FRONT BARNETT ASSOCIATES LLC

I N V E S T M E N T   C O U N S E L

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Financial Market Update

Financial market sentiment has swung from strongly bullish in January when long term interest rates dipped below 6%, to somewhat bearish now that rates have pierced the 7% level (and are predicted by some to reach 7 1/2% or more before year-end). This thrashing around appears to be the result of an unusual disparity among respected forecasters as to the likely pace of economic activity. To cite just two examples of the extremes to which forecasts have run, one camp, led by analysts at Merrill Lynch, makes a quite convincing case that the economy is *weakening* as consumers retrench and capital spending moderates. They contend corporate earnings are likely to disappoint, and that bond yields and stock prices are, therefore, vulnerable. A second group, most notably economists at Morgan Stanley, on the other hand, is convinced that the economy is *accelerating*, that consumer spending will remain firm -- indeed, is receiving a significant boost from unusually large tax refunds -- and that industrial production will soon pick up since excess inventories are now almost depleted. Morgan sees synchronous growth of the world's major economies next year as a greater risk to stock prices which could lead to excessively rapid economic expansion coupled with greater consumer price inflation, higher interest rates and finally central bank tightening. Between these disparate and, we believe extreme perspectives, lie many shades of uncertainty which, in our view, accounts for the nervous volatility of the markets. For stock investors higher interest rates without predictably stronger earnings to compensate increases the odds of a choppy market. Indeed, analysts have been shaving their earnings expectations, insider selling has increased and oil and grain prices are sharply higher.

Not withstanding these uncertainties, global liquidity and general business conditions should remain favorable to financial assets. The Bank of Japan is likely to continue its efforts to reflate, U.S. investors continue to pour money into domestic and international equity mutual funds -- close to $80 billion in the first four months of the year -- and the Fed still has room to ease if the economy does, indeed, prove more fragile than is now apparent. Moreover, recent conversations with clients and industry contacts confirm our view that the economy is now growing more moderately, (following its vigorous snapback in February and March) and that inflation is likely to be only a shade higher this year than it was in 1995. If we are right in our assessment of the outlook, inflation fears will moderate, long term interest rates will work their way lower over the next few months and corporate profitability will remain respectable.

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In short, the bull market is likely to remain intact unless the pace of economic activity turns out to be far stronger than we now forecast, forcing the Fed to tighten the screws, an event we view as quite unlikely over the near term. However, our forecast by no means precludes the possibility of a stock market correction of 5-10% if rates continue to rise and/or earnings disappoint. Such a development would not be surprising, unusual, disturbing or undesirable when viewed in a longer term perspective.

Within clients' equity portfolios, where a unique blend of both *growth* and *value* shares defines our investment approach, we continue to tilt toward *growth* companies whose earnings are likely to remain strong in the uncertain period ahead. High quality technology companies, to which we added during periods of extreme weakness in late 1995 and earlier this year, dominate this group. On the *value* side, selected financial (First USA) and economically sensitive issues (Willamette) represent areas of current buying interest.

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