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TO: Clients and Friends of the Firm

SUBJECT: Presentation at the 59th Annual University of Chicago Booth School of Management Conference

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Marshall Front spoke at University of Chicago Booth School of Management Conference of Friday, May 20th. Attached is a summary of his written comments on the outlook for the US stock market which we believe you will find interesting.

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US STOCK MARKET OUTLOOK -- FAVORABLE

Here we are, almost at midyear. Equity investors are fretting about:

(1) End of 30-year bond bull market;

(2) Unprecedented geopolitical uncertainties in Europe, North Africa, and Mid-East;

(3) European sovereign debt crises;

(4) A slowdown here in the US, amidst a growing thicket of government regulations and the threat of higher taxes;

(5) Falling commodity prices, and;

(6) History appears to be less of a guide to forecasting the future -- as “black swans” pop up in increasing numbers.

Where do we go from here? First, let's look at some market benchmarks:

1. Doubling of the US Stock Market since March 2009 has largely mirrored the course of S&P 500 quarterly earnings which have risen from $12.83 per share to the current consensus of $24.69 per share. Stocks, therefore, are no more expensive on a P/E basis than they were at the bottom.

2. S&P 500 profit margins have been running at 9% -- close to their historical peak. Reversion to the mean is likely as this cycle matures.

BUT…

3. Wall Street analysts' S&P 500 earnings estimates have consistently fallen short of reported results. Margins are well-supported by pricing power, lagging labor costs, operating leverage to accelerating top line growth, and exposure to more rapidly growing economies abroad.

4. S&P 500 earnings are forecast to reach $95.00 per share this year and advance further to $105.00 in 2012, absent an exogenous shock. Current valuations of 13.9x and 12.6x are below their 10-year historical averages. At 15x next year's

forecast earnings, the S&P 500 index could reach 1575 -- implying the potential of a 19% return over the next year or so. But, beware of the inevitable corrections along the way -- be certain your asset allocation is appropriate for a bumpy ride.

In that regard, *immediately ahead*, we face a number of potential bumps:

a. The end of QE2;

b. Debt ceiling crisis;

c. Popping commodity "bublets";

d. Seasonally weak period for stocks; and

e. The need for signs of an improving economy.

5. Looking at the *intermediate term*, beyond the next few months, economic data should show renewed momentum in the second half of this year, following the current slowdown. Soft patches are to be expected in any

economic recovery. Likely drivers of second half GDP growth of 3.0%+, following subpar growth in the first half of this year, are:

- Lower price for crude oil is positive for 2H11 growth;
- Manufacturing momentum continues, aided by a relatively weak dollar;
- The current business inventory slowdown should reverse in response to improving end demand;
- Employment will continue to grow moderately but remain elevated when compared with historical benchmarks;
- Japan will rebound surprisingly quickly from its disaster amplified by the start of a major restoration and reconstruction effort boosted by huge fiscal stimulus spending;
- Supply chain disruptions will moderate in the important automotive and technology sectors;

- US Government spending will grow from 1Q11 low point;

- Fed Policy will remain accommodative at least through year-end given excess labor and manufacturing capacity.

6. Investors of every stripe remain underinvested in equities at a time the world is awash with liquidity in a low interest rate environment.

7. Releveraging and M&A activity will remain supportive of higher valuations.

8. The dividend payout ratio has been trending down for the past 20 years. Increasing the current payout ratio of below 30% to more historic levels (close to 40%) would be accretive to existing shareholders. So far this year, 101 of the S&P 500 companies have either initiated or raised their dividends.

9. Small cap stocks at 22x forward earnings are expensive relative to the S&P at less than 14x. Small caps have outperformed the S&P 500 by 450 bps on an annualized basis over the last 10 years. We expect this trend to reverse itself over the next several years given the current valuation disparity.

10. High quality stocks in the S&P 500 have underperformed low quality stocks since the market's low in 1Q2009.

11. That said, the US faces numerous *headwinds* to consumption growth, which accounts for over two-thirds of GDP, and to a rebound in housing:

    - Depression-like conditions in housing will persist into 2012 as the overhang of unsold homes pressures prices;

    - Consumers will see only modest income gains, constraining their spending as they work to repair stretched balance sheets;

    - Confidence will remain fragile for an extended period due to political and economic uncertainties.

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BANK STOCKS

Bank Stocks, which were early market leaders in 2009, have lagged the broader market in the past year. The S&P 500 index has risen 15.6% while the KBW Bank index has fallen 10%. With the economy improving, banking will benefit as:

- Capital markets activity picks up;
- Credit trends continue their dramatic improvement;
- Problem loans and delinquencies continue to fall;
- Recent data shows loan demand beginning to firm;
- Bank stocks are cheap. On average banks are selling at 0.9 times their book values per share compared with twice that prior to 2008;
- Current valuations reflect fears about new regulations and higher capital requirements. Bank Stock performance should improve as asset quality

normalizes and firms adjust for the regulatory, legal and higher capital requirements;

- Rising rates over the next few years will support improving net interest margins, a measure of the money banks earn on their loans. Banks can usually raise the rates on their loans more quickly than they have to raise the rates they pay depositors;

- As bank profits improve, banks are likely to boost their dividends, with regulatory approval, after having slashed them during the financial crisis to preserve capital. Fifty-eight banks have either initiated or raised their dividends in 2011.

- Bank stock performance is expected to improve as investors begin to anticipate improved net interest margins, stemming from higher interest rates, and that rising loan demand will persist.

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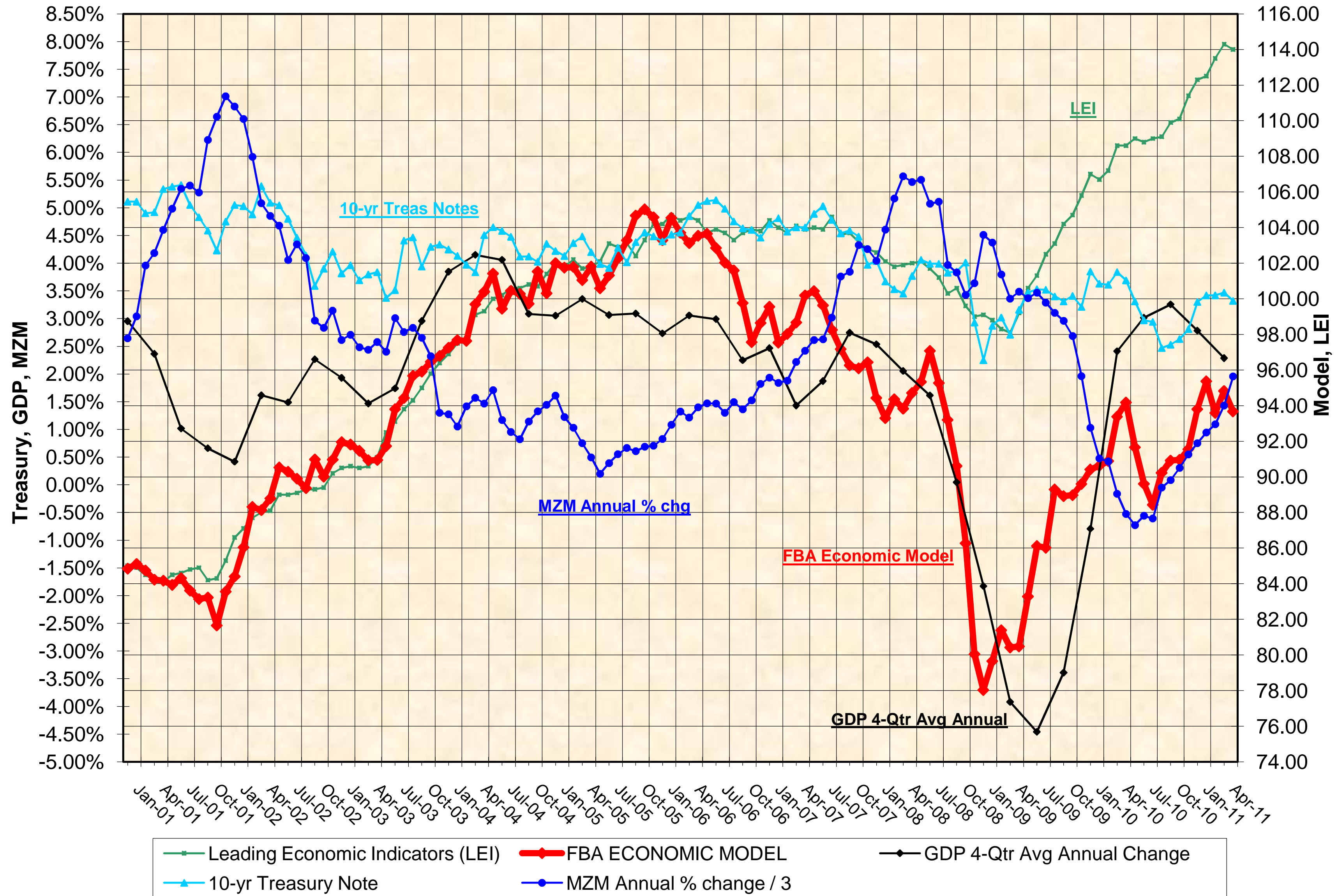
Front Barnett Associates LLC
Economic Model



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