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May 1, 2009

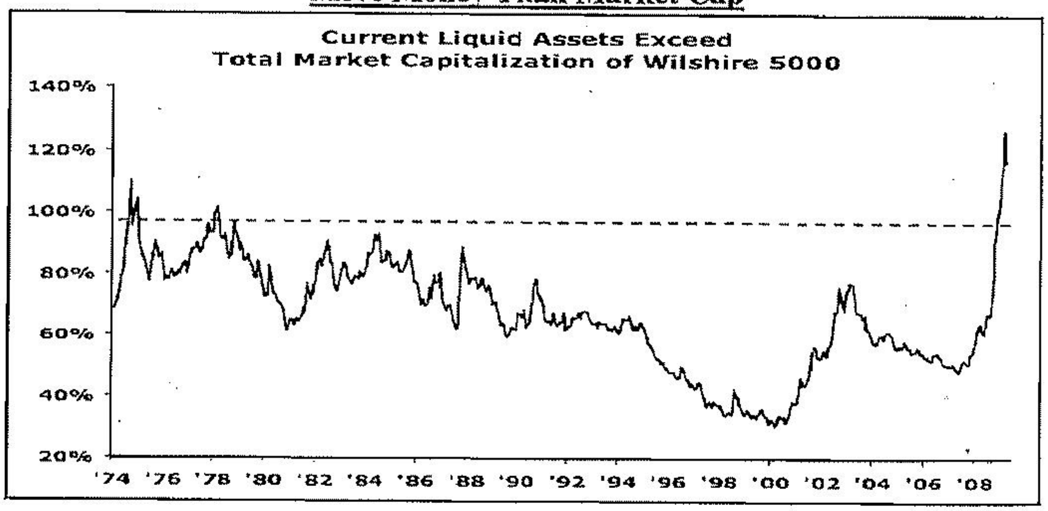
ECONOMIC OUTLOOK -- MARKET UPDATE

The stock market has now regained much of the ground it lost earlier this year as investors have refocused on a series of recent economic reports showing the economy to be stabilizing following the freefall of last fall and winter. Meanwhile, thus far, reported first quarter earnings for US companies have generally exceeded diminished expectations and analysts have begun raising their earnings estimates and stock price targets for the full year and 2010. In fact, almost 70% of the companies which have reported their first quarter results have done better than forecast. Another prop for the market's recovery has been the major improvement in financial market conditions. Central banks globally have taken unprecedented steps to shore-up confidence thereby reducing the counterparty fears which had gripped the markets for months following the failure of Lehman last September. As an example, the London InterBank Offered Rate (LIBOR), which had risen to over 6%, has now fallen to 1% -- a rate not seen since 2003.

Looking ahead, while unemployment is likely to rise through mid-2010 -- possibly approaching 10% -- business conditions are stabilizing and signs of an economic upturn here in the US are likely to emerge in the fourth quarter. Outside of China, whose economy is already in the process of recovering, growth abroad is unlikely to resume until next spring. US GDP growth in the current quarter is forecast to be –2.5% followed by a flat performance in the 3rd quarter. Fourth quarter growth is likely to be in the 2%+ range.

Against the backdrop of improving business conditions, stock prices are likely to continue to gain ground as investors decide a recovery is assured. An important consideration is the mountain of cash investors have accumulated. The chart below shows that current liquid assets as measured by the MZM (Money Supply with Zero Maturity) now exceed the total market capitalization of the largest 5,000 publicly traded companies in the US. This represents an unprecedented amount of "dry powder" that could fuel a surprisingly broad and large stock market rally.

More Money Than Market Cap



Source: Strategas

While not a problem today, inflation pressures remain a long-term concern. Given the massive fiscal and monetary stimulus being applied to the global economy, it is possible, if not probable, that in three or four years, inflation will become a problem, eroding the value of longer term fixed income obligations. Reflecting these concerns, we have avoided longer-term bonds and opted instead to purchase US Treasury Inflation Protected Securities (TIPS) which provide current income and principal preservation.

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