

# MCM Market Outlook

JANUARY 2006

## 1st Quarter letter

Your equities generated a high single digit return during the first quarter, which significantly exceeded the market indices. The advance was fueled by strong fourth quarter corporate earnings, which once again exceeded expectations. Earnings increased 15% and it was the eleventh consecutive quarter of double digit growth. Corporate profits reached 8.1% of GDP (the measure of the nation's total output), the highest level in over 50 years. These results reflect a strong worldwide economic expansion which is being supported by a high level of corporate investment which in turn is generating significant job and wage growth.

In our country the unemployment rate is 4.8% and the economy is generating two million net new jobs a year. Hourly wages are increasing at a 4% annual rate. We expect these positive fundamental trends will continue.

The first quarter was a period of transition in U.S. monetary policy. Ben Bernanke succeeded Alan Greenspan as Chairman of the Federal Reserve, our central bank. Chairman Greenspan earned a sterling reputation during his 18 year tenure. While he is a tough act to follow, Chairman Bernanke is an excellent choice to steer U.S. monetary policy. He is eminently qualified by virtue of both his academic training and experience. We expect the Fed, under his leadership, will build upon the Greenspan legacy.

The Federal Reserve Board met twice during the quarter and, as expected, raised interest rates both times. The general level of interest rates increased 0.5% (one half of one percent) during the quarter. Consequently, the vast majority of bond portfolios and bond mutual funds experienced a negative return. However, the actions we have taken, specifically shortening the portfolio's average maturity, protected your bond portfolio in the rising rate environment.

Your portfolio is now poised to take advantage of higher rates. We have begun the process of modestly lengthening your average maturity. The Federal Reserve is nearing the end of its program of raising interest rates. As the upward pressure on interest rates subsides, your portfolio is well positioned to take advantage of the higher rates that are becoming available. We will continue our policy of replacing low yielding short term bonds with higher yielding intermediate term bonds.

We are approaching the end of the Federal Reserve's period of increasing interest rates. That combined with a continued positive economic outlook makes this a particularly exciting time in the financial markets and we look forward to our next communication.