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Economic and Market Summary

October, 2005

The U.S. economy continues to absorb heavy blows and, like the Energizer bunny, just keeps on going. While this year's hurricanes were devastating to residents of the Gulf Coast, economic growth is expected to slow only slightly. The disruption to the nation's oil and gas infrastructure will lead to higher energy-led inflation over the next several months, but we don't see a repeat of the 1970's energy crisis. Our country is more energy efficient and has a more rational, market-oriented energy policy. In fact, there are silver linings to this disaster. Legislation, which would allow for exploration in environmentally-restricted, energy-rich areas and badly needed refining capacity in areas outside the Gulf Coast, is moving through Congress. On the demand side, energy consumption has declined the past two months as Americans rediscover the lost art of energy conservation. Consumption of non-energy items, specifically those that are highly discretionary to consumers with low and moderate income, will be negatively impacted by the dramatic increases in gasoline and heating costs. Continued strength in job creation and in wage and salary growth will help to minimize the impact this will have on the economy.

Economic statistics are noisy at the present time because of the hurricanes, so the picture is still blurry. What we've seen so far supports an outlook of continued economic growth and gradually rising inflation. GDP growth will probably be slower in H2 2005 and faster in H1 2006 than we had previously expected. Reported inflation will surge in H2 2005 then decelerate throughout 2006 as energy costs settle back. Core inflation will probably continue to gradually increase during 2006 as businesses recapture margin lost to higher energy and material costs. Profit shortfalls will likely tick up, particularly from companies with exposure to rising energy and commodity prices.

We are disturbed by the loss of spending discipline in Washington. The reaction to Hurricane Katrina highlighted this issue as the country's two political parties engaged in a bidding war to see who could throw the most money at the problem. If Republicans want to maintain their majority in Congress, they had better rediscover the fiscal conservativeness that got them there in 1994. Internationally, election results in Japan and Germany are an encouraging sign that market-based economic policies continue to displace socialist policies. Stock markets in both countries have performed well in response.

Bond yields rose during the quarter and we continue to expect further, possibly significant, increases. The Federal Reserve, in its most recent statement, stated clearly that it still views monetary policy as accommodative. This implies additional tightening, which we now estimate will result in a 4.25% federal funds rate at year-end. Beyond that, we believe that energy and commodity prices will correct, precipitating a halt to the FOMC's tightening campaign.

Corporate profit growth has been very resilient. We estimate profit growth will be 12% in 2005 and 8% in 2006. The PE ratio on the S&P 500 is 15.5 times 2005 and 14.4 times 2006 estimated operating earnings. Relative to a 4.5% 10 year treasury note yield and 7% real estate capitalization rates, stocks offer exceptional value. Our dividend discount model indicates that the stock market is more than 20% undervalued. Heavy merger and acquisition activity is another indicator that stocks are undervalued. Our enthusiasm for stocks has been tempered somewhat because of the increased inflationary risk resulting from the hurricanes. However, fundamentals such as solid domestic and international economic growth, low interest rates, strong corporate profit growth and liquidity, and reasonable valuation suggest a positive outlook for stocks, especially those of consistent growth companies.

Bradley E. Benz, President

To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address below.