

Monthly Chartbook

February 2004

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Executive Summary

Robust Growth Continues

- Global nature of recovery seen in rebound of moribund markets like Japan as Chinese growth spreads across Asia.
- IPO and Merger & Acquisition activity starting to heat up in the US markets.
- Mutual Fund flows positive and rising, signaling increased confidence and risk taking.
- *Data we follow have not changed drastically in the last 3-4 months. Continued growth domestically is status quo.*

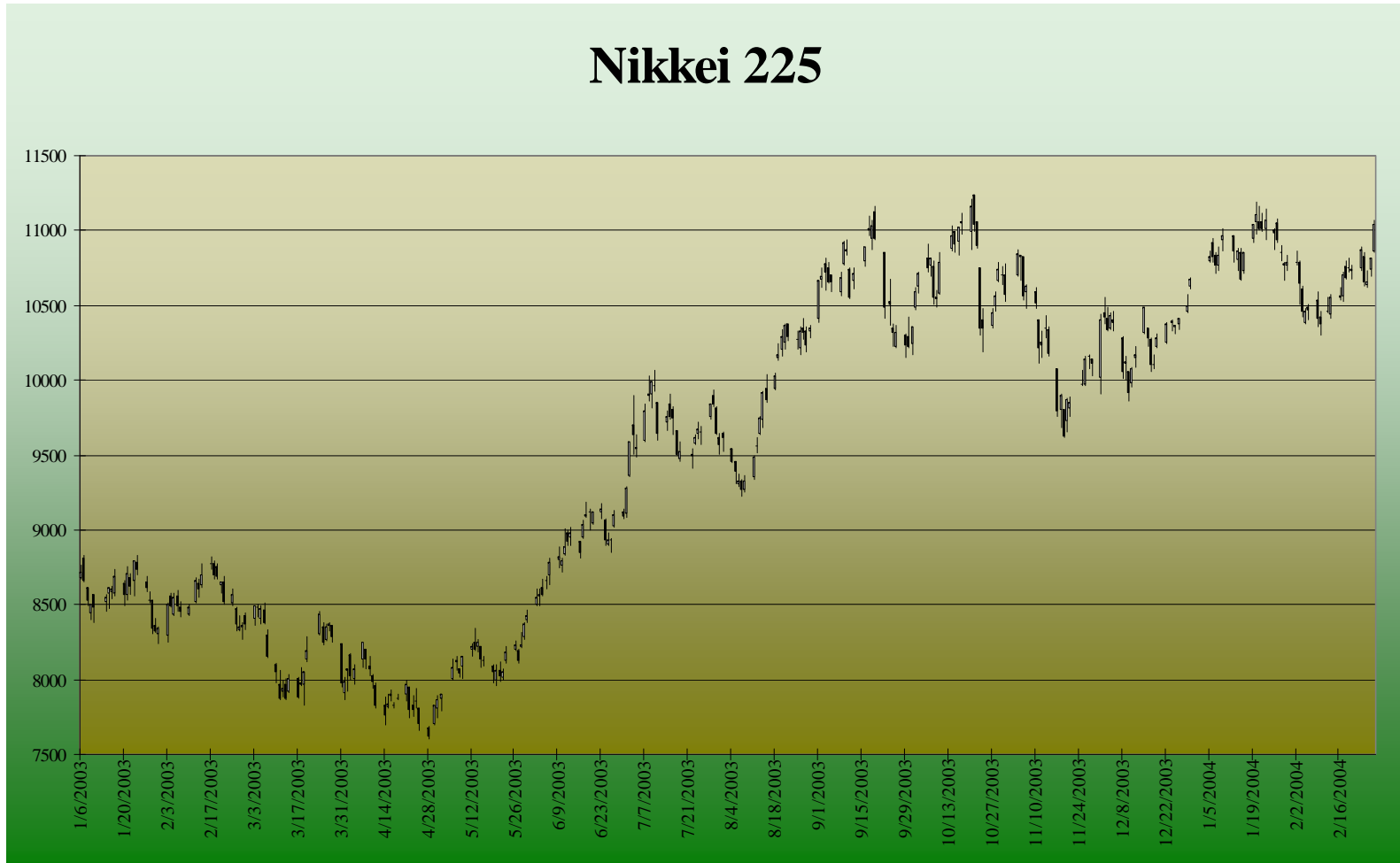
Executive Summary

- Don't be fooled by the weaker than expected Consumer Confidence numbers. Democrats have been “poor mouthing” the economy for weeks. Solid growth continues and job growth, while lagging, will kick in during 2004.
- Expect strong GDP and earnings growth going into the Presidential Election; a campaign platform based on a weak economy will be ineffective.
- The Federal Reserve has moved rates higher in election years before. If they don't, rate increases will be back loaded in November and December of this year.
- Things to watch for
 - **Rising Asia, expansion in China is boosting economies across the region**
 - **Energy prices (Oil/Gasoline/Natural Gas) tight supplies and growing demand may lead to problems**
 - **Weak Dollar**

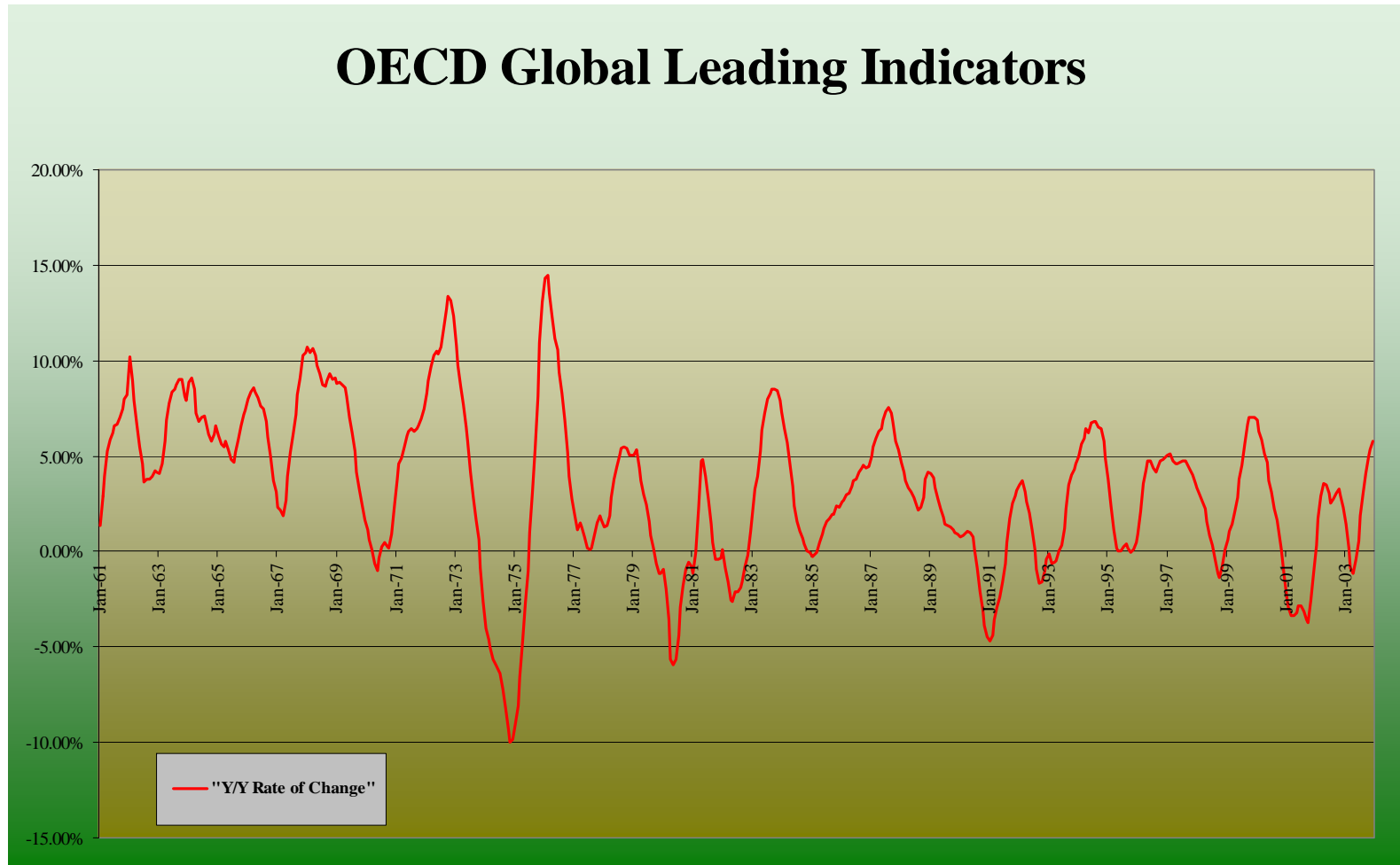
Capital Markets Expectations

Index	Current	Forecast		Range	Time Frame
S&P 500	1144.91	Trading range	↔	1050-1200	10-12 Months
Ten Year Treasury	4.05%	Bottomed June 2003	↑	4.00%-4.625%	10-12 Months
Inflation (all Urban)	1.98%	2.25%	↑	1.75%-2.25%	10-12 months
Fed Funds	1.00%	1.00%-1.50%	↑	1.00%-1.75%	6-10 months
S&P 500 Earnings	\$40.65	\$47	↑	\$42-55	4q2004
	Legend:	↑ "Good"	↓ "Bad"	↔ "Indifferent"	

Macro-economic Research



Japan is moving sharply higher, joining the global recovery as confidence and exports improve.

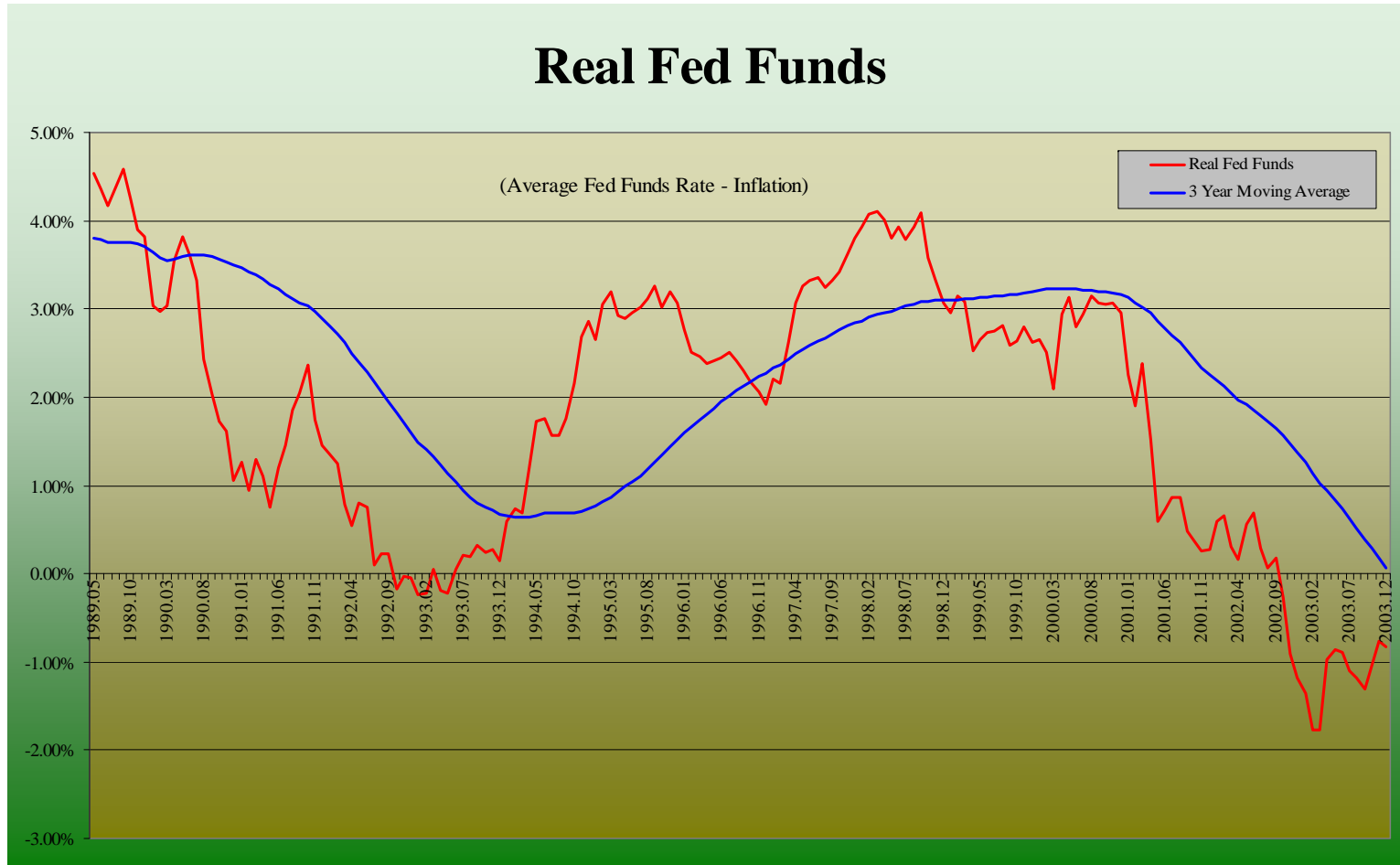


Global growth has rebounded sharply in the last six months.

Federal Reserve Watch

- Real Fed Funds have been negative for a prolonged period of time. We do not expect the Fed to keep real short term interest rates negative for years and years on end.
- Monetary policy is still accommodative, but look out for marginal tightening going forward.
- Rates rising .50% to 1.00% would not kill off this recovery; indeed, we believe it would confirm that it can be sustained.

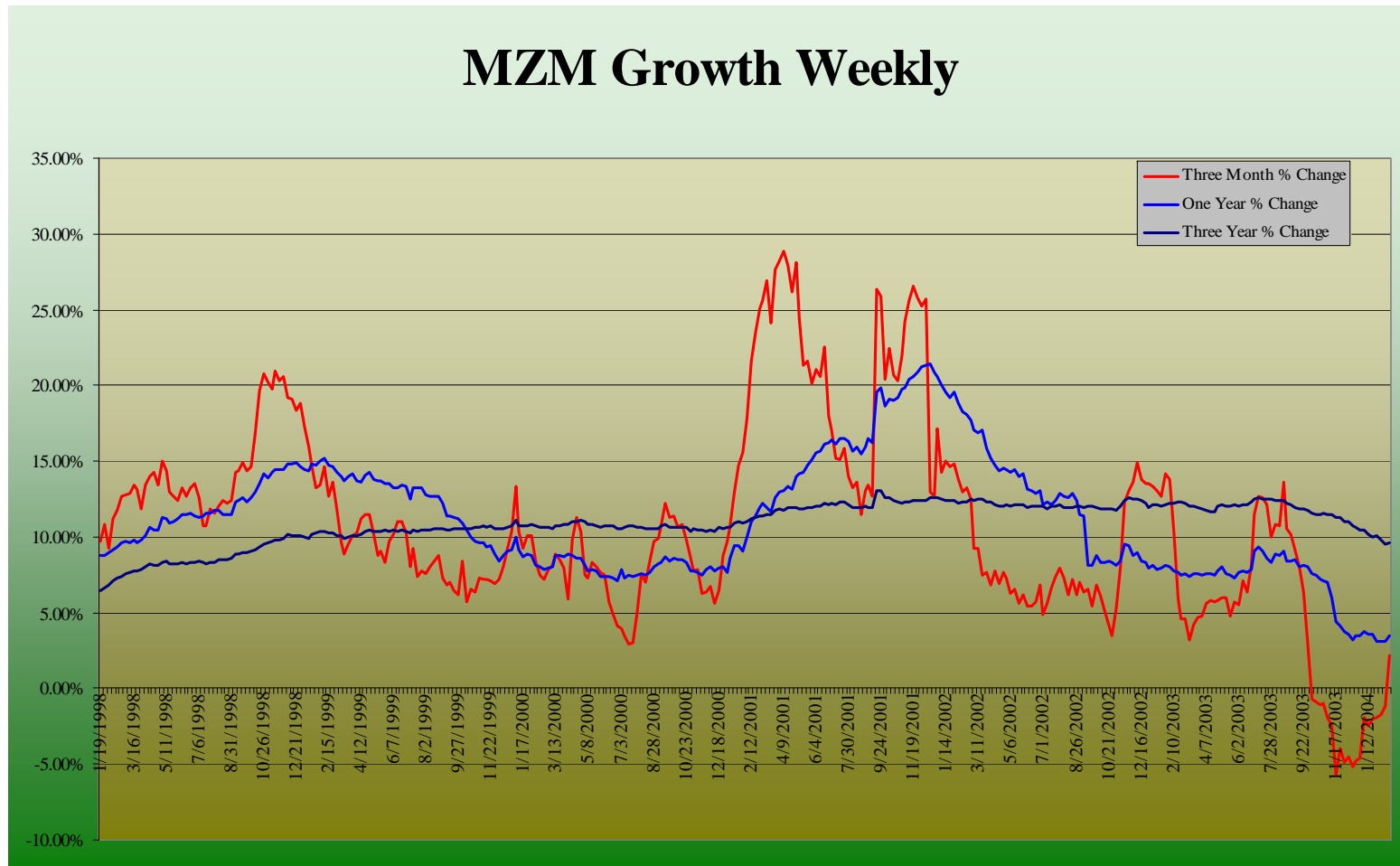
Federal Reserve Watch



The negative Fed Funds Rate explains why Bank & Money Market Yields are so low.

We believe the Fed will have few reasons to keep real interest rates negative as employment and output improve.

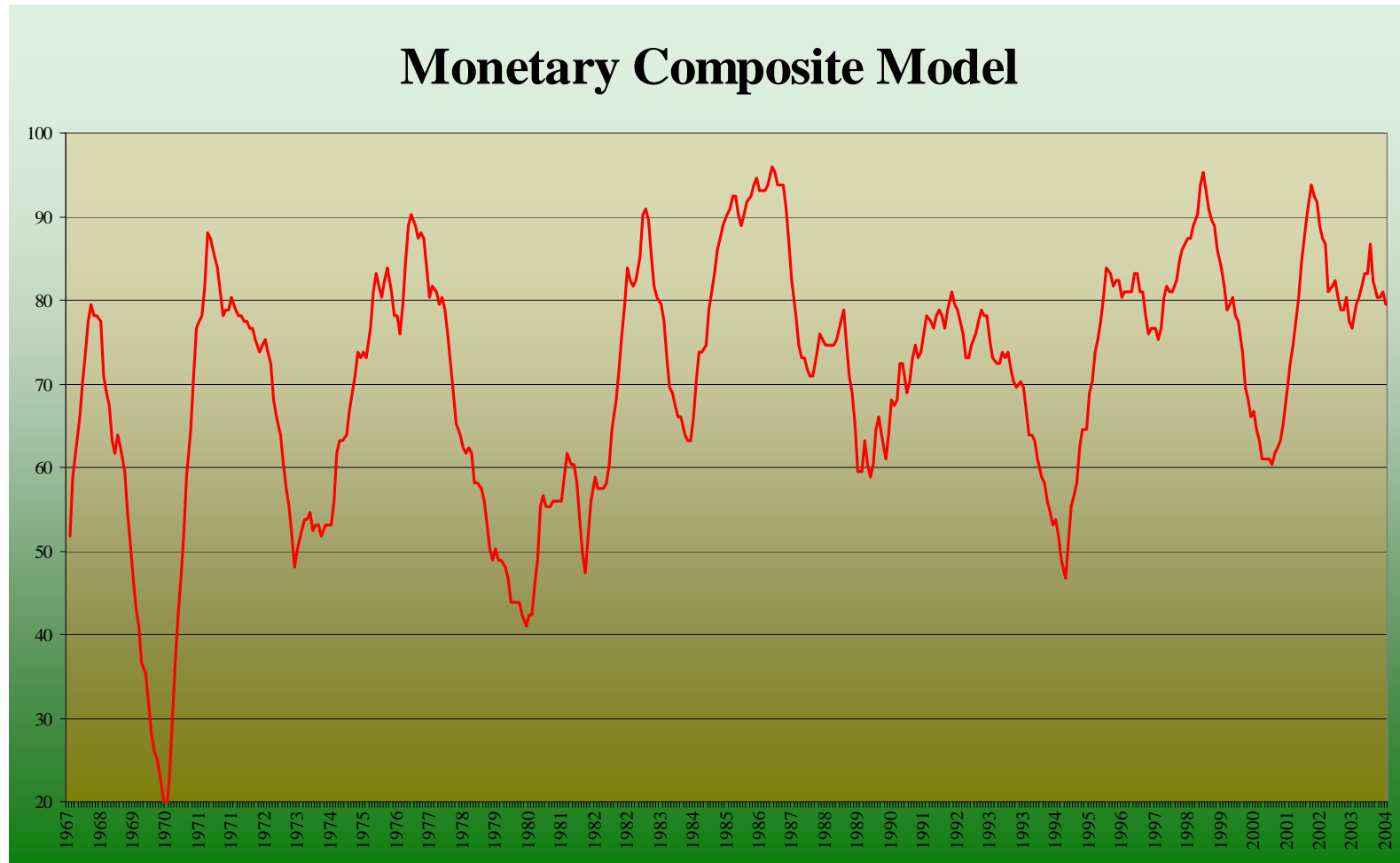
Federal Reserve Watch



Money Zero Maturity (MZM) is a broad measure of liquidity that is significant to lending, business activity, and equity prices.

The 3 month growth rate of money supply continues to improve considerably.

Federal Reserve Watch



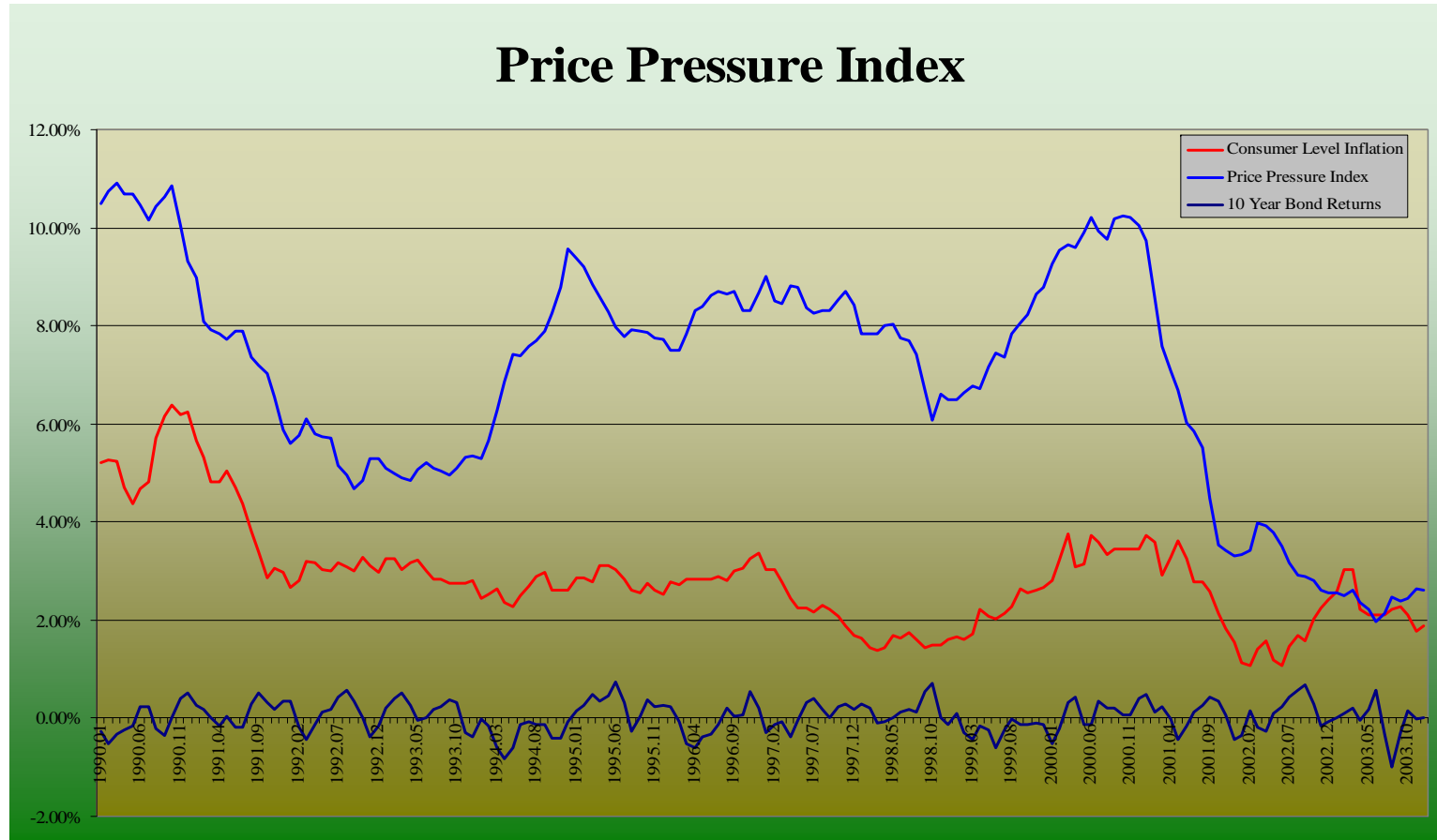
The direction of trend in this series is as important as the level. A score above 50 indicates the Fed's monetary policy is accommodative.

Money supply growth has been flat month to month in recent months.

Inflation expectations

- We may have recently reached an inflection point in prices. The future bias is towards higher rates of inflation as our proprietary Price Pressure Index bottomed June of 2003.
- Energy prices are the biggest current concern on the inflation horizon. But because they are not part of the “core” rate of inflation, many will discount this as unimportant. Beware, if energy prices remain stubbornly high, they will bleed over into the core rate of inflation.
- The market anticipates higher inflation (2.5% expected versus 1.98% current) over the next cycle, as indicated by its pricing of inflation-protected Treasuries.

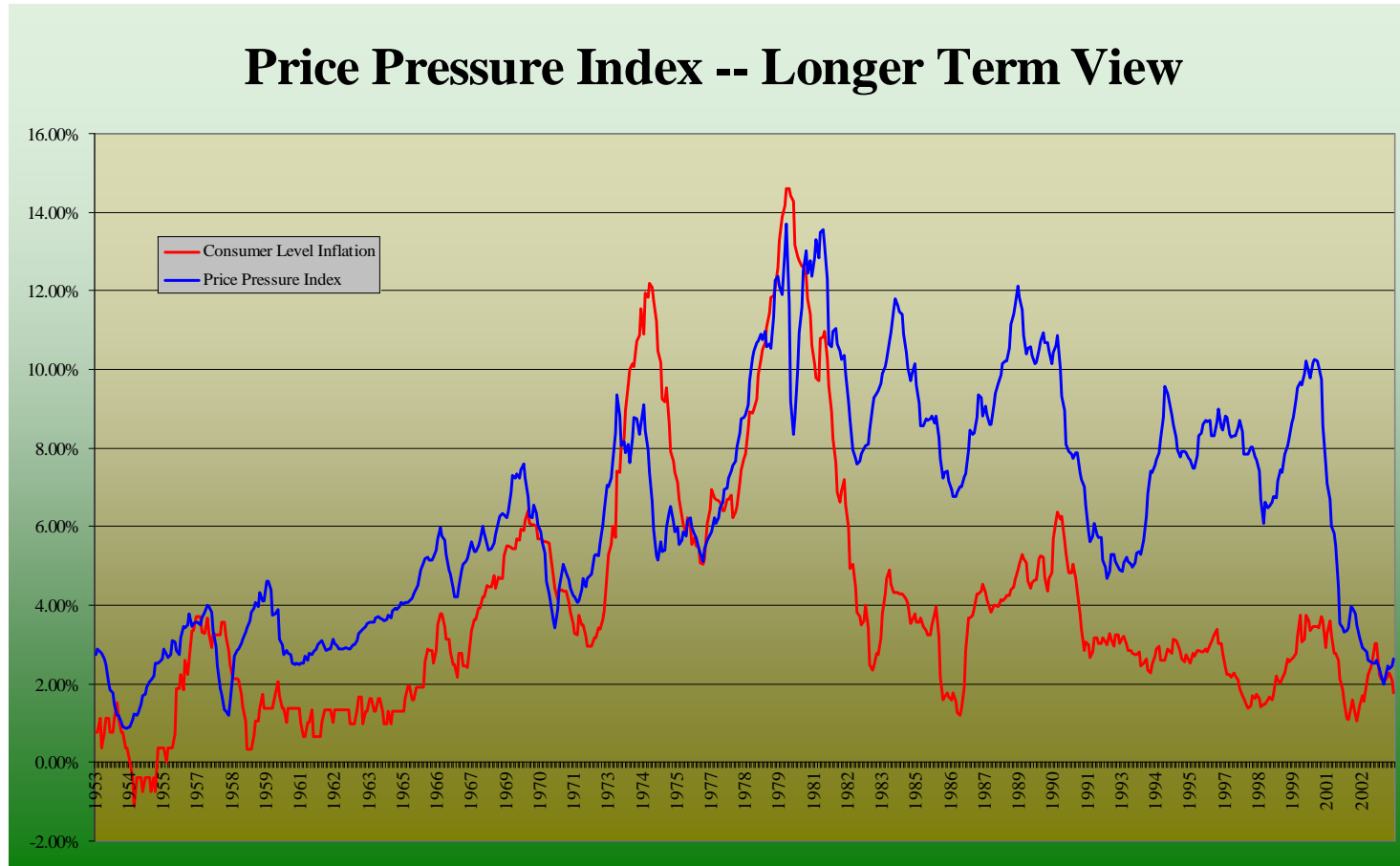
Inflation expectations



A declining index value indicates receding inflationary pressure within the economy, and a rising index value foretells higher consumer prices.

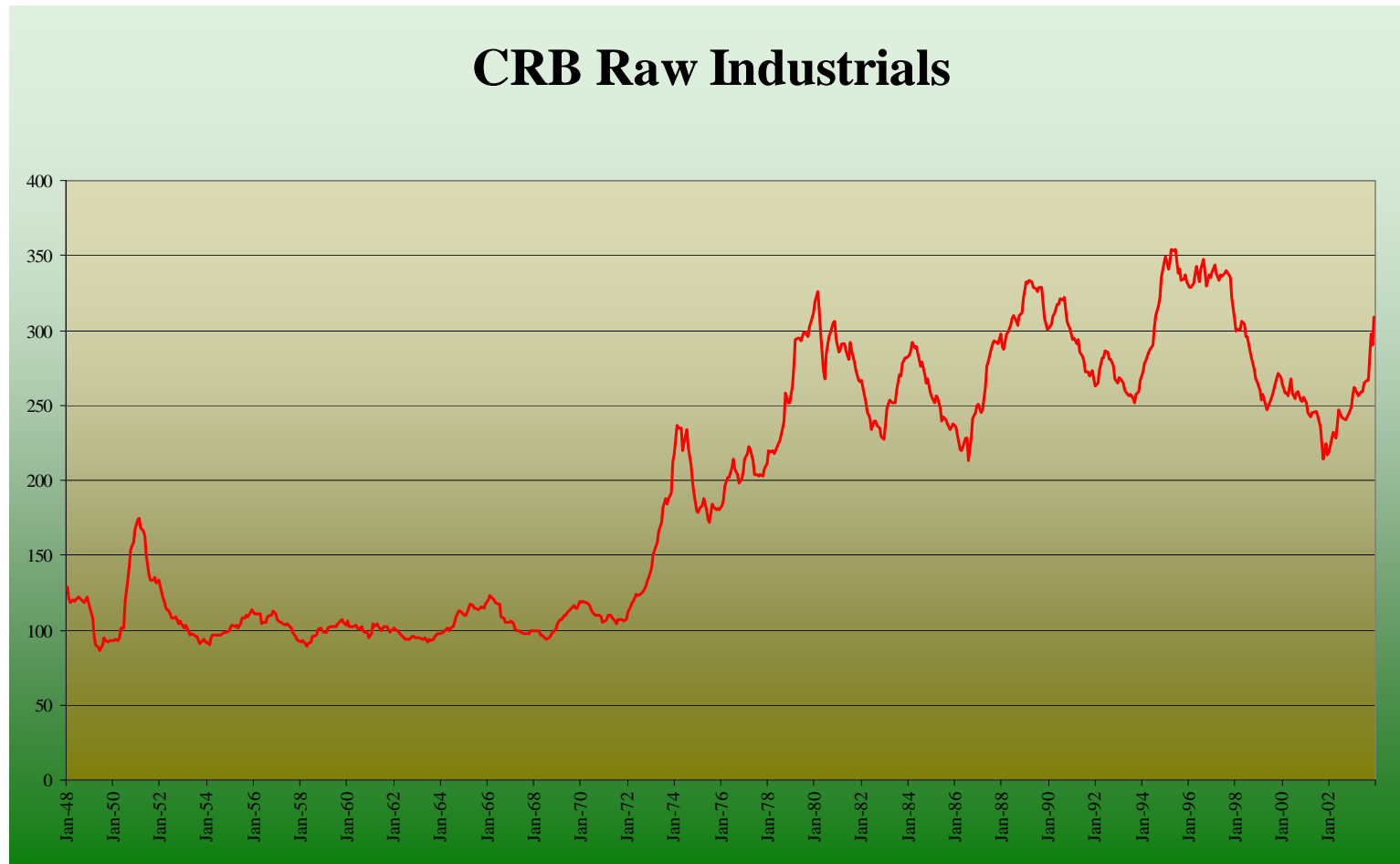
The Price Pressure Index bottomed June 2003.

Inflation expectations



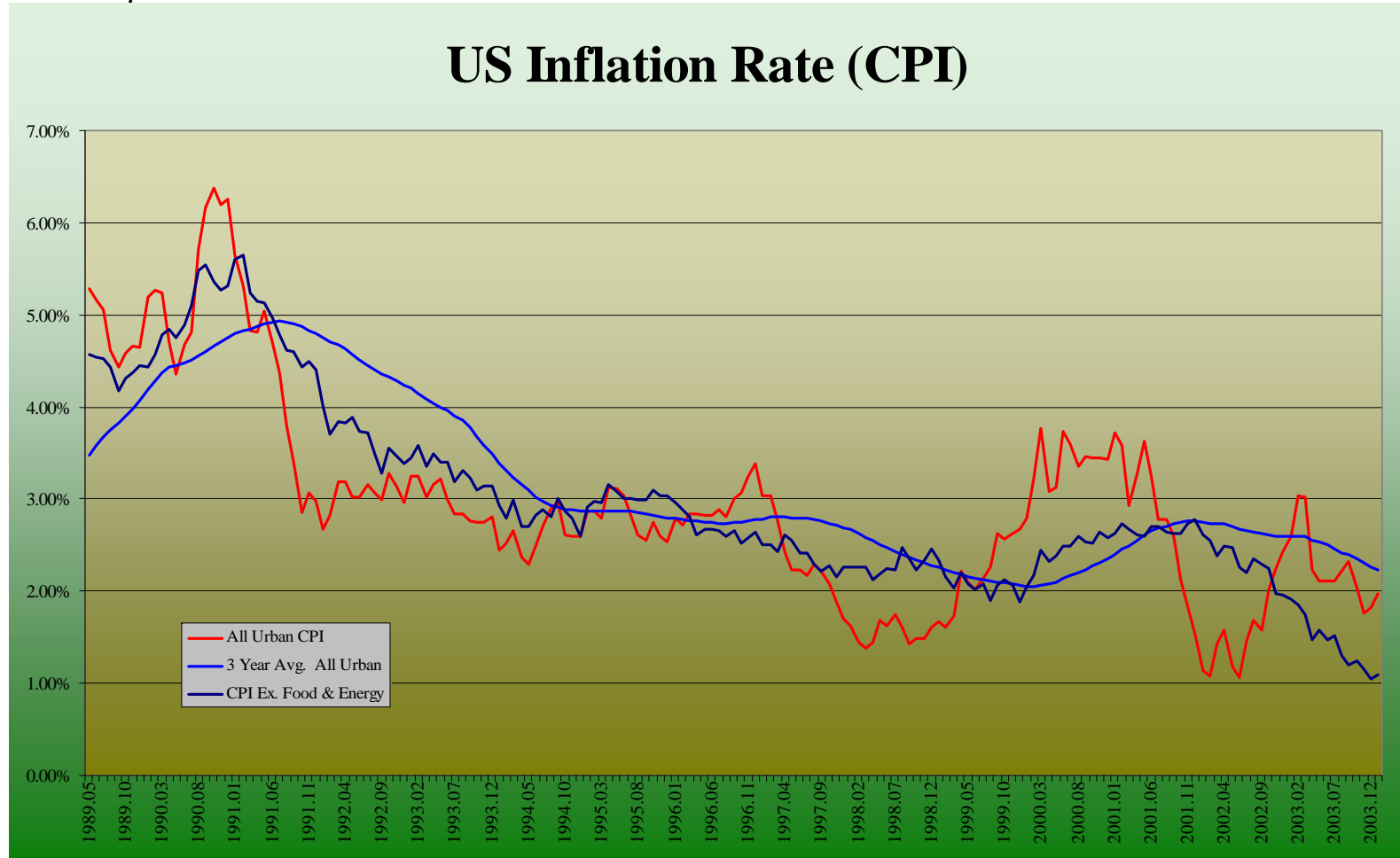
The Price Pressure Index is at its lowest levels since the mid-1950's.

Inflation Expectations



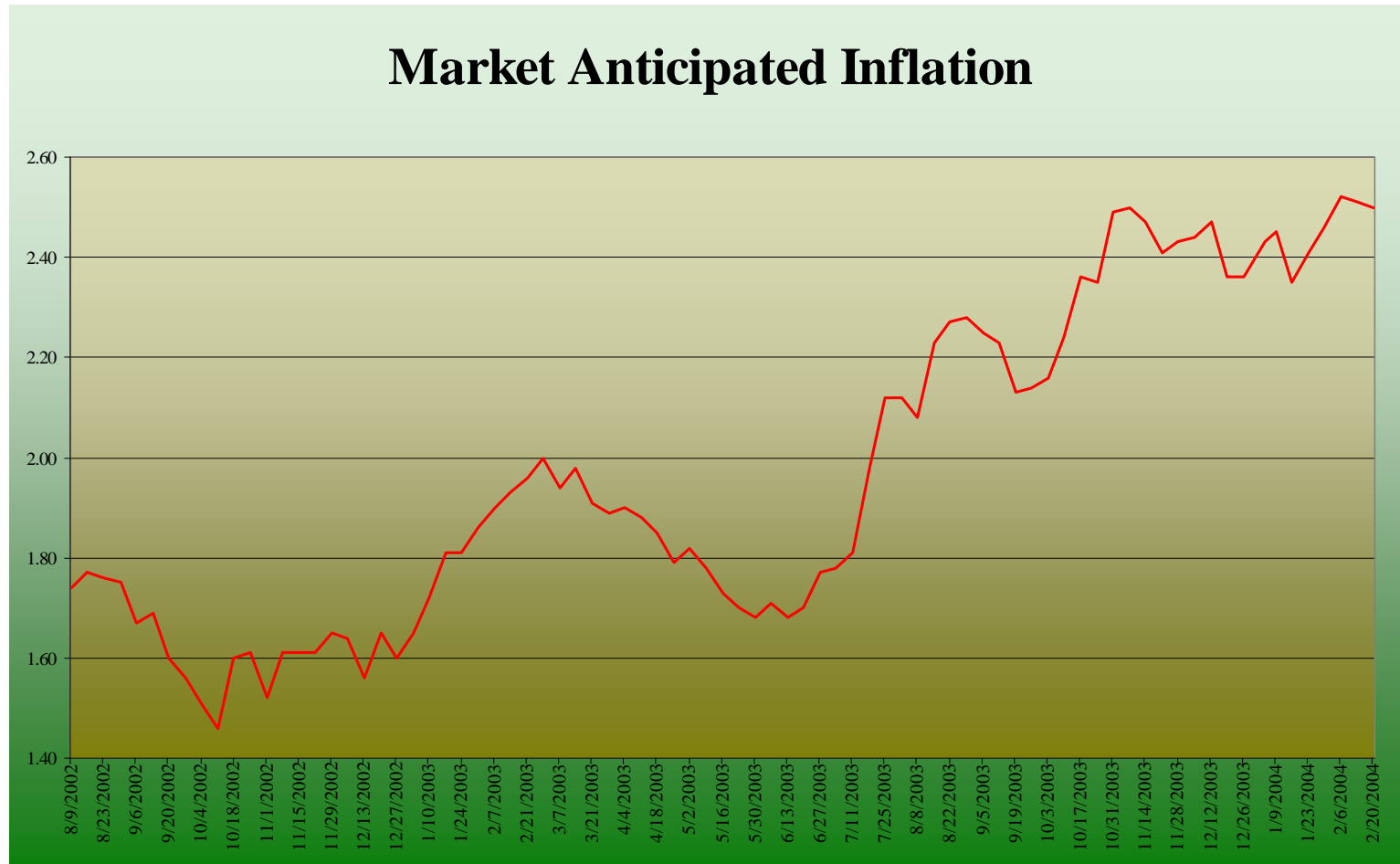
Raw materials prices bottomed in 2001 at almost the same time that China joined the World Trade Organization (WTO).

Inflation Expectations



Inflation remains low at the consumer level even though there has been an increase in the cost of raw materials. Core rate remains low, but “all urban” leads and is moving slightly higher.

Inflation Expectations

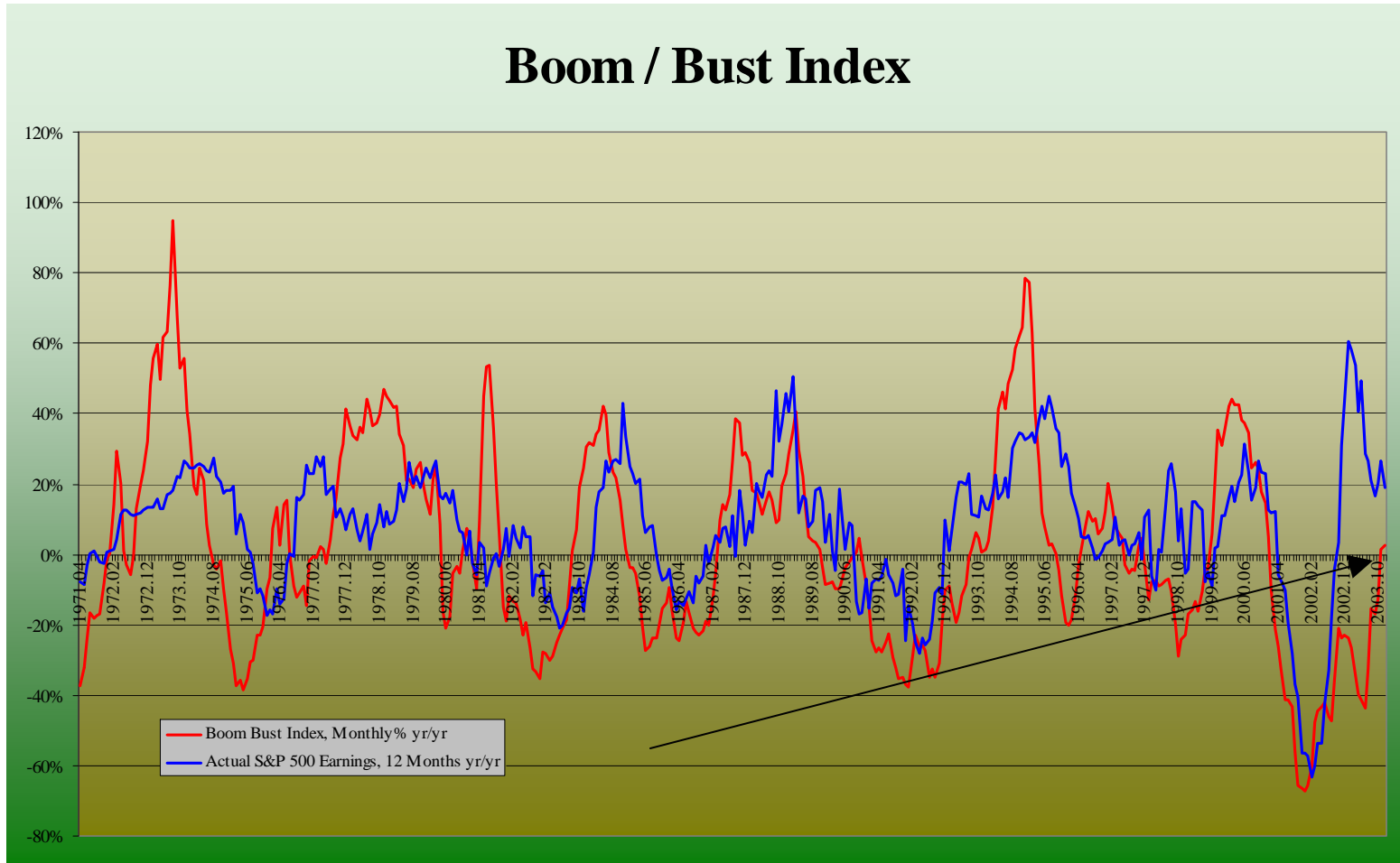


The market anticipates inflation (based on TIPS) to remain just below the 2.5% level over the next ten years. Inflation has averaged 1-3%, so that is right in line with experience.

Outlook & Forecast

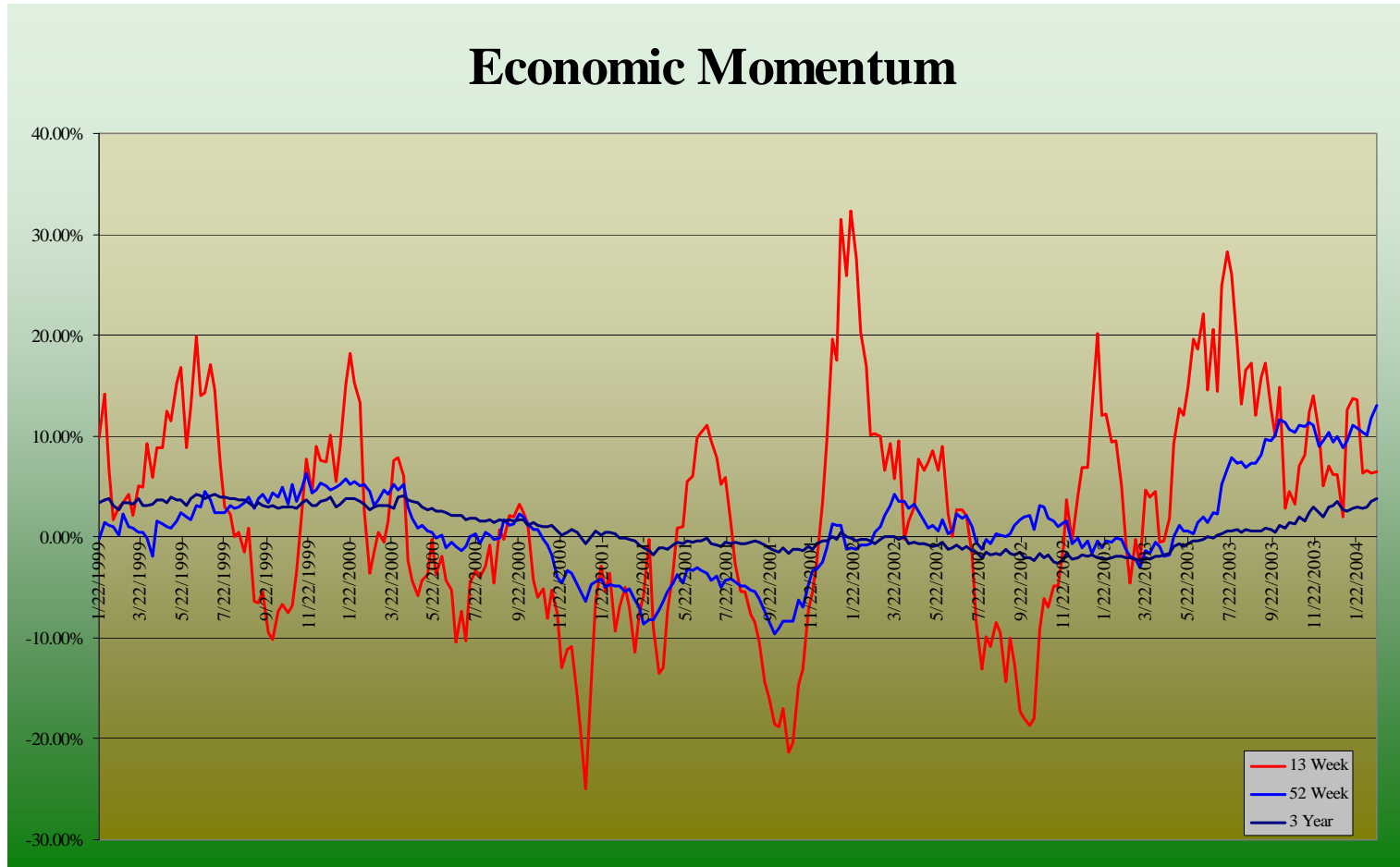
- Cornerstone is still cautiously optimistic:
 - Growth continues
 - Earnings will be strong.
 - Jobs creation is underway and will continue.
 - But, stocks are not cheap, and we don't see much low hanging fruit. Stock picking will be key.
- Equities with 2.0% to 4.0% dividend yields may be better income vehicles than most bonds at this point.
- Foreign exposure, particularly Asia including Japan is timely.

Outlook & Forecast



The Boom/Bust Index tracks several key variables within the economy that correlate with earnings. The red line is predicted S&P 500 earnings direction, indicating positive movement continuing for earnings.

Outlook & Forecast



Data presented is the ECRI Weekly Leading Indicators (source: www.businesscycle.com).
Y/Y Momentum continue to be at the highest levels we have seen in a number of years.