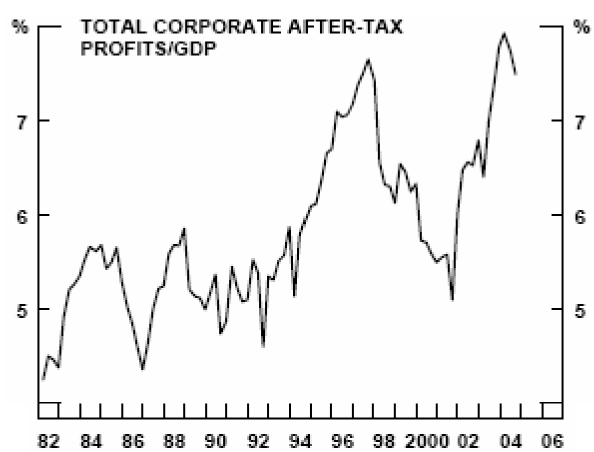
Economic & Market Commentary
January 2005

Concerns about the outcome of the U.S. presidential election and high worldwide energy prices dissipated in the fourth quarter of 2004. The U.S. equity markets responded by rallying 9.23% (using the Standard & Poor's 500 as a proxy) to produce a total return of 10.87% for the year.

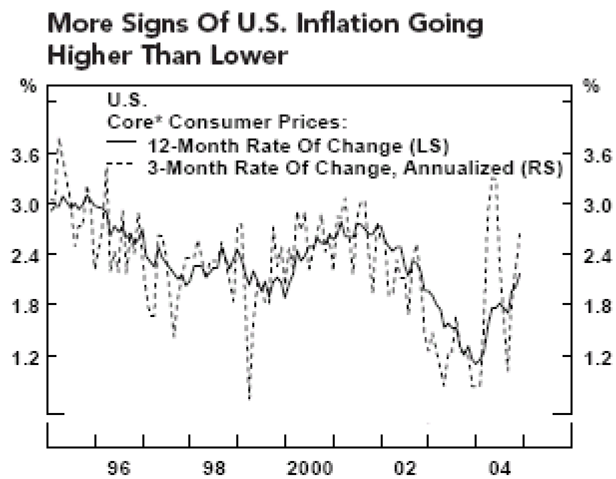
We believe the 2005 outlook for many of the key macroeconomic variables (GDP growth, inflation, exchange rates, interest rates) will be similar to last year. We expect the U.S. economy to grow 6-7% in nominal terms and 3-4% in real terms this year, although consumer spending should grow modestly slower. Although employment growth should continue expanding at 150,000-200,000 jobs per month and wages should also increase, consumers' low savings rates and high debt levels may finally restrain their spending.

The corporate sector, after years of restructuring, is enjoying very high profit margins and strong balance sheets. Businesses certainly have the financial flexibility to expand, and we expect business spending to increase moderately faster than overall Gross Domestic Product (GDP).

**U.S. Profit Growth:
Next Move is Down**



In view of the persistently large U.S. trade deficit, we expect the dollar to fall another 5-10% versus the euro and the yen. Given rising labor costs, high energy prices and the weak dollar, we expect inflation to creep upward from approximately 2.25% towards 3.0%, as measured by personal consumption expenditures, which the Federal Reserve prefers as the benchmark for inflation.



The Fed has made it clear that they intend to raise the Federal Funds rate at a "measured pace" to a neutral level, which they haven't defined. Given current economic conditions, we think a neutral Federal Funds rate would approximate 3.5%. We would expect intermediate to long-term U.S. interest rates to increase as well to offset the effects of higher inflation and as a necessary enticement to attract foreign investors who are faced with losses from a weakening dollar.

Corporate profit margins are at historically high levels and are unlikely to expand further in the face of rising energy and labor costs coupled with limited or weak pricing power. Therefore, we expect Standard & Poor's 500 earnings to grow roughly in line with nominal GDP this year.

While the U.S. stock market appears to be modestly undervalued at the current level of interest rates, we do not believe investors will pay higher valuations in light of slowing earnings growth and rising rates. Therefore, we expect broad market total returns to approximate the underlying S&P earnings growth rate plus the current dividend yield of 1.7%, or 8-9% combined. However, we believe our "Growth at a Reasonable Price" investment philosophy and disciplined investment process should continue providing opportunities to enhance clients' investment results versus the broad market's returns.