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INVESTMENT COUNSEL

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The Business Outlook:
Continued Sluggish Growth Through Mid 1996

Recent discussions with clients, industry contacts and consultants confirm that for several reasons sluggish growth will persist well into next year:

- *real* interest rates remain high by historical standards;
- uncertainties abound over the final shape and details of the deficit reduction/tax cut package;
- federal spending will not support growth in the near term the way it evidently did in the 3rd quarter;
- weakness in retail spending and in the backlog of unfilled orders will probably prolong the inventory liquidation cycle;
- growth of several major U.S. trading partners (i.e. Mexico and Europe) has been below earlier general expectations; and,
- historically, there has been about a six month lag between a Fed easing and an improvement in business conditions.

Meanwhile, continued slippage in our consulting economist David Bostian's macro-economic index, which over the years has proven to be extremely accurate in forecasting the direction of the economy, also portends continued slow growth with no acceleration in sight. David strongly believes, as do we, that the Federal Reserve should and will lower interest rates a notch or two. This easing could commence as early as next week or the Fed might wait until after a deficit reduction measure has been signed by President Clinton. Without this more accommodative stance, we believe there is a growing risk that the present sluggishness will turn into a more protracted and deeper slowdown -- clearly an undesirable backdrop for the presidential and congressional campaigning which will soon begin in earnest. Benign inflation, a more stable dollar, mixed signals on the economy's growth and a budget deal would appear to cinch the case for Fed easing.

By late next spring we expect signs of a strengthening economy to emerge with housing, business investment and exports leading the way. As the economy gains strength, some of the current optimism regarding the inflation environment is likely to fade, and the more balanced view that inflation has, in fact, been largely trendless over the past year or two should become the operative framework for the financial markets. Indeed, once growth picks up, there is good reason to believe that inflation will edge up a bit as well, as goods prices firm in response to stronger demand. Until this occurs, the favorable environment that now prevails in the bond market is likely to persist. Our fixed income strategy, therefore, is to defer extending maturities until interest rates back up toward the upper end of the 5 3/4 % to 6 3/4 % trading range we now forecast for 30 year U.S. treasury bonds through mid 1996. Financial

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stocks, which typically perform well in a period of stable to lower interest rates, should also benefit from the interest rate climate we foresee over the near term and remain important *value* core holdings.

Below are our current "best guess" expectations for four key benchmark indicators of the business outlook through mid 1996 which reflect the sluggish business environment we foresee:

	1995		1996	
	Q3A	Q4E	1QE	2QE
Real GDP	+ 4.2%	+ 2.0%	+ 2.5%	+ 2.7%
Inflation Rate (CPI)	2.0%	2.3%	2.3%	2.5%
Federal Funds Rate	5.8%	5.7%	5.0%	5.0%
30 Year Bond Yield	6.6%	6.2%	6.3%	6.5%

As for stock investment strategy, earlier this quarter we began adding to holdings which should recover as investors shift their focus from current defensive favorites among drugs, foods and tobaccos to companies that will benefit from the strengthening in businesses we forecast. Among the favored groups are housing (Home Depot), *growth* industrials (Morton International, Illinois Tool Works, General Electric, Nucor) and high quality technology (Intel, Molex, Microsoft, Motorola). And, given their attractive valuations, long dormant cable communications companies' shares should lift once the telecommunications bill now working its way through congress is approved next year.

Finally, 1995 has been an exceptionally good year for the stock market. Few, if any, forecasts a year ago envisioned the 35% + returns we have enjoyed thus far. While our own forecast, in retrospect, understated the market's potential, calling only for a year "solidly in the black," we were fully invested throughout and, therefore, our clients have fully participated in the stock market's remarkable advance. Looking ahead, we believe stocks are now reasonably valued, and we, therefore, do not expect a repeat stellar stock market performance in 1996. Rather we believe returns will be more in line with historic norms. Clearly, given the market's recent surge and the uncertain timing of a reacceleration in business activity, the elusive 10 -15 % correction many forecasters have warned of could commence at any time. We would view such a decline as an opportunity to build positions in equities likely to do well in the stronger business environment we see emerging in the second half of 1996 rather than prelude to a major bear market.

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I am pleased to inform you that now, via the internet, you may access our firm's client accounting system at any time using your own PC to view a current valuation of your portfolio. Please phone me if you would like to take advantage of this enhanced client service.

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