

# MCM Market Outlook

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## Stock Market Changes letter

Based on the reaction of the stock market over the past couple of weeks, one would think first quarter corporate earnings reports had a decidedly negative tone to them. The truth is actually quite the opposite. Company after company, including the ones in your portfolio, reported strong results and corporate managements expressed considerable confidence in the underlying strength of their business. So what's upsetting the market? It appears to be a growing concern that the rate of inflation is about to take a big jump and the Federal Reserve will have to keep pushing up interest rates.

Some prices are going up, most notably oil and other commodity prices. Inflation, however, is a rise in the overall price level. The most recent data indicate the current rate of inflation is modestly above 3%. That's consistent with our history. Over that last 100 years inflation has averaged 3% a year.

Inflation occurs when the rate of money and credit growth exceeds economic growth. Money and credit growth is controlled by the Federal Reserve and currently is running at about a 5% annual rate. Economic growth in 2006 will range between 3.0% and 3.5% as corporations increase capital expenditures and create jobs. Low unemployment and new job opportunities will support an already strong consumer. If the Federal Reserve continues its present policy of keeping the growth of money and credit in the 5% range and the economy continues to grow in the 3% range, the rate of inflation will be contained within its historic range.

Solid economic growth and modest inflation provide an environment for well managed companies to grow their earnings at above-average rates. MCM's proprietary model continues to uncover several market leading companies with attractive valuations. Most of your companies have reported their first quarter results. In the aggregate the companies are growing their earnings at a 20% annual rate and the shares are selling at 20 times earnings. That is a very attractive combination.

This recent setback in the stock market should provide an attractive buying opportunity for patient investors. As earnings growth and attractive valuations become the central focus of the investment community, share prices will once again resume their upward trend.

Please call with your questions and comments.