INVESTMENT OUTLOOK

1ST QUARTER 2005

The end of another quarter and so much has changed. Corporate balance sheet repair is over. In the post Enron, Worldcom era, corporate America deleveraged their balance sheets, they didn't spend money on business expansion nor add to their labor forces. Corporate America paid down debt and accumulated the highest levels of cash since the 1970's. Now, those same Captains of Industry are desperate to "add to shareholders value" or I should say, goose their stock prices in order to grease their own greedy palms.

So "Katy bar the door", anything goes now! We are going to see more share buy backs, leveraged buy outs and take-overs. And yet, the accounting cockroaches continue to proliferate i.e. AIG, MBIA, Interpublic Group, El Paso Corp. Delphi Automotive and the list goes on.

Couple that with the Federal Reserve acknowledging and warning that "pressures on inflation have picked up in recent months and pricing power is more evident." It's clear, short term interest rates are moving higher.

Higher short term rates threaten stocks. The financial sector represents the largest percent of profits for the S&P 500. It represented 28% of earnings by corporations in the index last year. We are entering an environment that will take a while for higher rates to slow economic growth.

Go run and hide in commodities or real estate? Gee, how much more can and will those markets maintain their trajectory?

As you are reading you must think we have more questions than answers. Not in the least. Regarding corporate bonds, we have been stealthily getting out of high yield junk because default rates have no where to go but up. We are constantly re-examining the underlying credit quality of your municipal bond holdings since MBIA, the largest municipal bond insurer, is restating earnings going back to 1998 and clearly has done some illegal deals in order to smooth out earnings. Which begs a larger question; Do they really have the reserves they and the accountants say they do?

We continue to maintain your short durations. It seems with every economic release the bond market sits on a trigger of volatility. This creates buying opportunities and we will continue to take advantage of them.

Just look at your "Yield to Worst" report that is organized in maturity date order. For clients that have been fully invested in corporate bonds, you've got positions maturing this year and increasing percentages in 2006, 2007 and 2008. Between maturities, potential calls and cash flows, your portfolios are positioned to be reinvested at "hopefully" higher rates.

Municipal bond investors; the beauty of your high coupon premium bonds is that if we pass the 2005 call dates your yield kicks up and keeps up with short rates.

We will reach a point in the cycle when; higher short term rates coupled with the high cost of gas, oil, higher prices for consumer goods, fear of faster and tighter monetary policy will spook and slow economic growth. That will take several more months but it will happen. In the meantime, expect to earn your coupon income.

We've had a great multi-year run in the bond market. Last June, when the Fed began moving Federal Funds from a 40 year low of 1%, marked the end of a chapter. Now, after seven rate hikes we can see there's more work to be done. It's not a Bear Market for bonds just a readjustment...a badly needed one.

Please feel free to call with any questions or remarks.

Marilyn