FRONT BARNETT ASSOCIATES LLC
INVESTMENT COUNSEL

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Portfolio Strategy-- Stay the Course

In our view, the economic climate remains favorable for financial assets for several key reasons.

- Business activity and corporate profits continue to advance, albeit at low or decelerating rates of growth.
- The trend of inflation remains muted, driven by the influence of intense global competition.
- The Democratic Administration, described as the most conservative of modern times, deserves high marks for its management of the economy.
- The U.S. dollar's strength indicates growing confidence in the competitiveness, stability, and growth potential of our markets.
- The budget deficit has narrowed sharply when measured against GDP.

All in all, the well-balanced almost uninterrupted economic expansion we have enjoyed for the past seven years remains a favorable backdrop for both bond and stock investors. However, later this year, as earnings growth decelerates, many companies are likely to fail to meet the aggressive earnings expectations of Wall Street analysts. Avoiding these negative surprises is an important focus and challenge of our firm's analytical effort.

Our clients' equity holdings will remain tilted toward *growth* reflecting our view that the U.S. economy will continue to grow slowly. In this environment, companies which produce consistent, above average earnings gains should be favored. Within technology, the quintessential growth area, our emphasis continues to be on the dominant market leaders: Microsoft, Intel, Cisco Systems, Motorola, and L.M. Ericsson. Financial equities, a cornerstone of our *value* sector, are weighted toward banks (Citicorp and Chase) and asset accumulation vehicles (Travelers and Mellon). Finally, the market has and will continue to reward large multinational, global leaders, such as American International Group, Gillette, General Electric, Disney, Abbott Labs, and Roche Group. In recent weeks, we have added holdings of Pfizer and Novartis-- global pharmaceutical firms whose above average earnings growth are well assured.

With regard to fixed income strategy, we are maintaining a fairly short average maturity and duration given the bond market's heightened volatility and the possibility of a back-up in rates. Extensions of maturities will be undertaken each time rates reach or exceed the upper end of our

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presumed 6.125%- 7.0% trading range for thirty year U.S. Treasury bonds which is consistent with our forecast of 2%- 2.5% real GDP growth.

As we noted in our January 16th piece, The Economy and Financial Markets : Irrational Exuberance?, our forecasts for 1997 are guarded, but are by no means pessimistic. Nevertheless, over the past few months we have received calls from a number of clients concerned with the level of stock valuations and the age the current bull market. Our response has consistently been, and continues to be: **Stay the course**. This recommendation is based upon three observations:

- The current stock market valuation is, indeed, by many yardsticks on the high side, but it is consistent with the extremely favorable macroeconomic environment we currently enjoy. It is also within the range of valuations we have historically experienced during similar periods of low inflation and moderate interest rates.

- Indeed, history has seen valuations sustained at *both* high and low levels for extended periods of time. For example, from the late 1950's through the 1960's valuations were consistently high, while the latter 1970's and early 1980's saw consistently low valuations.

- High valuations *per se* do not cause bear markets. Bear markets have occurred from starting points of low valuations (most recently 1980-1982), and bull markets have occurred from starting points of high valuations (1995- ?).

We have, however, also discussed two caveats with clients. First, current valuations are reflective of the favorable macro-economic environment which seems to pose less risk for equities. From this starting point, returns for stocks *in general* should be lower than historic norms, in line with the lower macroeconomic risk. Second, as we have said many times, a number of things could cause a normal 10-15% correction. At present, though, we see no developments that would lead to a fundamental shift downward in stock prices.

In this environment we have continued to seek out companies able to deliver consistently superior earnings growth and companies with financial strength and dominant competitive positions. With moderate economic growth we believe the market will continue to reward shareholders of these companies. A disciplined strategy, employing both *growth* and *value* shares within a single portfolio should continue to add value over the returns of a broad market index. We continue to remain fairly fully invested in both stocks and bonds despite the likelihood of a rough spot or two as the markets react to the inevitable surprises and shocks that seem to have become more and more commonplace.

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Clients have asked for guidance in accessing their account information via the Internet. Account information includes portfolio valuations updated daily, year-to-date capital gains and losses information for taxable portfolios, and detailed descriptions of the companies represented in client accounts. Please call Phil Lahey at (312)641-9004 if you would like to learn more about how you can take advantage of this client service.