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INVESTMENT COUNSEL

November 11, 2003

ECONOMIC UPDATE – MOMENTUM IS BUILDING

Data released during the past month showing rapid economic growth, the best job creation in nearly three years and strong profit performance by US businesses lend credence to our long held view that momentum is building for a *sustainable* economic expansion.

- The US economy awoke from its earlier lethargy to its best quarterly growth rate in nearly twenty years as the Commerce Department reported third quarter real GDP advanced 7.2%. Moreover, the gain reflected the broadest-based improvement in the economy in three years. While, as expected, spending by consumers, exports and residential construction all registered sharp gains, investment by businesses grew at a surprising 11% annual rate, the most rapid pace since early 2000. For months, economists have argued that a durable expansion would not take hold until business executives have the confidence to invest in capital equipment and add to payrolls. That now appears to be taking place. The Business Roundtable, an association of executives from large companies, reported in October that 23% of its members expected to increase capital spending in the months ahead, while only 12% foresaw spending cuts. Three months earlier, the percentage of those planning additional investments was about equal to the percentage that planned to cut.

- Despite continued talk by presidential aspirants of a "jobless recovery", the Department of Labor reported last week that

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employment grew by 126,000 jobs in October, the best showing in nine months, and that job growth in August and September totaling 160,000 was significantly stronger than the government initially estimated, producing the greatest job expansion over a three month period since late 2000. The service sector, accounting for well over half of the economy, added to its payrolls while manufacturing jobs continued their two decade decline, albeit at a reduced pace. Interestingly, the number of people working only part-time because they could not find full-time work fell by 139,000 as more full-time jobs became available.

- The willingness of business executives to invest and add to their payrolls is being driven by a resurgence in corporate profit growth. Profits grew by 14% in the second quarter, compared with a year earlier, and we estimate third quarter profits of the S&P 500 companies rose by 20%. While cost reduction efforts continued to enhance profits, renewed revenue growth and a weaker dollar also contributed meaningfully to profit performance. The sectors experiencing the greatest gains in third quarter profitability included energy, financials, technology, healthcare and materials.

Looking ahead, we continue to forecast vigorous economic activity in the current quarter with this momentum carrying over into 2004. Real GDP should reach 4.5% this quarter and continue at a 4%+ pace in the first half of next year. S&P 500 profit growth in the current quarter will be similar to the 20% growth reported in the third quarter and then begin to moderate next year as second half comparisons become more difficult. Unemployment, currently 6%, will decline only slowly to 5.5% next fall, restrained by the high level of excess manufacturing capacity, business emphasis on productivity enhancement and the continued migration of jobs overseas. All in all, the economy will likely provide a very favorable climate for equity investment. On the other hand, we see an increasingly challenging environment for fixed income securities where large deficits, a weaker dollar and the likelihood of a reversal of the Fed’s easy money policy will not play well.

Financial Market Outlook

Commodity and economically sensitive shipping prices continue to rise providing further evidence a global economic recovery has begun. Global interest rates have troughed and have started to rise from their historically low levels. In fact, central banks in Australia, New Zealand and the UK have in recent days raised their benchmark interest rates for the first time in years. In the US, the Federal Reserve is likely this December to prepare the financial markets for a reversal of its very accommodative policy. Open market rates have already begun to discount this possibility. The Fed will, in our opinion, begin to raise short-term rates before mid 2004 as it gains greater conviction the current economic expansion is sustainable and shifts its focus from preventing deflation to averting future inflation. We believe rates on 10 year US Treasury Notes, now at 4.45%, will drift higher toward 5.0% over the next several months.

Against this backdrop, with the US stock market having recovered 32% from its March 2003 lows, as measured by the S&P 500, future equity performance will importantly depend upon earnings growth which should be quite positive. Historically low interest rates, the favorable tax treatment of dividends and capital gains, and $5.2 trillion of low yielding fixed income securities maturing in a year or less should provide for a continuation of the shift toward equities from fixed income instruments we have seen since late last winter. While geopolitical concerns remain, as they always will, the prospects for equities are quite favorable and should prove rewarding when compared with the alternatives.

Equity Portfolio Strategy and Performance

Through the end of October, equity portfolios under our supervision have, on average, risen 24.6% (after fees) as compared with 21.2% for our benchmark, the S&P 500 stock index. As the following table illustrates, our large commitments to technology, consumer discretionary and financials have driven this year's out-performance. Portfolios continue to be under weighted in utilities, energy, and consumer staples which have been laggards.

Sector	Portfolio Weighting	S&P 500 Weighting	S&P 500 Sector Performance 12/31/02 – 10/31/03
Information Technology	27.4%	18.0%	+40.8%
Consumer Discretionary	18.0	11.4	+30.6
Financials	18.4	21.0	+24.7
Materials	1.4	2.8	+22.1
Industrials	12.7	10.6	+21.2
S&P 500	0 .0	0.0	+21.2
Utilities	0.0	2.8	+17.5
Energy	0.0	5.4	+ 9.7
Consumer Staples	6.1	11.4	+ 8.1
Health Care	12.8	13.0	+ 6.8
Telecommunications	3.3	3.4	- 1.5

As we anticipated, sectors leveraged to an improving economy have provided market leadership and it has been in these groups that we have concentrated client's equity capital. These trends are likely to persist for the next few quarters despite the inevitable shorter-term periods of market consolidation we are sure to experience.

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As the Holidays approach, we send season's greetings and good wishes to our clients and friends whose valued confidence has supported our growth during almost a decade of service.