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America's Trusted Wealth Advisor

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CAPITAL MANAGEMENT

U.S. ECONOMIC PROJECTIONS

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FOR WEEK OF MAY 3, 2004

RAISING THE BAR TO MEMBERSHIP

CURRENT MARKET FOCUS

As the European Union welcomes 10 new countries into its ranks effective May 1, U.S. financial markets seem to be raising the qualifications for gains. Economic and profit numbers need to excel to meet investors' elevated standards.

First-quarter GDP (gross domestic product) just barely passed the test, with a less-than-expected annualized gain of 4.2%. Consumer spending, government outlays, business investment in equipment and software, exports and housing all posted gains. Inventory building fell short of expectations, but a catch-up in the second quarter could boost GDP growth to an annualized pace of 5.2%.

March economic indicators promptly paid their dues. Sales of existing single-family homes jumped 6% to the highest level since last September, while new-home sales advanced 9% to an all-time high. Consumers kept their wallets moderately open at quarter's end with a 0.4% advance in spending, supported by an equal rise in after-tax income.

Early numbers for April suggest that the economy is eager to remain in expansion mode. The Conference Board reported an impressive leap in its measure of consumer confidence, while the University of Michigan revised upward its estimate of April consumer sentiment. Finally, the Chicago Purchasing Managers' Index reflected the rebound now taking place in the nation's industrial heartland.

Rising inflation could block the economy's membership in the sustainable growth club, although numbers still remain reasonably contained. Employee costs jumped 1.1% in the first quarter on rising benefit costs, but were likely offset in large part by further advances in output per hour. The most comprehensive measure of underlying inflation — the personal consumption price index excluding food and energy — did rise at an annualized pace of 2.0% in the first quarter, suggesting that companies are experiencing an increase in pricing power.

THE WEEK AHEAD

The coming week will proffer a series of data trials, with the jobs report serving as the ultimate initiation.

Look for the remaining March reports to substantiate prior releases pointing to a notable rebound from February. Better weather probably boosted construction spending, while a pickup in outlays for capital spending and inventories likely pushed factory orders sharply higher. Consumer borrowing also probably picked up as consumer confidence and spending improved.

Expect first-quarter productivity to record a solid, but not outsized advance similar to the 2.6% growth rate of the prior quarter. This moderation in output-per-hour growth will be key to companies gradually ramping up new hiring.

April economic reports should show the economy acceding to a program of sustained growth. Look for readings on manufacturing and non-manufacturing activity from the Institute for Supply Management (ISM) to reflect a broad-based buy-in of the expansion theme. Meanwhile, expect

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another sizable boost in motor vehicle sales, perhaps to their highest number since December, as tax refunds and purchase incentives continue to lure buyers.

Finally, look for Friday's jobs report to endorse the recovery theme with a gain of around 180,000 new workers. Job growth may only be able to nudge the unemployment rate down a tad to 5.6%, but the payroll number should be enough to scrap the notion that this recovery is a jobless one.

THE STOCK MARKET

Despite generally good earnings news, stock market bulls found little support among their peers this last week. Ongoing concerns about interest rates and the situation in Iraq sapped much of investors' enthusiasm.

As of noon on Friday, all three major market indices — the Dow Jones Industrial Average, S&P 500 Index and Nasdaq — appeared headed for losses for the week.

Companies in the materials industry (steel, copper, aluminum, etc.) were hit especially hard on word that the Chinese government is continuing to pursue efforts to cool down its economy. Technology stocks also were adversely affected by disappointing results by JDS Uniphase and LSI Logic Corp.

Fewer companies are up for review during the coming week, although they will merit attention. Companies reporting results include: Qwest Communications (telecom); Northrop Grumman (industrials); Calpine (utilities); Clear Channel Communications (consumer discretionary); and Prudential, MetLife and MBIA (financial s).

On balance, rising sales volumes, firming pricing power and ongoing gains in operating efficiencies should drive operating earnings for the S&P 500 universe of large companies up by around 19% this year. This would even top last year's 17% climb and should ultimately offset some of the anxiety now prevalent in the stock market fraternity.

THE BOND MARKET

Economic and inflation data continued to impose hefty fines on the bond market this past week. By Friday, the yield on 10-year U.S. Treasury notes had climbed to 4.51%, not much higher than the prior week's close of 4.48% but up by more than three-quarters of a percentage point from the March low.

The jump in the Federal Reserve's preferred inflation barometer — the personal consumption price index excluding food and energy — to an annualized rate of 2.0% was particularly disturbing for the bond market. It was nearly double the 1.2% rate of the prior quarter and contrasted sharply with the inflation pace of less than 1.0% registered just a year ago.

Do not expect the Federal Reserve to overreact to one or two data points; however, look for the Fed to change its assessment of the balance of risks at the conclusion of its policy-setting meeting this coming Tuesday. In contrast to the view that the risk of lower inflation outweighs that of higher inflation, look for policymakers to shift to a neutral position. This will start the countdown toward the first rate hike, which we believe will take place in August unless employment and price numbers show surprisingly strong gains during the next two months.

April 30, 2004

INDICATORS TO WATCH

Indicator	Institute for Supply Management Manufacturing Index – April
Release Date	Monday, May 3, 10 a.m. Eastern
March	62.5
Forecast	63.0 (62.8 to 63.2 range)
Comments	Look forward to signs of further strength in the manufacturing sector as rising capital spending, exports and inventory rebuilding boost orders, output and pricing power.

Indicator	Construction Spending – March
Release Date	Monday, May 3, 10 a.m. Eastern
February	-0.1%
Forecast	0.5% (0.3% to 0.7% range)
Comments	Anticipate higher construction spending for March in part because of better weather. Residential building probably led the advance.

Indicator	Auto and Light Truck Sales – April
Release Date	Monday, May 3
March	16.6 million
Forecast	17.0 million (16.9 million to 17.1 million range)
Comments	Expect an increase in motor vehicle sales as manufacturers heavily promoted products in April to reduce inventories and consumers benefited from tax refunds.

Indicator	New Factory Orders – March
Release Date	Tuesday, May 4, 10 a.m. Eastern
February	1.1%
Forecast	2.2% (2.0% to 2.5% range)
Comments	Count on total factory orders to be much improved, with the durable goods segment already reporting a hefty 3.4% advance. Nondurable goods orders also should reverse some of the loss registered in February.

Indicator	FOMC Meeting
Release Date	Tuesday, May 4, 2:15 p.m. Eastern
Comments	Expect no change in the target federal funds rate, but look for some significant changes in the press release. Anticipate a more upbeat message on the economy, acknowledging a pickup in job growth but also a firming in core inflation. Expect a shift in the Fed's assessment of risks to indicate that the risk of higher inflation is now equal to the risk of lower inflation.

Indicator	Institute for Supply Management Non-Manufacturing Index – April
Release Date	Wednesday, May 5, 10 a.m. Eastern
March	65.8
Forecast	65.0 (64.9 to 65.5 range)
Comments	Do not be disappointed to see some erosion in this index of non-manufacturing activity from the record high set in March. A reading around 65.0 still indicates that a substantially larger percentage of companies are reporting stronger as opposed to weaker conditions.

Indicator	Initial Claims for Unemployment Insurance – week ended 4/1/04
Release Date	Thursday, May 6, 8:30 a.m. Eastern
Prior Week	338,000
Forecast	340,000 (337,000 to 342,000 range)
Comments	Expect jobless claims to remain at a relatively subdued level as corporate confidence continues to strengthen.

Indicator	Productivity and Costs – 1Q04 Preliminary
Release Date	Thursday, May 6, 8:30 a.m. Eastern
Prior Release	2.6%
Forecast	2.7% (2.5% to 3.0% range)
Comments	Look forward to another healthy boost in output per hour as firms continue to reap the benefits of prior investments in equipment and software. Still, do not be surprised if these productivity gains fail to prevent a rise in unit labor costs, the first in a year.

Indicator	Unemployment Rate – April
Release Date	Friday, May 7, 8:30 a.m. Eastern
March	5.7%
Forecast	5.6% (5.6% to 5.7% range)
Comments	Do not expect a vast change in this indicator, as job growth was likely sufficient to at least accommodate those entering or reentering the workforce. The unemployment rate should slowly drift lower as we move through 2004, however, with job growth slightly outpacing the rise in the labor force.

Indicator	Nonfarm Employment – April
Release Date	Friday, May 7, 8:30 a.m. Eastern
March	308,000
Forecast	180,000 (160,000 to 200,000 range)
Comments	Anticipate another significant increase in jobs, although not as strong as the bounce reported for March. Recent data on the economy suggests that company revenues and profits have been strong enough to justify a step-up in hiring.

Indicator	Hourly Earnings – April
Release Date	Friday, May 7, 8:30 a.m. Eastern
March	0.1%
Forecast	0.2% (0.2% to 0.3% range)
Comments	Look for continued modest wage gains as companies remain attentive to costs and considerable slack persists in the labor market.

Indicator	Consumer Credit – March
Release Date	Friday, May 7, 3 p.m. Eastern
February	$4.2 billion
Forecast	$8.0 billion ($7.0 billion to $8.2 billion range)
Comments	Count on a sizable pickup in consumer borrowing as spending on cars and other goods and services ramped up during the month.

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ECONOMIC FORECASTS

	2003Q3a	2003Q4a	2004Q1a	2004Q2f	2004Q3f	2004Q4f	2003a	2004f
Real GDP (% chg. annual rate)	8.2	4.1	4.2	5.2	4.3	4.3	3.1	4.8
CPI (% chg. annual rate)	2.3	0.7	3.6	2.9	1.7	2.0	2.3	2.2
Personal Consumption Price Index (% chg. annual rate)	1.8	1.0	3.2	2.0	1.5	2.0	1.8	1.9
S&P 500 Operating Earnings ($ per share)	14.42	15.10	15.75	16.25	16.50	17.50	55.50	66.00
Federal Funds Rate (%, end of period)	1.00	1.00	1.00	1.00	1.25	1.50	1.00	1.50
10-Year Treasury Note Yield (%, end of period)	3.96	4.27	3.86	4.65	4.80	5.00	4.27	5.00
Euro ($/euro, end of period)	1.17	1.26	1.23	1.19	1.20	1.20	1.26	1.20
Yen (yen/$, end of period)	111	107	104	108	105	103	107	103

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