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ECONOMIC UPDATE -- MORE STRAWS

During the two weeks since publication of our latest Economic Outlook, incoming economic data has supported our view the economy's downward slide has moderated -- a prerequisite to an eventual upswing probably commencing in the fourth quarter. Among these additional straws-in-the-wind are the following indicators:

- Housing: While the S&P/Case-Schiller index of home prices in 20 US cities fell 19% in January from a year ago, the steepest drop on record, and the decline from the prior month was 2.8%, sales of new and previously owned homes rose in February -- an indication the housing slump, now in its fourth year, may be easing as policy efforts to unclog credit and aid borrowers begin to gain traction. In addition, recent reports showed builders broke ground on 22% more homes in February than the prior month.

- Consumer Confidence: The Conference Board Consumer Confidence Index, which had declined sharply in February, was flat in March at 26.0 and its Expectations Index rose to 28.9 from 27.3 in February. While consumers remain extremely pessimistic about the intermediate term outlook, their short-term expectations are less negative this month. Consumers expecting business conditions will worsen over the next six months edged down to 39.1% from 40.7% while those anticipating conditions to improve increased to 9.1% from 8.5% in February. Meanwhile, a Reuters/University of Michigan survey, released on March 27th, showed sentiment rose to 57.3 from 56.3 in February. Both indicators may be signaling a bottom for confidence.

- Consumer Spending: Growth in consumer spending rose 0.2% in February after climbing 1.0% in January according to the Department of Commerce. Taken together, these figures offer a picture of an economy that remains in recession, while the pace of the contraction has eased from the end of 2008 -- signs of stabilization.

- North American Rail Volume: Total US rail freight volume fell 13.8% in the last week, a notable improvement over the rolling four-week trend of down 15.6% and the 15.4% pullback for the quarter-to-date.

- US Durable Goods Orders: Orders for durable goods rose in February as demand for machinery, computers, and defense equipment rebounded. The 3.4% increase, the largest gain in over a year and the first gain in seven months, following a 7.3% decline in January -- a further indication of stabilization.

- MBA Mortgage Applications: Mortgage applications rose for the third consecutive week as a drop in borrowing costs helped spur a wave of refinancings and encouraged purchases. Applications for mortgages, according to the Mortgage Bankers Association, rose 32% in the week ended March 20 from the prior week.

Our takeaway from these datapoints is consumer spending and related orders and production readings are "probing the depths" of the current downturn, and could be bottoming in a lasting way. However, we expect any turnaround to be slow, uneven and subject to brief reversals in individual indicators.

Investor confidence remains fragile. Calling a bottom to the market drop we have experienced since October 2007 may be premature. However for those of us who are willing to take a longer term view, US equities remain cheap by historical standards despite the market's 25% rise from its mid-March bottom. Bonds of US corporations are also very attractive and we continue to purchase four to seven year maturities as offerings are presented. US Treasury Securities remain overpriced.

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