FRONT BARNETT ASSOCIATES LLC
INVESTMENT COUNSEL

May 5, 2006

To: Clients and Friends of the Firm

Subject: Presentation at the 54th Annual University of Chicago Graduate School of Business Management Conference

Marshall Front will speak at the University of Chicago GSB Conference on Friday, May 19th. Attached is an outline of his prepared comments which we believe you will find interesting.

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University of Chicago GSB

54th Annual Management Conference

Mid-Year Economic Outlook

May 19, 2006

Marshall B. Front
Chairman

Talking Points: Spring 2006 Economic Update

The Economy -- Strong Now but…Mid-cycle Slowdown Ahead

1. **Overall, first quarter GDP rebounded sharply; the economy remains strong, entering the current quarter with good momentum.**

   - **Real GDP grew 4.8%, the fastest pace in more than 2 years, as a recovery in consumption pushed growth higher, following an anemic 1.7% advance in the prior quarter.**

   - **Durable goods spending jumped 20.6%, the largest since +37.4% in the fourth quarter of 2001 when consumer spending rebounded following the 9/11 retreat.**

   - **Business fixed investment rose at a 14.3% annual rate, after rising at a 4.5% rate in the prior period.**

   - **Core consumer goods prices (PCE) were up 2.0% after a rise of 2.4% in the fourth quarter -- an indication higher energy and raw material prices were not lifting the general level of inflation. Core PCE prices, though, remain at the top of the 1% to 2% range the Fed considers acceptable.**

2. **Beyond the strong first quarter data, the following are worth noting:**

   - **Personal consumption, which accounts for about 70% of GDP, rose 5.5% at an annual rate in March. After adjusting for inflation, personal spending was on a trajectory to rise at a 3% annualized rate in the second quarter, consistent with expectations that the economy's growth will slow in the current quarter as higher gas prices, a cooling housing market and higher interest rates bite.**

The Economy -- Strong Now but…Mid-cycle Slowdown Ahead (continued)

- **The first significant piece of economic data for April, the Institute of Supply Management's (ISM) March index showed *manufacturing* entering the second quarter with good momentum, its index rising to 57.3 from 55.2 in March. Readings above 50 indicate growth. The March index compares well with an average of 55.5 for all of 2005. A reading in the mid-50's is strong for an economy in its fifth year of expansion. The prices paid component increased to 71.5 from 66.5 in March, the highest level since last October.**

- **While ISM's March *non-manufacturing* index demonstrated strength, rising sharply to 63 from February's 60.4 pace, showing this sector is continuing to grow at a very healthy rate, the prices paid component, driven by higher oil prices, rose to a six month high of 70.5 compared with 60.5 the prior month.**

- **March factory orders rose to 4.2%, the most in 10 months, with unfilled orders rising 21% year-over-year.**

- **US employers added 138,000 jobs in April, fewer than expected, following a string of above consensus increases. Last month's non-farm payroll gains were consistent with a stable unemployment rate.**

- **Despite high gas prices, consumer confidence remains near a four year high driven by a strong job market that is lifting incomes.**

- **Market-based indicators point to continued firm economic conditions.**

3. **Housing has weakened as higher borrowing costs and rising home prices have made purchasing less affordable for many buyers and discouraging speculators -- pleasing Fed governors who have sought to cool this sector.**

The Economy -- Strong Now but…Mid-cycle Slowdown Ahead (continued)

- **Earlier data highlighted housing's shaky supply/demand balance pointing to a slowing in broad housing activity. The lengthening in selling times, sharply rising inventories of unsold homes, declining foot traffic, reduction in bidding wars, and rise in seller incentives all underscore the supply/demand mismatch.**

- **Now, hard data, along with a variety of anecdotal reports, suggest housing will be a modest drag over the balance of this year and into 2007, causing aggregate demand to moderate to a more sustainable pace.**

- **Higher prices, interest rates, and real estate taxes have adversely impacted affordability. The Affordability Index has fallen to its lowest level since the early 1990's, a period of spotty housing activity. The number of homes for sale is at a record high both absolutely and as a share of the aggregate housing stock.**

- **We believe the pace of the downshift in demand will not be disruptive, barring a far greater than expected hike in borrowing costs or some other event that creates widespread financial stress.**

Forecast

4. **Recent developments confirm our view that the outsized 4.8% gain in first quarter real GDP is likely to give way to growth of 3% to 3 ½% for the balance of this year. We believe the slowdown will become more apparent by mid-year and would be consistent with lessening inflation risks and an end to the Fed's two year long tightening campaign.**

    - **Strong company earnings reports, declining unemployment, and double digit increases in business spending offer evidence the economy's first quarter performance was exceptional following the weak storm depressed fourth quarter of 2005.**

The Economy -- Strong Now but…Mid-cycle Slowdown Ahead (continued)

- **Early year momentum will give way to a more moderate pace of growth slowed by higher energy prices and interest rates, as well as stalling housing.**

- **The dollar will continue to drift lower as relative monetary policy, higher levels of global interest rates, our large current account deficit, and slowing domestic growth take their toll.**

- **The good news is -- weaker housing and more moderate consumer spending gains will be in part offset by business spending momentum, stronger exports stimulated by the weaker dollar, and strong government spending.**

- **Corporate profit growth, while slowing from the torrid pace of the past few years, will remain above trend, rising 8-10% for the year. Earnings of major multinationals will benefit from the weaker dollar.**

- **Despite higher energy and commodity prices, inflation will remain well contained given the continuation of impressive productivity gains and intense global competition.**

- **Our Firm's proprietary Economic Model (see page 8) signals a continuation of the business expansion.**

Interest Rates -- Drifting Higher

- **Interest rates are rising globally.**

- **Fed officials have signaled a pause in the current interest rate cycle highlighting the importance of moderating final demand in closing off a primary source of inflation risk.**

Interest Rates -- Drifting Higher (continued)

1. **FOMC minutes and speeches are presenting the view that the end of U.S. rate hikes may be close at hand if forward-looking data signal near trend-like growth and subdued inflation expectations.**

2. **Fed concerns remain: (1) strong demand; (2) the tight labor market; (3) limited spare manufacturing capacity with utilization above 81%; and, (4) a big boost from shelter costs.**

- **We continue to expect the Fed to raise the Fed Funds rate 25 basis points to 5.0% at its May 10th meeting followed by a pause to assess the impact of its prior 16 rate increases.**

- **Clearly, stronger than expected incoming data later this spring will increase the likelihood of yet another rate increase at the June FOMC meeting before the Fed pauses.**

- **Longer-term bond yields have decoupled from domestic economic fundamentals, somewhat normalizing the term structure, assisting the Fed. We believe generally favorable inflation developments limit the upside to yields.**

- **For the first time in four years we began late last month to modestly extend bond maturities as 5 year U.S. Treasury rates approached 5% and 10-year yields (see page 9) broke through 5%. Given the narrow yield spreads, we favor concentrating current purchases in U.S. Treasury obligations with medium term maturities. We expect to extend maturities further as rates drift higher.**

Stock Market Outlook -- We remain Optimistic

- **We remain optimistic regarding the outlook for common stocks for 2006.**

    - **We are nearing the end of Fed rate increases.**

Stock Market Outlook -- We remain Optimistic (continued)

- **Double-digit returns -- in line with corporate profit growth are expected.**

- **Investor sentiment remains subdued, valuations are reasonable and in some sectors, compelling; earnings trends remain a firm underpinning to share prices.**

- **Given high capacity utilization rates, capital spending should remain robust.**

- ***Growth* is finally likely to outperform *value*.**

- **Large caps will outperform small caps.**

- **Rising interest rates should impact rampant commodities speculation.**

- **Out of favor groups like financials, media, and pharmaceuticals should recover.**

• **Corporate balance sheets have shown impressive improvement; since 1990, the debt to capital (ex financials) ratio has declined from about 45% to 25%. Corporations are flush with cash.**

• **Stock prices have not adequately reflected the surge in productivity and profitability of recent years. Since the third quarter of 2001, after tax S&P operating profits have increased nearly 60%, and yet the S&P 500 stock index has risen only 24%. This is surprising since during the period interest rates have fallen. Only recently have stock prices taken a modest upward turn as investors have begun to sense an end to the Fed's rate increases is near (see page 10).**

Stock Market Outlook -- We remain Optimistic (continued)

- **Stocks remain reasonably priced at less than 16 times expected 2006 S&P 500 operating profits of about $83 per share – a gain of 9.2% in profits over 2005.**

- **The Fed Valuation Model (see page 11) shows stocks to be about 20% undervalued relative to bonds.**

- **Large Cap, high quality *growth* shares, out of favor for 5+ years, (see pages 12 and 13) should benefit as investors recognize the sustainability of their earnings growth, the benefits of the diversification of their businesses, their global reach, and their ability to prosper in the slowing economy we foresee. Equity portfolios under our supervision remain tilted toward large cap *growth* shares.**

- **As corporate profit growth slows and bond yields rise, stock market valuations will take on added significance. Consider the following comparative price earning ratios:**

Index	Current P/E	Historical P/E*
Mega Cap (Russell 200)	16.9x	19.1x
Large Cap (Russell 1000)	17.8x	19.1x
Mid Cap (Russell Mid Cap)	20.3x	19.0x
Small Cap (Russell Small Cap)	27.7x	22.6x

***Based on data since 12/78**

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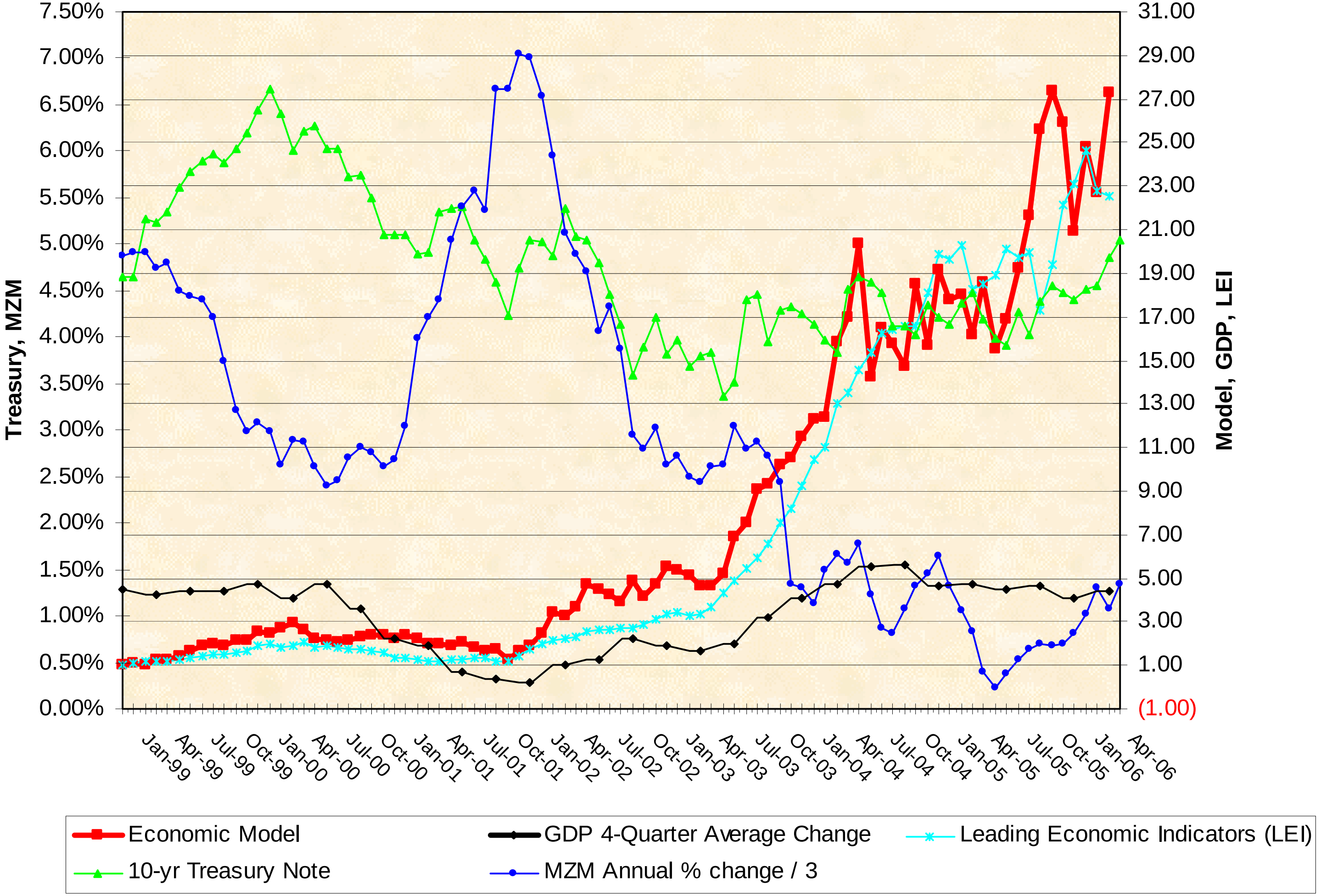
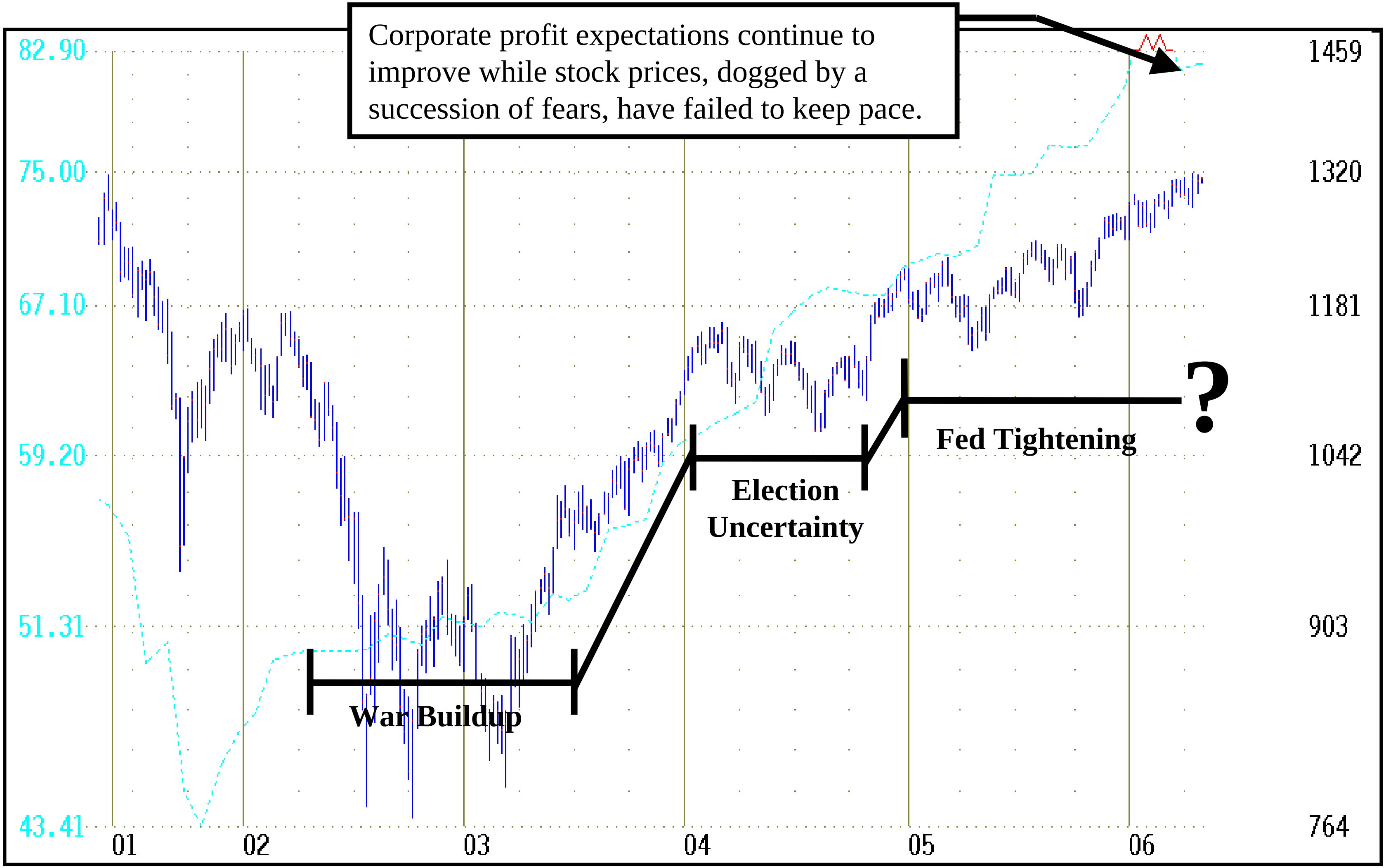
MBF
5/05/06

Front Barnett Associates Economic Model



Ten Year Treasury Bond Yield

S&P 500 vs. Consensus Earnings Estimate for the S&P 500



Fed Valuation Model

The Fed stock market valuation model, which incorporates the yield on 10 year US Treasury Notes and estimated S&P 500 profits, shows stocks remain undervalued.

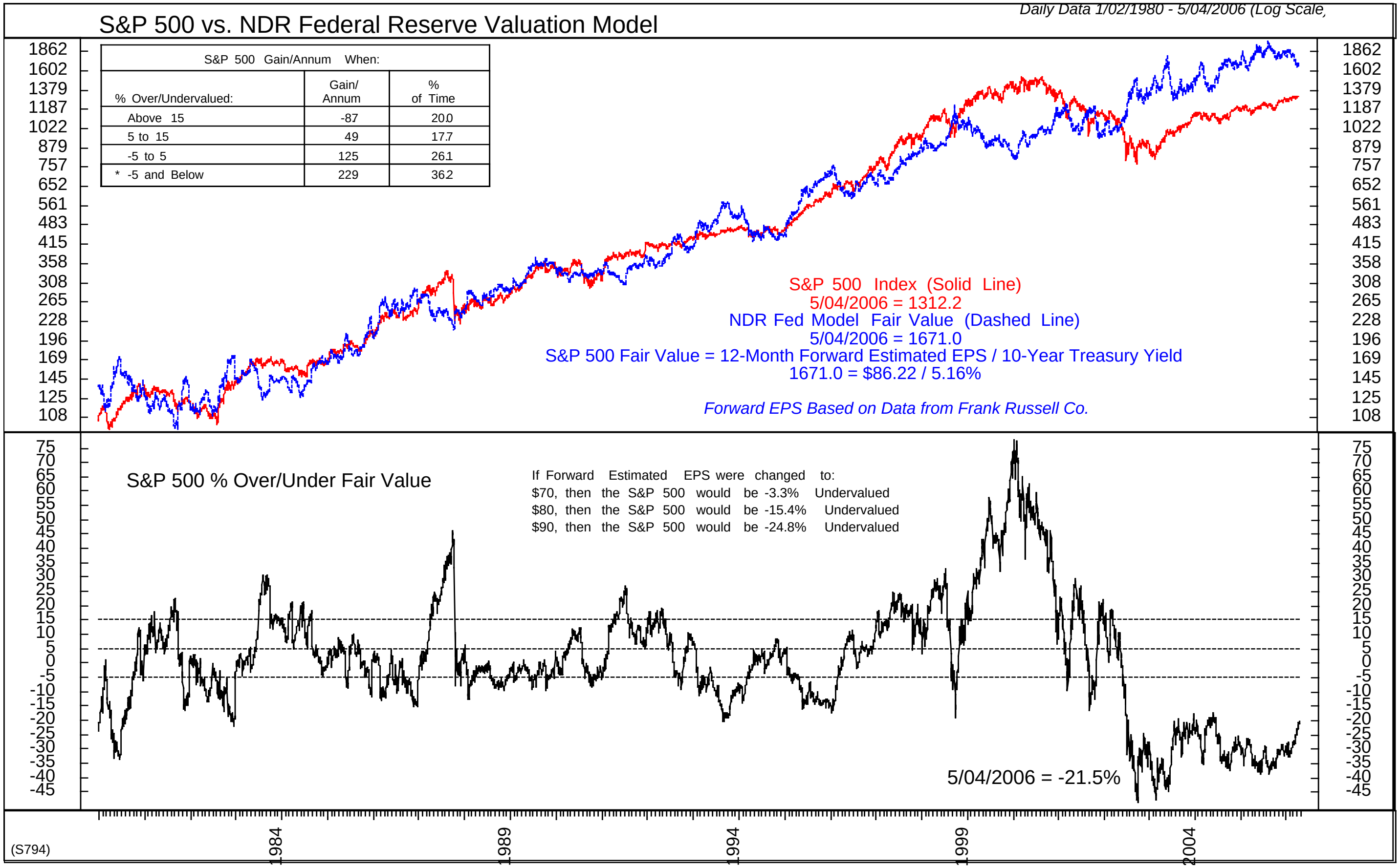
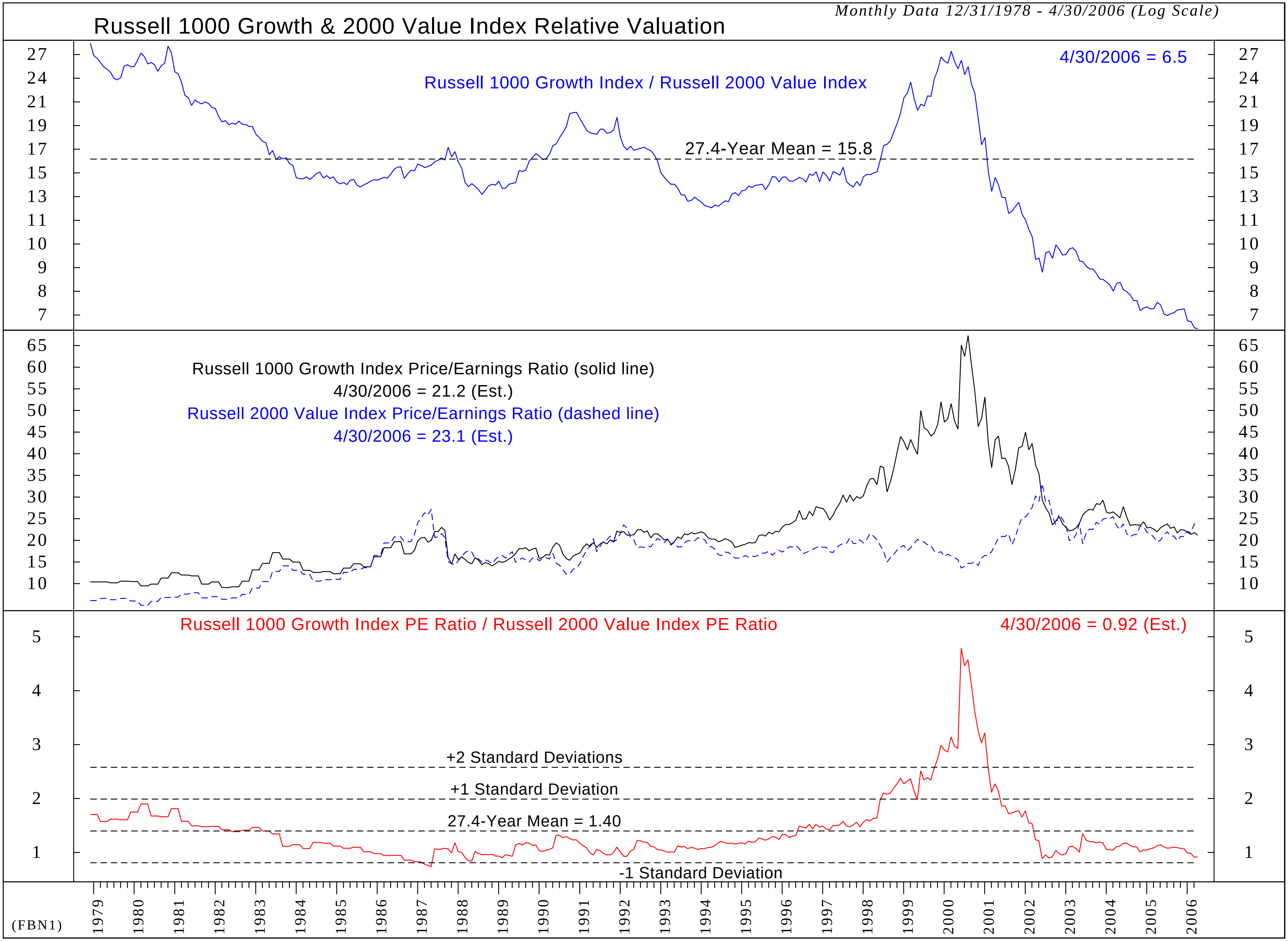


Chart Courtesy of Ned Davis Research


Monthly Data 12/31/1978 - 4/30/2006 (Log Scale)
Russell 1000 Growth & 2000 Value Index Relative Valuation
4/30/2006 = 6.5
Russell 1000 Growth Index / Russell 2000 Value Index
27.4-Year Mean = 15.8
Russell 1000 Growth Index Price/Earnings Ratio (solid line)
4/30/2006 = 21.2 (Est.)
Russell 2000 Value Index Price/Earnings Ratio (dashed line)
4/30/2006 = 23.1 (Est.)
Russell 1000 Growth Index PE Ratio / Russell 2000 Value Index PE Ratio
4/30/2006 = 0.92 (Est.)
+2 Standard Deviations
+1 Standard Deviation
27.4-Year Mean = 1.40
-1 Standard Deviation
(FBN1)

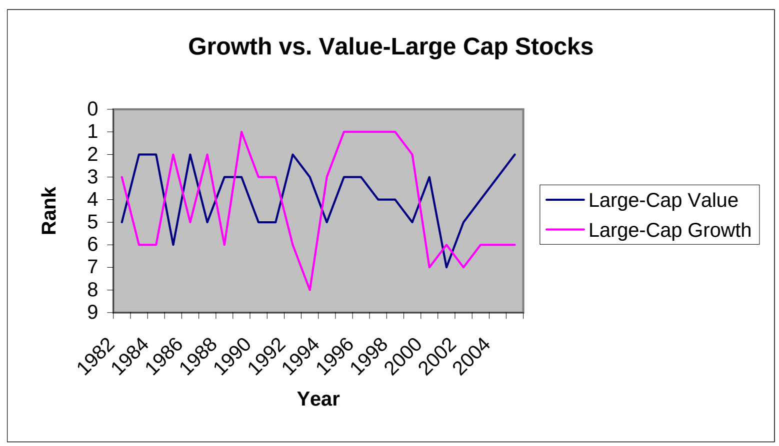
Investment Style Migration is Inevitable

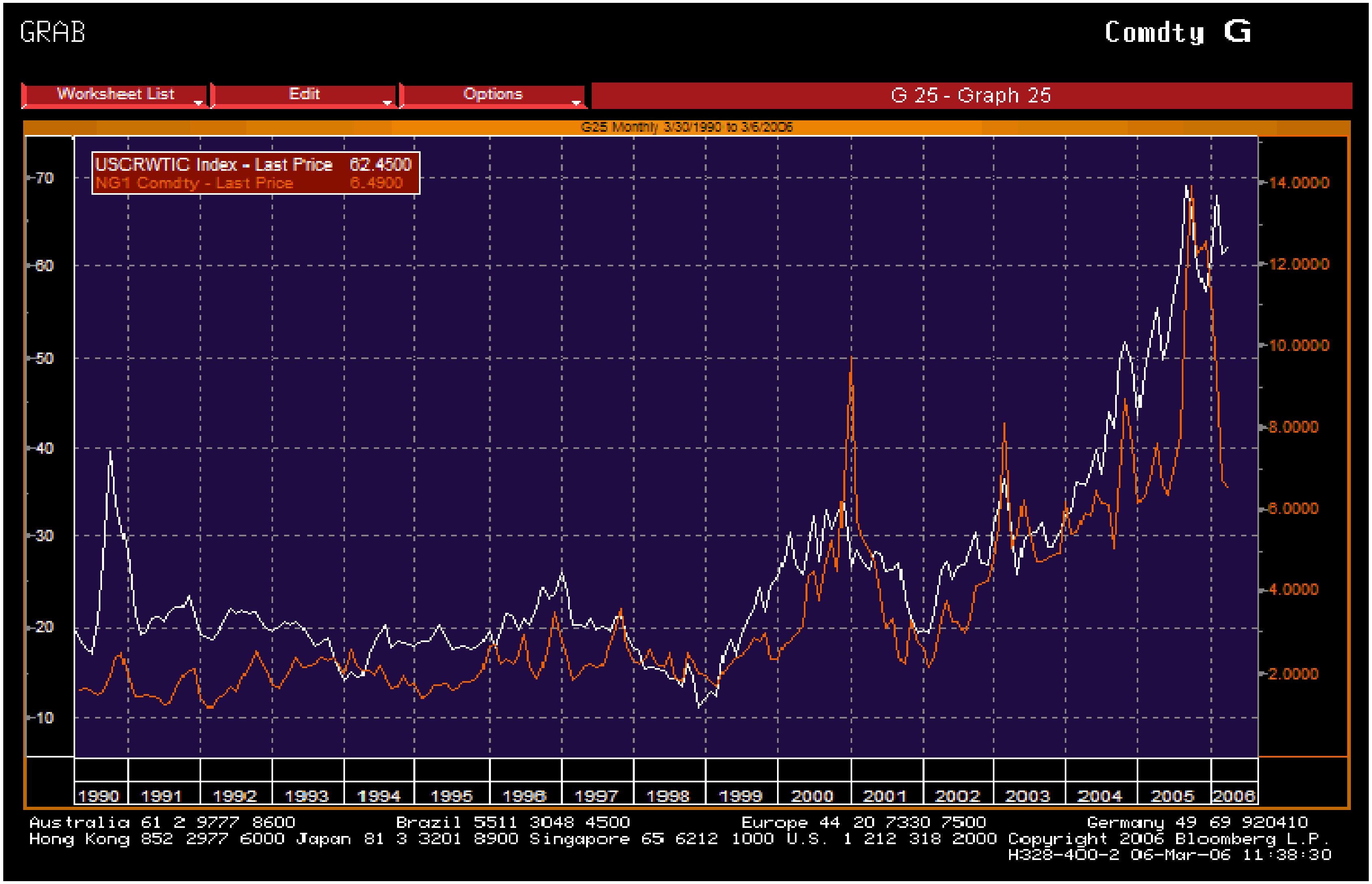
Historical Returns Achieved by Various Asset Classes
Annual Returns Ranked in Order of Performance

1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Int'l 56.16%	Int'l 69.44%	Int'l 24.64%	Small Cap Value 29.47%	Large Cap Growth 36.40%	Fixed Income 8.96%	Small Cap Growth 51.19%	Small Cap Value 29.14%	Int'l 32.56%	Int'l 7.77%	Large Cap Growth 38.12%
Large Cap Growth 33.31%	Large Cap Value 21.67%	Large Cap Growth 6.50%	Int'l 28.27%	Large Cap Core 31.68%	Cash 7.77%	Small Cap Value 41.70%	Large Cap Value 10.59%	Small Cap Value 23.84%	Cash 3.85%	Large Cap Core 37.58%
Large Cap Core 31.76%	Large Cap Core 18.67%	Cash 5.45%	Large Cap Value 21.67%	Large Cap Value 26.13%	Large Cap Growth 0.20%	Large Cap Growth 38.37%	Small Cap Growth 7.77%	Large Cap Value 18.60%	Large Cap Growth 3.13%	Large Cap Value 36.99%
Small Cap Value 31.01%	Fixed Income 15.24%	Large Cap Core 5.27%	Small Cap Growth 20.37%	Small Cap Growth 20.17%	Large Cap Core -3.10%	Large Cap Core 30.47%	Large Cap Core 7.62%	Small Cap Growth 13.36%	Large Cap Core 1.31%	Small Cap Growth 31.03%
Small Cap Growth 30.97%	Large Cap Growth 14.49%	Large Cap Value 3.68%	Large Cap Core 16.60%	Fixed Income 14.54%	Large Cap Value -6.85%	Large Cap Value 22.56%	Fixed Income 7.40%	Large Cap Core 10.07%	Large Cap Value -0.64%	Small Cap Value 25.75%
Large Cap Value 29.68%	Small Cap Value 7.41%	Fixed Income 2.77%	Large Cap Growth 11.95%	Small Cap Value 12.43%	Small Cap Growth -17.41%	Fixed Income 16.00%	Large Cap Growth 5.14%	Fixed Income 9.75%	Small Cap Value -1.55%	Fixed Income 18.47%
Fixed Income 22.12%	Cash 6.16%	Small Cap Value -7.11%	Fixed Income 7.88%	Int'l 10.54%	Small Cap Value -21.78%	Int'l 12.13%	Cash 3.55%	Cash 2.94%	Small Cap Growth -2.43%	Int'l 11.21%
Cash 7.72%	Small Cap Growth 3.58%	Small Cap Growth -10.48%	Cash 6.38%	Cash 8.21%	Int'l -23.45%	Cash 5.61%	Int'l -12.17%	Large Cap Growth 1.68%	Fixed Income -2.92%	Cash 5.54%

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	YTD Thru 4/26
Large Cap Growth 23.97%	Large Cap Growth 36.53%	Large Cap Growth 42.16%	Small Cap Growth 43.10%	Small Cap Value 22.80%	Small Cap Value 14.02%	Fixed Income 10.26%	Small Cap Growth 48.20%	Small Cap Value 22.10%	Int'l 10.90%	Small Cap Growth 14.20%
Large Cap Core 22.97%	Large Cap Core 33.37%	Large Cap Core 28.59%	Large Cap Growth 28.25%	Fixed Income 11.63%	Fixed Income 8.44%	Cash 1.78%	Small Cap Value 44.50%	Int'l 18.20%	Large Cap Value 5.70%	Small Cap Value 13.70%
Large Cap Value 21.99%	Small Cap Value 31.78%	Int'l 20.00%	Int'l 26.97%	Large Cap Value 6.08%	Cash 4.46%	Small Cap Value -13.20%	Int'l 35.30%	Large Cap Value 15.30%	Large Cap Core 4.80%	Int'l 13.30%
Small Cap Value 21.36%	Large Cap Value 29.98%	Large Cap Value 14.67%	Large Cap Core 21.04%	Cash 5.86%	Small Cap Growth -9.23%	Int'l -17.50%	Large Cap Value 30.30%	Small Cap Growth 14.40%	Small Cap Value 4.10%	Large Cap Value 7.80%
Small Cap Growth 11.26%	Small Cap Growth 12.95%	Fixed Income 8.67%	Large Cap Value 12.73%	Large Cap Core -9.10%	Large Cap Core -11.76%	Large Cap Value -22.50%	Large Cap Core 28.70%	Large Cap Core 10.70%	Large Cap Growth 4.00%	Large Cap Core 5.10%
Int'l 6.04%	Fixed Income 9.68%	Cash 4.80%	Cash 4.60%	Int'l -14.16%	Large Cap Growth -13.96%	Large Cap Core -23.40%	Large Cap Growth 24.70%	Large Cap Growth 5.80%	Small Cap Growth 4.00%	Large Cap Growth 2.60%
Cash 5.03%	Cash 5.14%	Small Cap Growth 1.23%	Fixed Income -0.83%	Large Cap Growth -22.08%	Large Cap Value -14.71%	Large Cap Growth -24.50%	Fixed Income 4.10%	Fixed Income 4.34%	Cash 3.10%	Cash 1.35%
Fixed Income 3.61%	Int'l 1.78%	Small Cap Value -6.45%	Small Cap Value -1.49%	Small Cap Growth -22.43%	Int'l -23.39%	Small Cap Growth -30.70%	Cash 1.14%	Cash 1.30%	Fixed Income 2.40%	Fixed Income -1.19%

		CAGR 86-05	CAGR 96-05
Cash	90 Day Treasury Bills	4.62%	3.71%
Fixed Income	Lehman Aggregate Index	7.88%	6.16%
Small-Cap Value	Russell 2000 Value Index	12.47%	12.65%
Small-Cap Growt	Russell 2000 Growth Index	7.31%	4.59%
Large-Cap Value	S&P/BARRA Value Index	11.62%	8.60%
Large-Cap Growt	S&P/BARRA Growth Index	11.24%	7.92%
Large-Cap Core	S&P 500 Index	11.84%	8.88%
Int'l	Morgan Stanley Capital Int'l EAFE	9.07%	4.70%





There has been a natural correlation between gas and oil prices, and while that spread can fluctuate, when the divergence reaches an extreme point you can be assured of a regression to the mean. This graph of gas and oil prices over the last 16 years shows a big recent divergence (also note what happened when the spread went to extremes in 1990 and 2000/01 - divergences were quickly corrected). The white line is WTI crude oil, and the red line is the front month gas future contract.