approach, and in companies that possess the management, market position, and muscle to thrive in a slow growth world. We believe our blend of *growth* and *value* should provide the diversification necessary to offset the inevitable shifts in market sentiment over the near term as the economy shifts gears to a slower pace. However, given our expectation the economy will slow, we expect to generally maintain the current tilt towards *growth* through year-end.

Our emphasis on *growth* stocks has contributed to better than market performance this year as *growth* shares have, in general, outperformed *value* shares. Despite their downturn in late June and July, large capitalization technology stocks have been among the strongest performers in the market. By design, the greatest emphasis in the *growth* portion of portfolios under our supervision has been in the area of Information/Communication with Intel, L.M. Ericsson, Cisco Systems, and Microsoft occupying core positions and providing strong returns. Large capitalization, multi-national companies with leading market positions comprise another large portion of client's *growth* stock holdings and have also done well. Examples include Disney, American International Group, General Electric, and Gillette.

Financial stocks comprise the largest single category in the *value* portion of client portfolios. Low price-earnings ratios, good dividends and above average prospects have justified above-

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average returns in Federal National Mortgage, Mellon Bank, Chase Manhattan, and Citicorp. These issues should continue to perform well in the low inflation, stable to moderately lower interest rate environment we forecast.

Fixed Income

As for bonds, municipals have outperformed comparable maturity U.S. Treasuries for the year through September 30th, with shorter maturities faring somewhat better than longer dated bonds as interest rates have risen. Overall, demand for municipals has remained slack as investors have continued to redeem shares of municipal bond mutual funds. Market volatility has been high. Whenever long tax-free yields have reached the 6.0% level, buying by individual investors has resumed, indicating that, as history has shown, the individual investor is quite rate sensitive. We anticipate the new Congress will address tax reform next year, and while we do not expect a flat tax, a flatter tax is likely. Thus although the municipal bond market's worst fears over the consequences of a flat tax have dissipated, we continue to be cautious regarding municipals for taxable clients.

Durations in tax-free accounts were extended last winter when long-term U.S. Treasury rates spiked above 7%. Rates have since fallen to 6.65%. While we are currently neutral toward the taxable bond market, we would resume purchases if rates moved back up toward 7%-- the presumed upper end of a new 6.25% to 7% trading range for long dated U.S. Treasury bonds.

Finally, clients have asked about the possibility of a stock market correction of 15-20%. Clearly, one could occur at any time. Our focus, however, remains on finding and adding to client portfolios shares of companies we expect to perform well in the period of slow growth ahead. Should the stock market's advance turn more speculative and a parabolic advance occur, it may become prudent to reduce modestly our fully invested stock positions. For the moment we advise staying the course, but... stay tuned!

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