FRONT BARNETT ASSOCIATES LLC
I N V E S T M E N T   C O U N S E L

March 24, 2006

THE ECONOMIC OUTLOOK -- MID-CYCLE SLOWDOWN AHEAD

Recently released economic data confirms our view that despite the long awaited housing slowdown, broad based gains in employment and wages, continued strong business investment, outlays to rebuild the devastated gulf region, and export growth are driving consumer and capital spending, sustaining US economic momentum as we enter spring. Consider the following, gleaned from the important March 10th employment report issued by the Commerce Department:

- US employers added a greater than forecast 243,000 jobs in February following employment gains of 170,000 in January. The burst of job creation in February was the biggest since last November when employment rebounded sharply as Louisiana and Mississippi recovered following hurricanes Katrina and Rita. Monthly job growth this year has averaged 206,000, about 40,000 more than the average for 2005. While employment growth is solid, it provides no evidence of overtightness in the labor market at this point.

- Average hourly wages for workers, excluding those holding management positions, increased by $0.05 in February -- 3.5% above a year ago and the highest since September 2001 -- showing businesses are confident of their prospects and are willing to pay up to retain existing workers and attract new hires.

- While wages are rising, they are not exerting upward pressure on other prices. Core CPI inflation, which excludes the volatile food and energy components, has not crept up in tandem with wages, instead remaining stable since the end of 2004 at about 2% -- the upper end of the Fed's so-called 1% to 2% "comfort zone". Muted inflation, coupled with a rise in February of 140,000 in the pool of available labor and a slight decline in hours worked last month, should reassure Federal Reserve policy makers who may be concerned with a wage-price spiral.

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Following a soft fourth quarter for consumer spending, which accounts for over two thirds of GDP, economists and retailers began to fret about an economic slowdown. More recently, these fears have been allayed as consumer outlays have risen sharply since year-end. Estimates of first quarter retail sales growth of 4.5% or more, compared with 1.2% in the fourth quarter, are probably close to the mark. The recovery in consumer spending, following the post-hurricane lull and sluggish auto sales late last year, should ripple throughout the economy over the next several months. Interestingly, despite the surge in consumer outlays, the Commerce Department reported that its index for personal consumption expenditures (excluding food and energy), former Fed Chairman Alan Greenspan's favorite inflation gage, increased only 1.8% in January from a year ago -- also within the Fed's "comfort zone".

The Federal Reserve's March 16th Beige Book, prepared for Fed policy makers in advance of their interest rate setting meeting next week, indicated that capital spending this year continues to rise at about the 10% rate of last year. We believe businesses will deploy a growing portion of their vast $3.0 trillion cash hoard on productivity enhancing computing and telecommunications equipment in an effort to maintain their profitability as rising raw material prices, higher labor costs and savage global competition continue to pressure their profit margins.

Other key economic data confirm the favorable business climate:

- Adjusting for the unusual weather patterns of the past few months which have distorted trends, and the normal month-to-month volatility in sales of autos and gasoline, average retail sales for January and February were up 0.8% and rose 6.7% from February 2005. The two months together show a favorable trend in retail activity which, in our view, signals continued healthy growth in outlays as consumers express their optimism about the economy.

- The Institute of Supply Management's (ISM) February index showed *manufacturing* accelerated for the first time since last October, supporting our view business investment will underpin economic growth this year. This index rose to 56.7 last month from 54.8 in January. Readings above 50 indicate growth. The February reading compares well with an average of 55.5 for all of 2005. In addition, the ISM reported their prices paid index fell to its lowest level since July 2005, well below the six month average reflecting less inflationary pressure from raw material prices.

- The ISM's February *non-manufacturing* index also demonstrated strength, rising sharply to 60.1 from January's 56.8, showing this sector is continuing to grow at a healthy pace.

Indeed, our firm's proprietary Economic Model, a copy of which is attached, is pointing to continued growth this year.

HOUSING

The one prominent area of weakness remains housing, as higher borrowing costs and rising prices have made home purchasing less affordable for many buyers and caused speculators to pull back.

- Sales of existing single-family homes, town homes, condominiums and cooperatives declined in January for the fifth consecutive month to 6.56 million units -- the lowest since 6.44 million in February 2004 -- showing housing has shifted away from its earlier frenzied pace. Particularly hard hit were condominium and cooperative sales, which declined 10.6% to an annual rate of 791,000. Excluding condominium and cooperative units, January single-family existing home sales fared better, declining only 1.5% to an annual rate of 5.77 million from 5.86 in December.

- Also, in the face of less robust demand, the supply of both new and existing homes for sale is rising. The inventory of unsold homes stood at 2.914 million in January, representing a 5.3 month inventory at the current rate of sales -- the highest since 5.5 months in August 1998. By comparison, the backlog of existing homes for sale represented a 5.1 month supply in December 2005 and only 3.7 months in January 2005.

- Builders took advantage of the warmest January on record to start work on the largest number of new houses in 33 years -- 2.276 million units, up 15% from December and the most since March 1973. While we expect new home sales to decline 5% this year -- the first decline since 2001 -- housing starts will continue to rise as builders work off backlogs in new orders from last year through this year's first half. Builders may also have stepped up construction to try to close agreements before ambivalent buyers can back out.

- Mortgage applications, an indicator of future home purchases, have been declining for months. At mid-March the Mortgage Bankers Association index of loan applications stood 26% below its peak in June 2005.

While unseasonably warm weather and lower mortgage rates may fuel a rebound in February home sales, we believe the trend toward a slower housing market is well entrenched.

FORECAST

Looking ahead, given the economy's momentum, we expect continued above trend growth in the first half of this year, in part owing to post-hurricane reconstruction, but tempered by a slowing in housing and related businesses. Consumer spending and capital outlays by US businesses will remain positive contributors to economic growth. Growth in the US will also be supported by a likely acceleration of activity in Asia thanks to a reinvigorated Japan and the continuing boom in China. We also believe Europe will pick up as signs that Germany's long dormant consumers are stirring, a positive for US exports. Specifically, we see *real* GDP growth of 4.6% this quarter, slowing to 3.75% in the second quarter followed by a mid-cycle economic slowdown with growth moderating to 3.00% - 3.25% in the back half of the year. Corporate profits, as measured by reported S&P 500 company earnings, are forecast to grow 11% + this quarter and then ease to the high single digits for the balance of 2006 -- down from mid-teens growth in 2005 and sharply below the 21% growth of 2004. We see the dollar reversing course this year, declining moderately against the Yen and Euro as interest rates abroad rise, making US exports cheaper and thus benefiting US multinational manufacturing firms.

INTEREST RATES AND BOND STRATEGY

With manufacturing businesses operating at 81% of capacity and the current 4.8% unemployment rate at or near "full employment", absent some slowdown in economic activity, the strain on the economy's resources could build, intensifying near term inflationary pressures. Such pressures at this point in the economic cycle would be particularly unwelcome because inflation, though muted, is now toward the upper end of the Federal Reserve's "comfort zone". Many Fed governors remain wary, fearing that should the economy overheat and inflation accelerate, it will be harder to reverse the process than it was decades ago. We believe these factors, to a degree, weigh in favor of the Fed erring on the high side of higher rates even though there are other indicators that suggest the economy still has slack in it. Balancing these factors, we believe the Fed will raise its Fed Funds rate by 25 basis points at its meeting next week and again at its May 10th meeting, thus bringing the rate to 5% before pausing to assess the cumulative impact of its tightening moves since mid 2004. In any event, we are very close to the end of this Fed tightening cycle.

While the Fed has been busy raising short-term rates, long-term rates have in recent months remained relatively unchanged. The possible reasons for this anomaly have been the subject of intense debate in the financial press. Federal Reserve governors have endlessly opined on the matter and recently, in a speech before the New York Economic Club, Fed Chairman Bernanke spent an hour pondering the subject. Faith that the Fed has the capacity, willingness and mandate to do whatever was needed to control inflation and inflation expectations, combined with strong broad-based demand for dollar-dominated fixed income assets as a result of the US current account deficit, and a surplus of global savings are generally cited as reasons for the current flat yield curve. While these two major factors remain intact, a few new concerns have crept into the interest rate equation, helping to push rates somewhat higher in recent weeks. The first of these is that, just as the US is approaching the end of its tightening cycle, the central banks of Europe and Japan are beginning theirs. Some investors are concerned this pattern will reduce global liquidity or make overseas bonds more attractive versus US obligations as foreign rates climb. Secondly, there are some signs, as implied above, that US labor costs could be pressured higher, as the unemployment rate has edged lower and fourth quarter productivity came in weaker than expected. This has led to concerns about how much and how quickly the consumer will pull back and how much more the Fed will have to tighten to squelch inflation fears. Thus, the risks of higher near-term inflationary expectations, bringing the yield on 10-year US Treasury bonds, currently 4.70%, to 5.00 % +, have grown. We, therefore, will continue to defer the purchase of longer dated bonds, preferring instead shorter maturities with essentially similar yields, until returns on longer dated bonds adequately compensate investors for their higher risk.

EQUITY INVESTMENT STRATEGY

As noted above, central bankers in several countries are boosting short-term interest rates, reducing the amount of monetary stimulus, principally because their economies no longer require as much added accommodation, not because of the intensification of inflation fears. We believe that despite these rate hikes, economic expansion will continue and that the pace of GDP growth is likely to accelerate in Europe and Japan while slowing here for a few quarters. We expect stock prices to rise in most major equity markets, including the US, as investors conclude that neither higher interest rates nor the flat yield curve will lead to recession or fully offset the gains projected in earnings. Stock prices in the US remain reasonably priced at 16 times forecast 2006 earnings and are expected to rise in line with corporate profit growth once investors become convinced the Fed has largely completed its round of tightening.

Equity portfolios under our supervision are generally fully invested and are tilted toward *growth* -- 54% *growth* and 46% *value* -- favoring companies whose earnings' growth is likely to persist despite the mid-cycle slowdown we forecast for the US. Within our portfolios, significant sector concentrations in large cap stocks -- out of favor for several years -- reflect our preference for growing businesses in both categories with roughly 57% invested in the top three sectors as follows:

	- - - Portfolio Weightings - - -			**S&P**
Sector	**Growth**	**Value**	**Total**	**Weighting**
Financials	--	21.9%	21.9%	20.3%
Technology	18.1	--	18.1	14.5
Healthcare	14.2	3.3	17.5	12.3
Industrial Capital Goods	3.5	6.1	9.6	8.6
Discretionary Consumer Goods	6.6	2.7	9.3	7.2
Energy	--	7.1	7.1	9.5
Services & Media	2.1	4.4	6.5	6.9
Consumer Staples	5.8	--	5.8	8.2
Telecom Services	3.2	--	3.2	2.4

One of the benefits of investing in the equities we have held has been their growing dividends which have expanded at a rapid 19%+ annual rate as compared with 7.8% for the S&P 500 stocks over the past five years. Their earnings are projected to grow at about 12% per year over the next five years as compared with 7% for the S&P 500. On average, they are favorably priced, with current price earnings multiples to future growth rates of less than 1.4 times as compared with 2.0 times for the S&P 500.

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We are, indeed, pleased to welcome Jennifer Doyle to our firm's portfolio management team. Jennifer, who has seven years of prior investment experience, will receive her MBA from the Kellogg School of Management at Northwestern University in June.

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Front Barnett Associates LLC
Economic Model

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