FRONT BARNETT ASSOCIATES LLC
INVESTMENT COUNSEL

January 14, 2005

THE ECONOMIC OUTLOOK – CORPORATE INVESTMENT LEADS

Recently released economic data lends credence to our view the US economy exited 2004 with considerable momentum which we believe will carry over into the New Year. While many market observers thought rising commodity prices and higher short-term interest rates would cause a slowdown in growth, the fact is the economy emerged from last summer's "soft patch" with renewed strength as evidenced by the following:

- The December Department of Labor Establishments Survey showed that monthly employment growth averaged 202,000 in the fourth quarter, up from 134,000 in the previous three months. Additionally, the survey reported 2.3 million jobs were created in all of 2004, the best showing since 1999.

- The Commerce Department reported that its index of consumer confidence rose sharply from 92.6 in November to 102.3 in December. This increase, which was well above expectations and represented the highest reading since July, reversed four months of declines in this time series. The University of Michigan sentiment index confirmed this finding by advancing from 92.8 in November to 97.1 the following month.

- The Commerce Department also reported retail sales rose 1.2% in December from the previous month and were up 8.7% when compared with December 2003. For the full year, sales rose 8%. Both the annual sales growth and the December-to-December gains were the strongest since 1999 at the height of the prior economic boom.

- Third quarter real GDP growth was revised up to 4.0% from the 3.3% originally estimated in October.

- The Leading Economic Indicators (LEI) advanced for the first time in four months in December, mirroring an uptick in our firm's Economic Model.

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- The Institute of Supply Management's (ISM) manufacturing index moved up to 58.6 in December from 57.8 the previous month -- the 19th consecutive monthly report signaling expansion. Important for the 2005 outlook, the new orders component rose to 67.4 last month from 61.5 in November.

- The ISM non-manufacturing index rose to 63.1 in December from 61.3 the prior month -- the highest level since July and the 21st successive expansionary reading. This report also showed strong increases in order backlogs and exports.

- Industrial production, according to the Federal Reserve, advanced a robust 0.8% in December while capacity utilization rose to a four year high of 79.2%.

All in all, the economy continues to perform well despite long term concerns over the low household savings rate, wide budget and trade deficits and geopolitical uncertainties. While these issues are valid and are certain to persist, they are highly unlikely to derail the current expansion anytime soon.

2005 Outlook

The above-trend 3.5% - 4.0% economic growth we forecast will be driven principally by *corporate investment*, which represents about 16.5% of GDP. Despite 10 consecutive quarters of double digit profit growth, many corporate managers have taken a conservative approach to spending, preferring instead to build large cash reserves. Until recently, merger and acquisition activity, capital spending and hiring have all been muted due to the tenuous situation in Iraq, high commodity prices, the US presidential election, escalating employee benefit costs and the costly and time consuming implementation of Sarbanes-Oxley reforms. With a number of these impediments either removed or diminishing, we believe corporate managers will be more willing to take risks and deploy some of the excess cash they have on their balance sheets to increase capital spending, hire more employees and pursue acquisitions. The weaker dollar which makes our exports more affordable, rising US industrial capacity utilization, moderating productivity gains, and low but rising real interest rates are among the catalysts for expanding capital outlays.

Consumer outlays, which amount to over 70% of GDP, are likely to grow at a mid single digit rate -- not much of a change from 2004 or the longer-term trend. While rising debt loads, higher borrowing rates and little pent-up demand limit the possibility of a surge in consumer spending, there is little reason to expect consumers to retrench given the employment growth, wage gains, and moderating energy costs we anticipate. Specifically, we expect the economy to add at least 2 million jobs this year and for wage gains to accelerate modestly as the unemployment rate declines from 5.4% to 5.2% by yearend.

Government spending growth, which surged in the first three years of the Bush administration and helped to bring the economy out of the 2001 recession, has moderated over the past year. We expect this trend to persist in 2005 as pressures to reduce the budget deficit, arrest the dollar's fall and address longer term societal needs (e.g. Social Security and health care reform) force renewed budget discipline. All in all, government spending, which represents about 18.5% of GDP, is likely to play a somewhat diminished role in stimulating economic growth.

Lastly, US *net exports* will be less of a drag on the economy this year. With the dollar having weakened on a trade weighted basis by over 30%, we expect the US trade deficit to begin narrowing. While this development will inhibit the ability of the European, Latin American and Japanese economies to grow through exports to the US, it will eventually force necessary structural reforms in these countries to spur domestic demand which will, in turn, expand export opportunities for US businesses.

Interest Rates

In the minutes of its December 14th Federal Open Market Committee meeting, the Federal Reserve made it clear they intend to continue removing the unusual accommodation they provided over the past three years. At 2.25%, the Federal Funds rate remains below inflation spurring excessive global speculation in commodities, real estate and the bond market, a troubling trend for the Fed. Moreover, an economy generating over 200,000 jobs a month and growing at 4% no longer requires the stimulus of cheap money. In fact, the Fed should "normalize" rates so it has the ability to become more accommodative in the event of an unexpected shock to the system and to prepare for the inevitable next economic slowdown. Lastly, US short term rates which are below those of many of our trading partners have contributed to the US dollar's weakness. Absent a severe geopolitical shock, or a notable change in inflation expectations which we now peg at 2.5%, we expect the Fed to increase their benchmark rate by 0.25% at each of its next five meetings, bringing the rate to a "neutral" 3.5%.

Meanwhile, longer term rates barely budged in 2004 confounding many fixed income managers, including our firm, who last year maintained shortened maturities in the anticipation of higher rates. The modest uptick in inflation, a growing budget deficit, five Fed rate hikes, surging commodity prices and a weaker dollar, usually drivers of higher interest rates, surprisingly failed to produce higher bond yields. One plausible explanation for this disconnect was the steady demand for US bonds by foreign central bank buyers seeking to reinvest their trade surpluses in US Treasuries without particular concern for the level of interest rates. Looking ahead, we believe the case for higher rates will intensify, particularly as the Fed continues to hike short term rates. We continue to expect 10 year US Treasury bond yields to approach 5%, although the timing

remains uncertain. We are, therefore, maintaining shorter than usual bond durations looking ahead to a better buying opportunity.

Equity Investment Strategy

Following two years of outsized profit growth approaching 20% annually, we believe S&P 500 earnings are likely to continue their expansion, albeit at a more moderate 8% - 10% pace, well above the 6% gain now forecast by Wall Street analysts. At this point, we estimate S&P 500 earnings of roughly $72 per share compared with Street expectations of $70. As overly cautious analysts raise their estimates over the balance of the year, stock prices should respond favorably. As a reminder, at this time last year the consensus expectation was for $60 per share of S&P 500 earnings which was well short of the roughly $66 now likely to be realized. We expect profit growth to stem from increased volumes rather than further profit margin expansion as the lagged effect of higher commodity prices, and the eventual need for corporations to step up their capital investments and hiring take their toll on margins. The following table summarizes 2005 consensus expectations by sector for profit growth.

	Expected 2005	12/31/04 Weightings		Overweight/
Sector	Profit Growth	FBA	S&P 500	(Underweight)
Information Technology	15%	24.9%	16.1%	8.9%
Consumer Discretionary	17	19.0	11.9	7.2
Health Care	9	14.5	12.7	1.9
Telecommunications	6	4.2	3.3	0.9
Materials	23	1.8	3.1	(1.3)
Consumer Staples	11	9.1	10.5	(1.4)
Industrials	19	9.7	11.8	(2.1)
Utilities	13	0.0	2.9	(2.9)
Financials	11	16.8	20.6	(3.9)
Energy	-3	0.0	7.2	(7.2)
		100.0	100.0	
S&P 500	6%			
FBA Portfolio*	13%			
* Dollar Weighted				

As the foregoing table shows, we continue to follow a concentrated style of equity selection with major overweights in the technology, consumer discretionary and healthcare sectors which account for 58% of the portfolio. While our 2004 equity

performance was held back by the underperformance of these groups, the rationale for maintaining these overweights is as follows:

Technology

- Primary beneficiaries of increased corporate spending and a weaker dollar.
- Intense competition requires investments in technology which enhances productivity and provides a quick payback on investment.
- Upgrade cycle on the horizon as equipment put in place in the 1998-2000 spending binge becomes obsolete.

Consumer Discretionary

- Media companies, which have been market laggards, are generally the beneficiaries of the intensified competition that occurs as the economic cycle matures and companies compete for market share.
- Our forecast for consumer spending remains above consensus providing a favorable climate for retailers.
- Turnaround retailers remain attractive due to management changes, adjustments to product offerings and tighter inventory controls.

Healthcare

- Post election beneficiaries due to reduced risk of price controls.
- Favorable demographics are a powerful secular trend. Recently enacted Medicare drug benefit will expand the customer base.
- Pharmaceuticals, at generational lows in valuation and providing above average yields, more than adequately compensate for product safety risks. Values are compelling and expectations are low.

The following sectors are notable underweights:

Energy

- We believe energy prices are likely to decline, falling toward $35 per barrel this year. Forecasts for 2005 profit growth are the weakest for any sector.

Financials

- Rising interest rates, diminished mortgage activity and a flattening yield curve provide headwinds for regional banks and REITS.
- Money center banks and brokers, centerpieces of our financial share holdings, stand to benefit from a sharp increase in both mergers and acquisitions and commercial loan activity.

Materials

- While analysts expect 2005 earnings growth of about 23%, we expect these estimates to be trimmed substantially through the year as additional sources of supply begin to come on stream, driving prices lower at the margin.
- Commodity stocks have been bid up sharply by mutual fund and hedge fund speculators. Since the shares of these companies can be illiquid, the downside risks associated with a change in sentiment could be substantial.

With stock market valuations unlikely to rise materially in the face of rising interest rates, returns from equities are expected to be in line with the general 8% - 10% improvement in profitability. Returns from stocks should outpace those of cash equivalents, bonds and real estate. Large cap, high quality *growth* shares, out of favor for the past 5 years, should recapture their market leadership. Results shown in the attached exhibit demonstrate how performance has been skewed toward small cap and *value* shares in this latest period, a divergence unlikely to persist.

Equity portfolios under our supervision continue to be “tilted” toward large cap *growth*, a strategy which last year until the November elections held back performance. The case for this asset allocation was presented in great detail in our November 15, 2004 client letter which is well worth rereading on our website.

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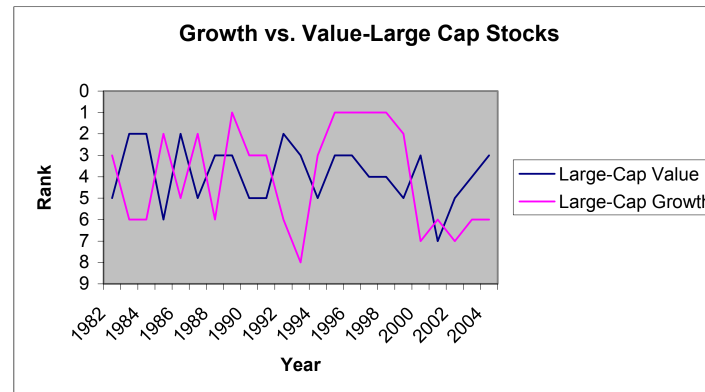
Investment Style Migration is Inevitable

Historical Returns Achieved by Various Asset Classes
Annual Returns Ranked in Order of Performance

1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Small Cap Value 38.64%	Fixed Income 15.15%	Int'l 56.16%	Int'l 69.44%	Int'l 24.64%	Small Cap Value 29.47%	Large Cap Growth 36.40%	Fixed Income 8.96%	Small Cap Growth 51.19%	Small Cap Value 29.14%	Int'l 32.56%	Int'l 7.77%	Large Cap Growth 38.12%	Large Cap Growth 23.97%	Large Cap Growth 36.53%	Large Cap Growth 42.16%	Small Cap Growth 43.10%	Small Cap Value 22.80%	Small Cap Value 14.02%	Fixed Income 10.26%	Small Cap Growth 48.20%	Small Cap Value 22.10%
Large Cap Value 28.89%	Large Cap Value 10.52%	Large Cap Growth 33.31%	Large Cap Value 21.67%	Large Cap Growth 6.50%	Int'l 28.27%	Large Cap Core 31.68%	Cash 7.77%	Small Cap Value 41.70%	Large Cap Value 10.59%	Small Cap Value 23.84%	Cash 3.85%	Large Cap Core 37.58%	Large Cap Core 22.97%	Large Cap Core 33.37%	Large Cap Core 28.59%	Large Cap Growth 28.25%	Fixed Income 11.63%	Fixed Income 8.44%	Cash 1.78%	Small Cap Value 44.50%	Int'l 18.20%
Int'l 23.69%	Cash 9.89%	Large Cap Core 31.76%	Large Cap Core 18.67%	Cash 5.45%	Large Cap Value 21.67%	Large Cap Value 26.13%	Large Cap Growth 0.20%	Large Cap Growth 38.37%	Small Cap Growth 7.77%	Large Cap Value 18.60%	Large Cap Growth 3.13%	Large Cap Value 36.99%	Large Cap Value 21.99%	Small Cap Value 31.78%	Int'l 20.00%	Int'l 26.97%	Large Cap Value 6.08%	Cash 4.46%	Small Cap Value -13.20%	Int'l 35.30%	Large Cap Value 15.30%
Large Cap Core 22.57%	Int'l 7.38%	Small Cap Value 31.01%	Fixed Income 15.24%	Large Cap Core 5.27%	Small Cap Growth 20.37%	Small Cap Growth 20.17%	Large Cap Core -3.10%	Large Cap Core 30.47%	Large Cap Core 7.62%	Small Cap Growth 13.36%	Large Cap Core 1.31%	Small Cap Growth 31.03%	Small Cap Value 21.36%	Large Cap Value 29.98%	Large Cap Value 14.67%	Large Cap Core 21.04%	Cash 5.86%	Small Cap Growth -9.23%	Int'l -17.50%	Large Cap Value 30.30%	Small Cap Growth 14.40%
Small Cap Growth 20.06%	Large Cap Core 6.27%	Small Cap Growth 30.97%	Large Cap Growth 14.49%	Large Cap Value 3.68%	Large Cap Core 16.60%	Fixed Income 14.54%	Large Cap Value -6.85%	Large Cap Value 22.56%	Fixed Income 7.40%	Large Cap Core 10.07%	Large Cap Value -0.64%	Small Cap Value 25.75%	Small Cap Growth 11.26%	Small Cap Growth 12.95%	Fixed Income 8.67%	Large Cap Value 12.73%	Large Cap Core -9.10%	Large Cap Core -11.76%	Large Cap Value -22.50%	Large Cap Core 28.70%	Large Cap Core 10.70%
Large Cap Growth 16.23%	Large Cap Growth 2.33%	Large Cap Value 29.68%	Small Cap Value 7.41%	Fixed Income 2.77%	Large Cap Growth 11.95%	Small Cap Value 12.43%	Small Cap Growth -17.41%	Fixed Income 16.00%	Large Cap Growth 5.14%	Fixed Income 9.75%	Small Cap Value -1.55%	Fixed Income 18.47%	Int'l 6.04%	Fixed Income 9.68%	Cash 4.80%	Cash 4.60%	Int'l -14.16%	Large Cap Growth -13.96%	Large Cap Core -23.40%	Large Cap Growth 24.70%	Large Cap Growth 5.80%
Cash 8.82%	Small Cap Value 2.27%	Fixed Income 22.12%	Cash 6.16%	Small Cap Value -7.11%	Fixed Income 7.88%	Int'l 10.54%	Small Cap Value -21.78%	Int'l 12.13%	Cash 3.55%	Cash 2.94%	Small Cap Growth -2.43%	Int'l 11.21%	Cash 5.03%	Cash 5.14%	Small Cap Growth 1.23%	Fixed Income -0.83%	Large Cap Growth -22.08%	Large Cap Value -14.71%	Large Cap Growth -24.50%	Fixed Income 4.10%	Fixed Income 4.34%
Fixed Income 8.37%	Small Cap Growth -15.83%	Cash 7.72%	Small Cap Growth 3.58%	Small Cap Growth -10.48%	Cash 6.38%	Cash 8.21%	Int'l -23.45%	Cash 5.61%	Int'l -12.17%	Large Cap Growth 1.68%	Fixed Income -2.92%	Cash 5.54%	Fixed Income 3.61%	Int'l 1.78%	Small Cap Value -6.45%	Small Cap Value -1.49%	Small Cap Growth -22.43%	Int'l -23.39%	Small Cap Growth -30.70%	Cash 1.14%	Cash 1.30%

		CAGR 85-04	CAGR 95-04
Cash	90 Day Treasury Bills	4.85%	3.95%
Fixed Income	Lehman Aggregate Index	8.83%	7.72%
Small-Cap Value	Russell 2000 Value Index	13.77%	14.80%
Small-Cap Growt	Russell 2000 Growth Index	8.55%	7.03%
Large-Cap Value	S&P/BARRA Value Index	12.76%	11.45%
Large-Cap Growt	S&P/BARRA Growth Index	12.63%	11.03%
Large-Cap Core	S&P 500 Index	13.13%	11.89%
Int'l	Morgan Stanley Capital Int'l EAFE	10.95%	4.72%



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