NEAR-TERM STOCKS / ECONOMY LINKAGE

In the next 12 months, the major wildcard is a compounding economic slump triggered by a larger than expected housing blowup resulting in broad-based layoffs, and reduced earnings estimates…

Otherwise, if the global and U.S. economy muddles along in fairly good shape, then further upside is certainly possible from the "economic" point of view.

Hopeful factoids: Earnings remain strong with no immediate sign of recession & reasonable valuations.

MARKET POSITIVES LONGER-TERM:

Profit Growth Forecasts Remain Strong Despite Market Jitters About Economy

Valuations Near 10-Year Low

BY ED CARSON
INVESTOR'S BUSINESS DAILY

Investors may be worried about inflation, interest rates and economic growth, but so far the earnings outlook remains robust.

Companies in the S&P 500 are expected to report an 11.2% gain in second-quarter profits vs. a year earlier, according to analyst forecasts compiled by Thomson Financial.

That would be the 12th straight quarter of double-digit growth. And growth is expected to accelerate in the second half of 2006.

The negative-to-positive ratio of earnings preannouncements for the second quarter is just 1.7, well below the typical 2.2.

"So far it's been quite good news for preannouncements," said David Dropsey, equity analyst for Thomson Financial.

Dirk van Dijk, director of research for Zacks Investment Research, agrees, seeing "zero evidence" of profit weakness.

"If things were going to fall apart, the first place it would show up would be in earnings revisions," he said. "But analysts are overwhelmingly raising, not cutting, estimates."

Eight of the 10 sectors Zacks follows are showing more upward earnings revisions in the past four weeks. Seven are enjoying a positive profit revision of 1.25 or more.

That hasn't helped the stock market. The Nasdaq fell 2% on Monday to a seven-month low while the small-cap S&P 600 sank 2.5% to a five-month nadir.

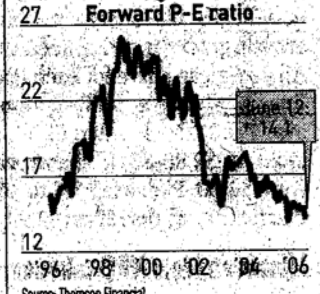
That combination of strong earnings and weak stocks continues to tighten the spring for the stock market.

The forward price-to-earnings ratio has fallen to 14.1. That's the cheapest since hitting a long-time low in mid-October, when the mar-

SEE EARNINGS ON A2

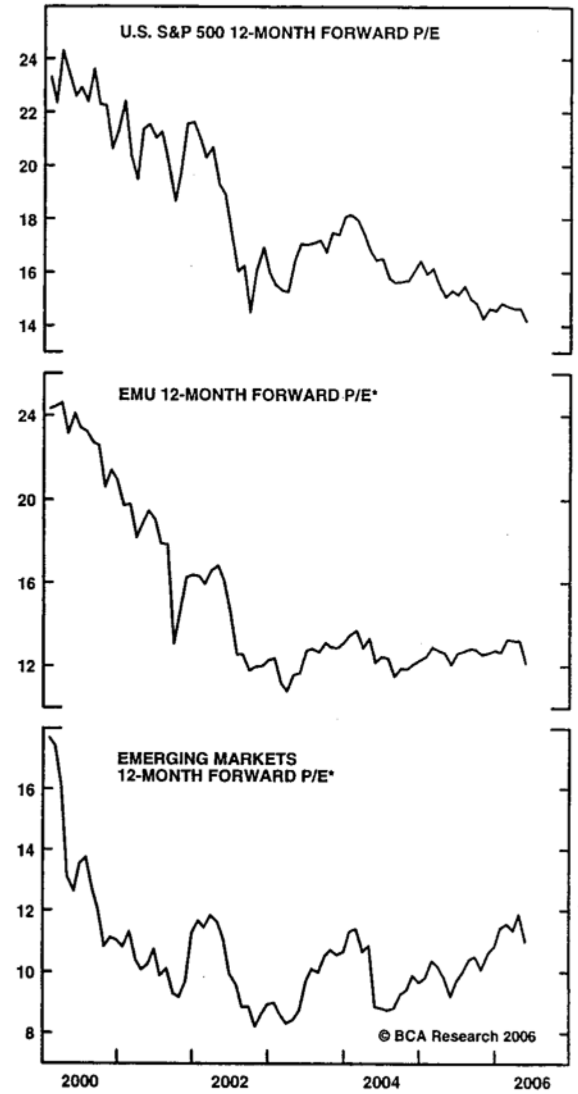
Getting Cheap

Falling stock prices and rising earnings are lowering valuations



Source: Thomson Financial

CHART 6
Equity Valuations Are Reasonable



*SOURCE: THOMSON FINANCIAL / IBES

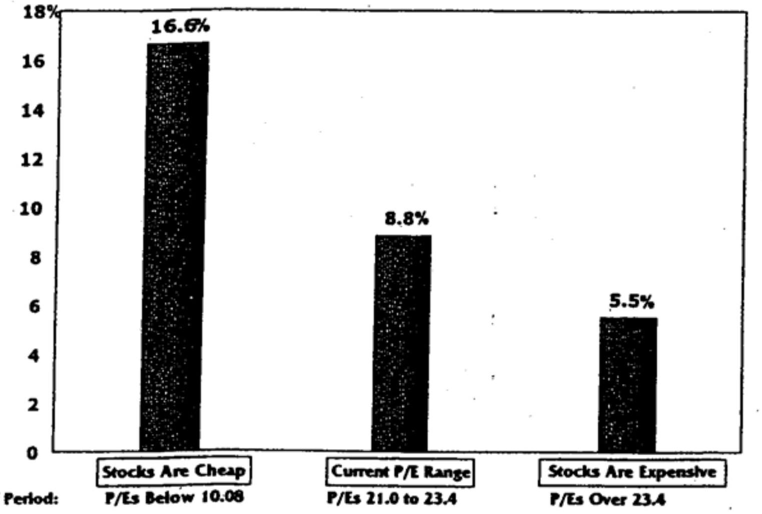
① PROFITS REMAIN SOLID

② VALUES NOT OUT-OF-LINE

③ THE MARKET RALLIED ON APRIL EPS BUT CRASHED IN MAY ON FED FEARS

Valuations not yet at levels typical of stock underperformance

re 3. S&P 500 Median 10-Year Annualized Return Various Valuation* Levels: 1950 to 2003



*Valuations are based on normalized earnings, an average of reported earnings over the prior five years. As of September 30, 2004, the price-earnings ratio of the S&P 500 was 21.5 based on this measure.
Source: The Leuthold Group.

CAN STILL MAKE SOME UPSIDE AT THESE PE'S

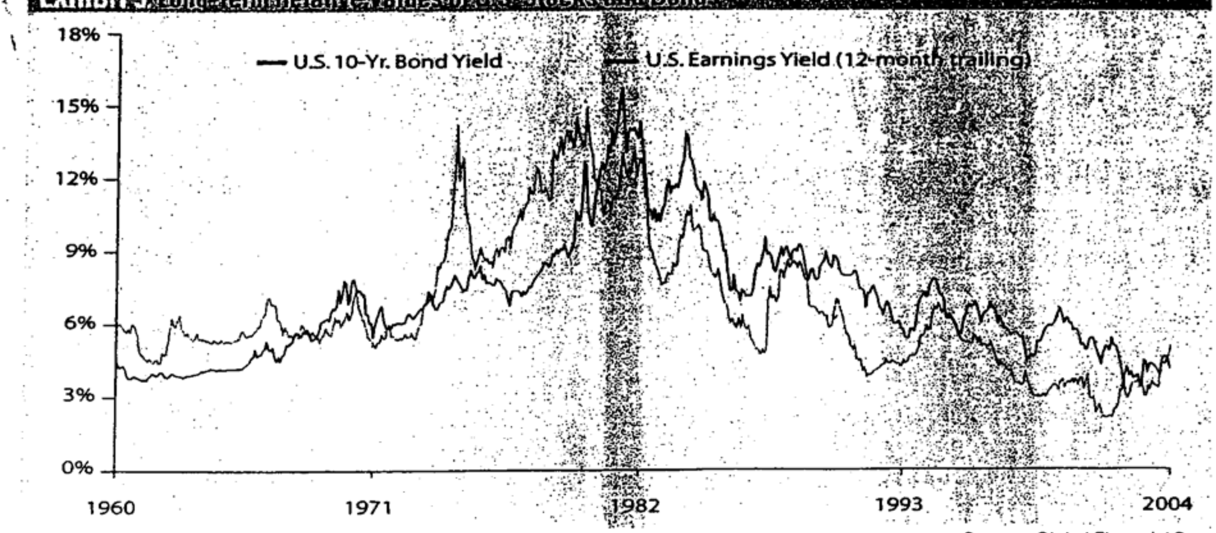
Where Do We Go From Here?

Looking ahead, equity returns will continue to depend on prospects for earnings, dividends and valuations. Despite strong earnings growth recently (four consecutive quarters of 20% year-over-year gains through the second quarter of 2004), some observers expect fairly modest growth in coming years—perhaps less than the long-term average of about 6%.

In addition, profit margins are at the highest level in several decades and the effective corporate tax rate is the lowest since World War II, so there could be more pressure on margins and therefore profits if economic growth slows or tax rates rise.

Kenneth L. Fisher is founder and CEO of Fisher Investments, Inc., a $24 billion money management firm. He is also Portfolio Strategy columnist for Forbes.

EXHIBIT 3: Long-Term Relative Values of U.S. Stocks and Bonds



Source: Global Financial Data

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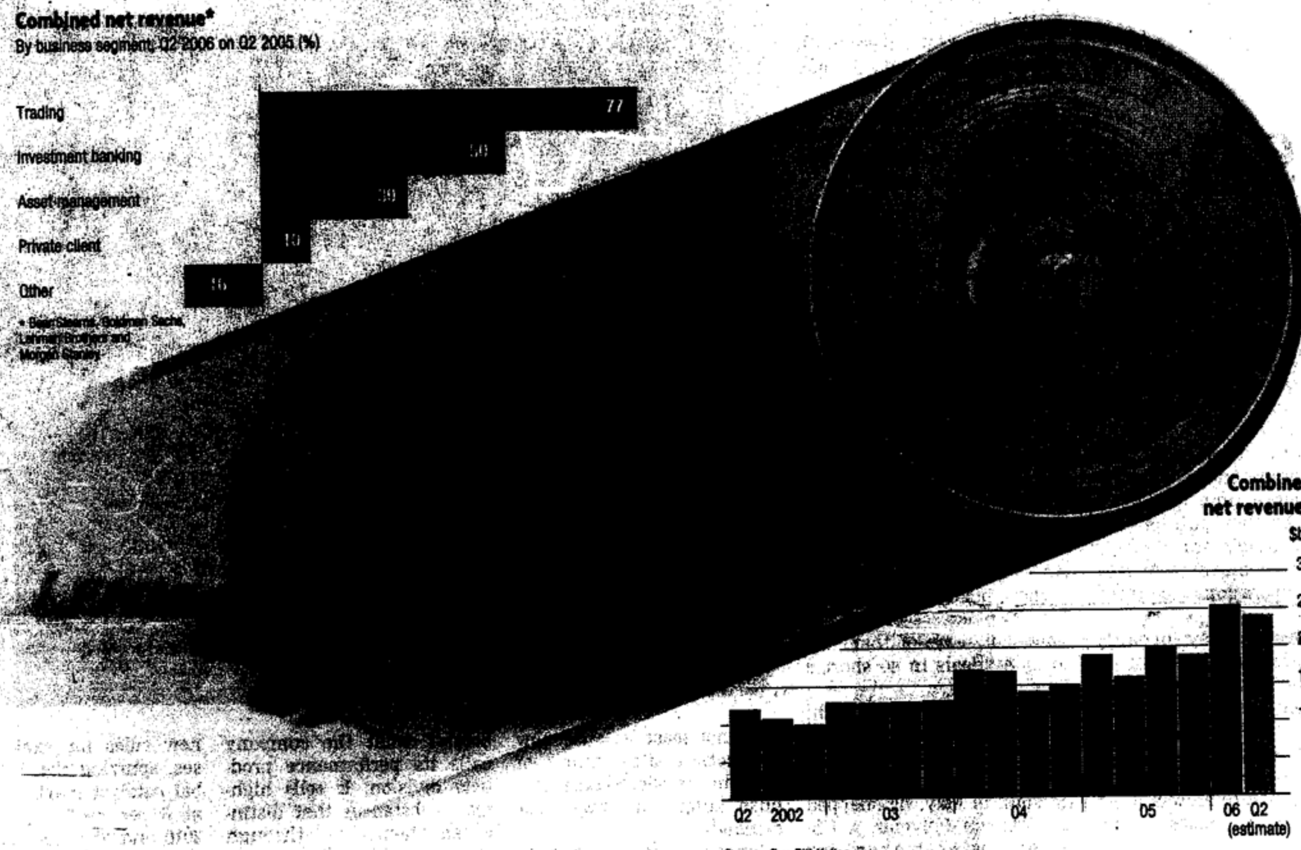
... and Wall Street profits remain high… usually good for stocks.

What's GOOD FOR Wall Street is usually good for stocks.

Bumper profits in store for Wall St banks

6-5-06 F.T.

By Peter Thal Larsen in London



FT montage

Wall Street investment banks are expected to shrug off market volatility to report the second most profitable quarter in their history in the next few weeks.

In spite of swings in equity, commodity and currency markets, analysts have been raising their earnings forecasts for Goldman Sachs, Morgan Stanley, Lehman Brothers and Bear Stearns.

The forecasts suggest that operating conditions for investment banks remain extremely strong. According to Thomson Financial, average earnings forecasts for the four banks reporting results later this month have increased since the correction. The most notable upgrade was for Goldman Sachs, which is now expected to report profits of $3.96 a share, compared with an average earnings forecast of $3.45 a share at the beginning of May.

This confidence is partly underpinned by the buoyant levels of activity before the market correction. In the three months to the end of May, equity underwriting volumes reached their highest level since the summer of 2000, boosted by initial public offerings from Kohlberg Kravis Roberts, the private equity group, and Debenhams, the retailer.

Fixed income underwriting has also remained strong in spite of rising interest rates. Investment banks also benefit from market volatility because it boosts trading volumes in the equity, bond and foreign exchange markets.

However, analysts have found it increasingly difficult to accurately predict quarterly earnings as the business has become more complex and banks have taken greater proprietary risks.

Observers point out that many hedge funds lost money in May owing to downturns in certain markets. Investment banks' proprietary trading desks, which use many of the same trading strategies as hedge funds, are likely to have reported similar results. Banks with significant exposure to emerging market debt and metals trading are also likely to have found conditions difficult.

Nevertheless, analysts say the investment banking industry is still enjoying the benefits of longer-term trends, such as the growth in credit derivatives.

Analysts at Morgan Stanley also estimate that investment banks' international businesses are growing at three times the rate of their operations in the US.

"For firms that report in June, the second quarter was 10 great weeks slightly hampered by two bad ones," said one analyst at a large investment bank.

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…and IPO Issuance has not yet reached "frenzy" levels often associated with speculative market tops….

Market's struggles haven't fazed IPOs

Number of filings up 22% over same period last year

By Matt Krantz
USA TODAY

5-25-06

The storm clouds forming over the stock market haven't yet spoiled the parade of IPOs being trotted out on Wall Street.

There have already been 67 initial public offerings this year, up 22% from the same period in 2005 and the best first five months of a year since 2000, according to data from Renaissance Capital. Meanwhile, 18 companies filed to go public last week, the busiest week for new filings since 2000, Renaissance says.

Not bad, considering the broad market has run into some serious trouble. The Russell 2000, a benchmark of small-company stocks that IPOs are often compared with, is nearly in correction territory, having lost 9% since its peak on May 5. That's why many are impressed the flow of IPOs has been so strong. "The momentum of companies coming public is picking up," says Kathy Smith, principal at Renaissance.

But IPOs are a lagging indicator of investors' good feelings, so it could be weeks before the ongoing trouble in the broad market rears up in the IPO market. Already there are some signs investors are beginning to get a little more skeptical, such as:

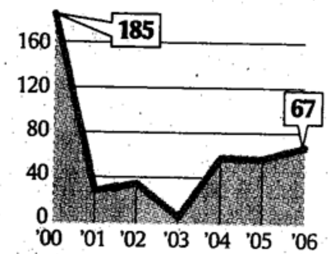
▸ **A weak high-profile debut.** The long-awaited debut of Internet telephone company Vonage landed on Wall Street with a thud Wednesday. Its shares cratered 13% from their initial price of $17, for the worst first-day performance of the year. The shares performed poorly because increasingly nervous investors don't like the fact the company has never made money, says Francis Gaskins, editor of IPOdesktop.com.

▸ **Shaky recent follow-through performances.** While the debut of Burger King last week was positive and shares rose 9% in their first two days of trading, some of that gain has since slipped away. The stock closed Wednesday at $17.66, essentially unchanged from its first-day closing price of $17.50.

▸ **Broadly struggling IPOs.** The First Trust IPOX 100 index, an exchange-traded fund that tracks IPOs, has fallen nearly 8% since the Russell peaked on May 5, which is seriously testing investors' resolve.

Raining IPOs

This is shaping up to be the busiest year for IPOs since 2000.



Source: Renaissance Capital's IPOhome.com

By Adrienne Lewis, USA TODAY

Rising investor unease could make it harder for companies that aren't household names to go public, says Joel Greenberg, partner of law firm Kaye Scholer.

IPO watchers are hoping things clear up before the expected launch of household name MasterCard today. The credit card processing company's IPO, which was priced at $39 a share late Wednesday and is expected to raise about $2.4 billion, would be the largest U.S. deal since Genworth Financial hauled in $2.8 billion in May 2004, Dealogic says.

A weak showing by MasterCard will be a big-time warning to companies and the investment banking firms taking them public that Wall Street has changed dramatically in the past two weeks, says Josef Schuster, founder of IPO index provider IPOX Schuster. "It's becoming a bad environment for companies to price (their IPOs)," he says. "Companies will have to come to the market cheaper; otherwise, they won't sell."

IPO ISSUANCE NOT YET AT "FRENZY" LEVELS

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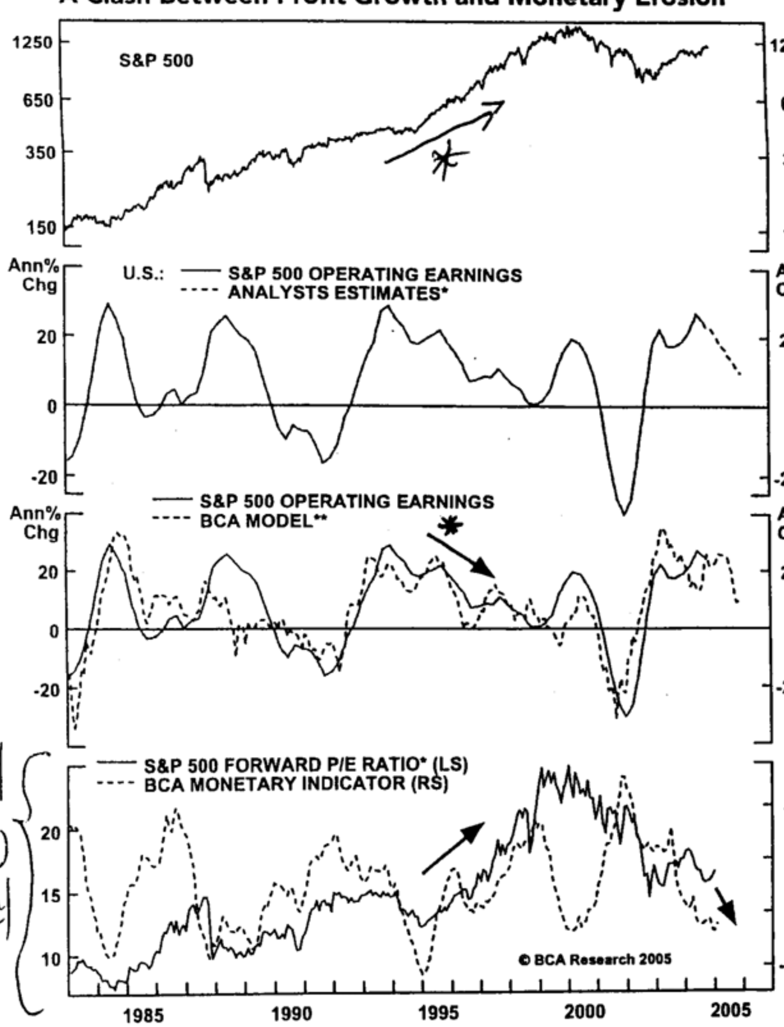
Hopeful factoid: markets can rise on slowing EPS growth, but only if the Fed is easing… a possibility in the quarters ahead…

BCA RESEARCH

* MARKET CAN RISE ON FALLING EPS GROWTH IF POLICY IS STIMULATIVE

CHART 1
A Clash Between Profit Growth and Monetary Erosion



*SOURCE: THOMSON FINANCIAL / IBES
**BCA MODEL IS A REGRESSION BASED ON THE YIELD CURVE (10-YEAR TREASURY LESS FED FUNDS RATE), UNIT LABOR COSTS, OIL PRICES AND THE DOLLAR

E's LOOSELY FOLLOW MONETARY POLICY

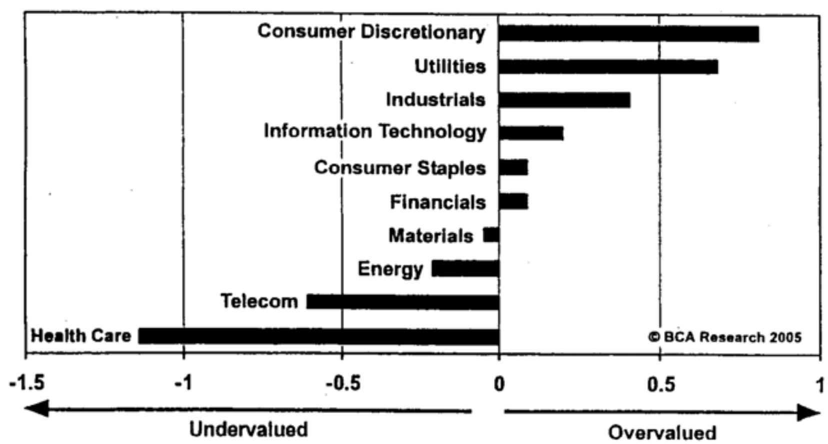
Still index upside as long as earnings remain positive, however the A/D line might tail off

Table 1
S&P Sector Earnings Growth (%)

SECTOR	Forward P/E	Expected Earnings Growth (%) 2004	2005
Financials	12.1	12	11
Energy	13.2	51	-4
Utilities	14.7	0	13
Materials	14.9	73	24
S&P 500	16.1	19.4	10.5
Telecom Services	16.2	-9	5
Health Care	17.2	10	9
Consumer Staples	18.1	10	10
Industrials	18.1	19	18
Consumer Discretionary	18.5	24	14
Information Technology	21.5	43	13

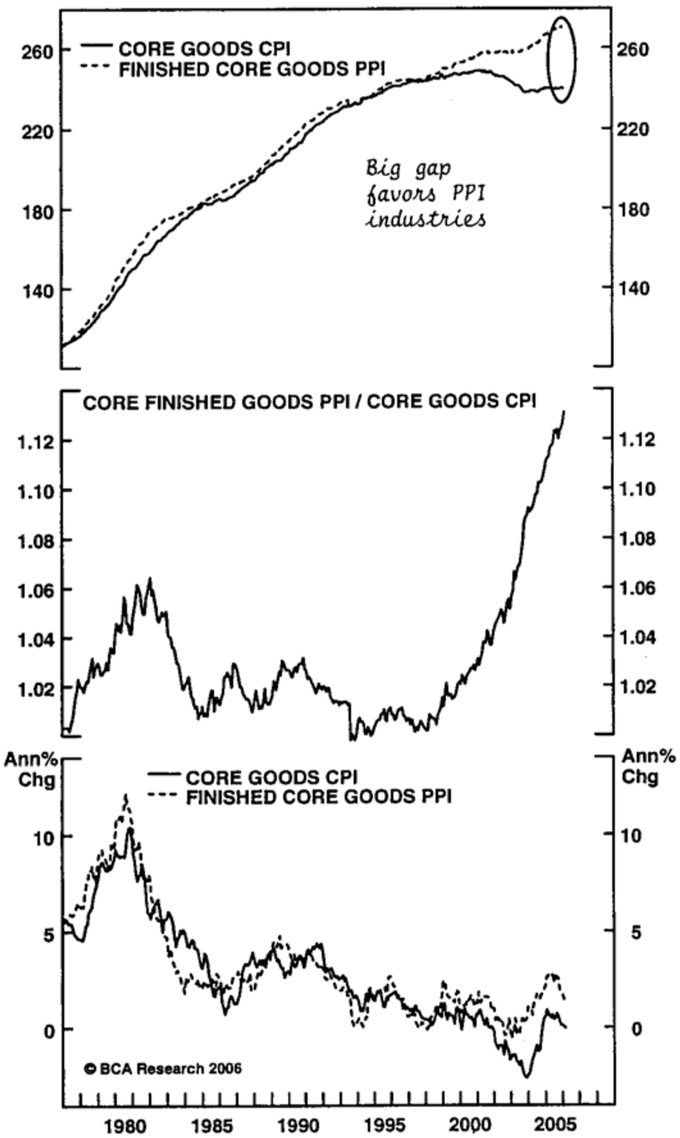
Source: Thomson Financial / IBES

Table 1
U.S. Equity Sector Valuation



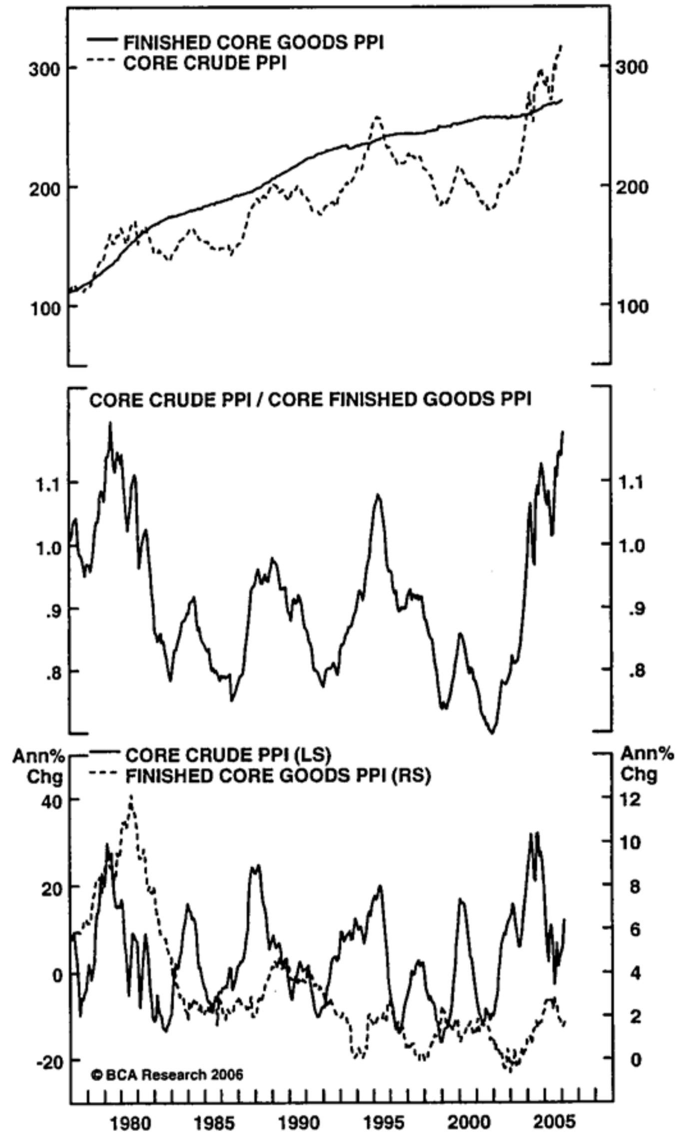
What industries might have the greatest pricing power ?….

CHART 6
PPI Is Outpacing CPI...



NOTE: SERIES REBASED TO 100 IN JANUARY, 1975
CORE EXCLUDES FOOD AND ENERGY,
CPI = CONSUMER PRICE INDEX, PPI = PRODUCER PRICE INDEX

CHART 7
... And Crude PPI Is Outpacing Finished Goods PPI



NOTE: SERIES REBASED TO 100 IN JANUARY, 1975
CORE EXCLUDES FOOD AND ENERGY,
PPI = PRODUCER PRICE INDEX

highest rates of inflation to lowest. The fifteen highest inflation rates are concentrated in the energy and industrial sectors, what we call producer price industries. The lowest inflation rates are mainly in consumer goods prices, underscoring that these industries suffer a lack of pricing power.

Inflation at early production stages will continue to outpace consumer price inflation. Even if domestic economic activity slows in 2006 as we expect, the bull run in energy and commodity prices is not over. There will likely be a correction when the U.S. economy cools, but global growth is improving and the insatiable appetite for raw commodities from China and emerging Asia will keep world commodity prices well-bid.

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A common denominator: basic materials low on the Industrial food chain…

Industries with greatest pricing power *

TABLE 1
Industry Group Pricing Power

S&P Industry Group	Inflation Rate* (Annual % Change)	PPI/CPI Industry	S&P Industry Group	Inflation Rate* (Annual % Change)	PPI/CPI Industry
Diversified Metals & Mining	37.0	P	Data Processing & Outsourced Services	2.8	P
Integrated Oil & Gas	30.1	P	Retail Food Chains	2.8	C
Oil & Gas Refining & Marketing	26.7	P	Movies & Entertainment	2.8	C
Gold	26.7	P	Paper Products	2.7	P
Energy Equip. & Services	25.9	P	Publishing & Printing	2.4	P
Gas Utilities	25.6	P	Banks	2.2	C
Aluminum	21.6	P	Industrial Machinery	1.9	P
Industrial Gas	16.2	P	Integrated Telecom	1.8	C
Railroads	10.6	P	Auto Parts	1.8	P
Electric Utilities	10.4	P	Brewers	1.7	P
Chemicals	9.8	P	Tobacco	1.7	P
Air Freight & Logistics	8.6	P	Capital Markets	1.2	P
Airlines	8.3	P	Personal Products	1.1	C
Homebuilders	6.7	P	Appliances	1.1	P
Oil & Gas Exploration	6.7	P	Footwear	1.0	P
Managed Health Care	6.4	C	Software	0.3	C
Pharmaceuticals	6.1	P	Leisure Products	0.2	C
Health Care Facilities	5.9	C	Insurance	0.2	C
Building Products	5.6	P	Auto Manufacturers	-0.4	C
Electrical Components & Equip.	5.4	P	Packaged Food	-0.6	P
Metal & Glass Containers	4.7	P	Communication Equipment	-1.0	P
Construction & Farm Machinery	4.3	P	Wireless Telecom	-1.2	C
Retail Drug Stores	4.0	C	Apparel	-1.8	C
Health Care Equipment	3.8	C	Computers & Electronic Retail	-3.6	C
Soft Drinks	3.6	P	Electronic Equipment and Instruments	-3.9	P
Advertising	3.6	P	Steel	-4.3	P
Hotels	3.3	C	Semiconductors	-5.1	P
Restaurants	3.0	C	Computer Storage & Peripherals	-5.7	P
Household Products	2.9	C	Forest Products	-17.4	P
Broadcasting & Cable TV	2.9	C	Computer Hardware	-22.6	P

**Defined as annual percent change in the CPI, PPI or underlying commodity price for the corresponding industry group.*
Note: P denotes PPI industries, C denotes CPI industry.

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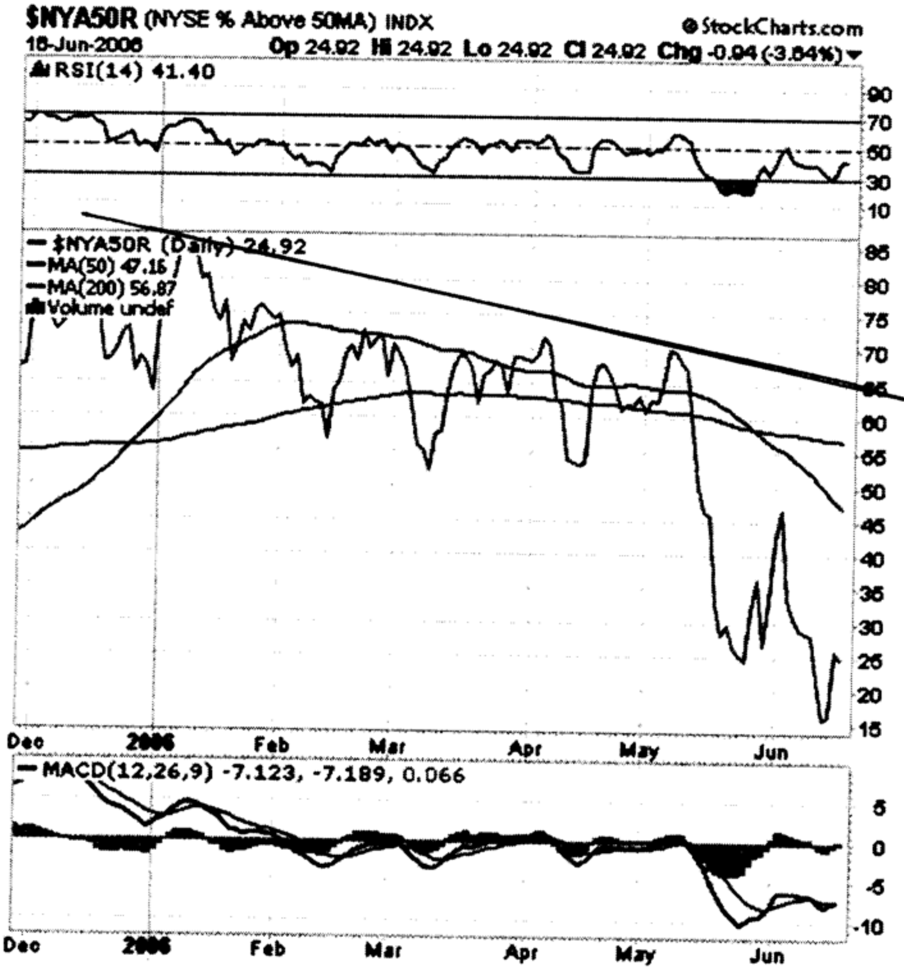
MARKET BREADTH HAS LIKELY PEAKED



The "stocks above their 50 day MA indicator topped out before the index peak in May

… but even under the best conditions, it is highly likely that the "broad" market has topped out. Look for tops in the "breadth" indicators:

A) Advance-Decline Lines
B) Bullish Percent readings
C) Stocks over/under their moving average
D) "Arithmetic" indices (not capitalization weighted)

If true, capitalization indices may still make higher highs As money chases fewer and fewer stocks.

The Bullish Percent breadth indicator actually peaked in 2004 as upside momentum waned on a point & figure basis