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Economic & Market Summary
July 2005

The U.S. economy is experiencing a broad-based expansion driven by solid gains in consumption and investment. While net exports continue to decline, there are signs that a turnaround is under way. On a year over year basis; real GDP growth is 3.7%, industrial production is up 2.7%, consumption is up 3.6%, capital spending is up 9.9%, corporate profits are up 20%, wages and salaries are up 7.0%, and employment is up 1.5%. Despite continuing increases in oil prices, inflation, as measured by the CPI, is a relatively benign 2.8%. Federal and state budget deficits are rapidly declining due to strong growth in tax receipts and moderating increases in spending. The U.S. dollar has stabilized in recent months due to strong economic fundamentals in the U.S. and to deteriorating economic and political conditions in Europe.

What is frustrating about all this good news is that few people seem to know about it or believe it and many doubt that it can continue. The popular press in this country seems intent on reporting bad news and on publishing opinions of those who can only see the risks to our country's future instead of its strength and opportunities. It's encouraging that ratings for network newscasts and subscriptions to newspapers and general news magazines are declining. Perhaps, Americans are tiring of the ideologically driven reporting practices of the major press organizations. Two threats to future economic growth and stock market performance that deserve attention are restrictive trade policies and excessive regulation. Expanding free trade and deregulation have been two main drivers of the U.S. economy over the past 25 years. We're hopeful that rational arguments will prevail on CAFTA, China and other trade issues and that the recent escalation in business regulation is just a temporary reversal of the long-term trend toward deregulation.

We were surprised by the strong rally in bonds during the second quarter. We continue to believe that current bond yields are not reflective of underlying fundamentals, but rather are a function of excess foreign savings and government reserves, especially in Japan, China and oil-producing countries; and of speculative investment strategies known generically as "carry trades." The Federal Reserve is well down the path toward its goal of achieving a neutral monetary policy, which we estimate will result in a 4% federal funds rate at year-end. We believe that the current rate of 3.25% is still modestly stimulative to economic growth.

Corporate profit growth, while decelerating is still respectable at an estimated 9% for 2005. Equity valuations have declined significantly over the past 5 years and are well within long-term historical ranges. The PE ratio on the S&P 500 is 16.5 times 2005 estimated earnings and 15.3 times 2006 estimated earnings. In contrast, bond yields and real estate capitalization rates are near generational lows. Our dividend discount model indicates that the stock market is 20% undervalued. The increase in acquisition and privatization activities is another indicator that stocks are undervalued. Contrarian investors should take note of the fact that stocks are the only major asset class to have delivered negative returns so far this decade. Real Estate, commodities and bonds have all experienced powerful bull markets. Given the multitude of positive economic fundamentals and the strong financial condition of U.S. corporations, stocks appear primed to outperform during the second half of the decade.

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