

The S&P US Equity Indexes all showed gains for the quarter. Small and Mid Cap companies continued to outperform Large Cap with the S&P Mid Cap 400 Index returning 7.63% versus the S&P 500 Index return of 4.21%. Value stocks dominated growth stocks in both the mid and large cap stock universes with the S&P 500/Barra Value Index returning 5.87% compared to the S&P 500/Barra Growth Index return of 2.61% while the S&P MidCap 400/Barra Value Index returned 9.07% versus the S&P MidCap 400/Barra Growth Index return of 6.17%. The best performing sectors for the quarter were Telecommunications Services and Energy, returning 13.39% and 8.60% while the worst performing sectors were Consumer Staples and Healthcare with returns of just 0.98% and 0.86%.

Government data still shows good growth. Final numbers for fourth quarter Gross Domestic Product show growth of 1.7%. This was 0.1% higher than previous estimates but much lower than the third quarter's growth of 4.1%. Unemployment has decreased from our last review. The data available in January (November's data) showed unemployment at 5% and since then has fallen to 4.8% (February's data). Preliminary estimates of job growth show 170 thousand jobs added in January and 243 thousand jobs added in February. In addition, the government reported that according to the latest data, corporate profits grew 21.3% in the fourth quarter, up from around 15% in the third quarter and the fastest rate since the third quarter of 2002.

Such spectacular corporate earnings growth has been tempered by continued Federal Reserve intervention with interest rates. The Fed has held two meetings since the beginning of the year and raised short term interest rates 0.25% both times. Currently the Fed Funds rate is at 4.75%. The yield curve remains flat with just a 0.25% difference between short and long rates. Many market watchers have been expecting the Fed to cease their tightening policy and the continued actions of the Fed have served to raise concerns in the equities markets.

One of the models we use to understand how the market prices stocks is a discounted cash flow model. The model predicts future cash flows generated by corporate assets and then discounts them based on a rate commensurate with each company's cost of capital. The model then produces a present value of these future cash flows. Stocks selling at a discount to this present value are considered to be attractively valued while stocks selling a premium to this present value are considered to be overvalued. Such a model also does a good job explaining the "worry" inherent in the market today. Despite the record cash flows that corporations are seeing right now, the market is also expecting higher interest rates. This competition between the positive news in record corporate profits and the negative news in anticipated interest rate increases makes for a very cautious market environment. Corporate America is choosing to use their record cash flows mainly for repurchasing their shares. The result has been to force Wall Street equity analysts to increase their earnings estimates. Strong numbers of upgrades have been seen in Technology, Materials, Capital Goods, Consumer Staples and Telecommunications. Going forward our methodology will continue to be to select stocks with strong cash flows, positive surprises and attractive valuations.

Kitty MacKenzie has decided to seek a job closer to her home and family and left Hutchens at the end of February. I know you will join us in wishing her the best of luck in her new position. Her duties have been transferred to Tracy Taylor who has been working with us since our move to Concord in June of last year. Feel free to contact Tracy or Chad for any needs that you have.

We sincerely thank you for your business and wish you a wonderful spring.