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TALKING POINTS

A Recap of October 2006

The Economy

For many analysts, the only question left after October's economic data was whether the economy was coming in for a hard or soft landing. Nonfarm payrolls increased a paltry 51,000 during September, the trade deficit exploded to $69.9 billion, retail sales fell 0.4% and industrial production dropped by 0.6%. To top it off, real GDP increased just 1.6% at an annual rate in the third quarter after a 2.6% reading during Q2. With weakness in home sales continuing in September, the markets started pricing in a Fed rate cut in 2007. The result was a surge in stocks and a drop in bond yields. But investors should be careful about reading too much into this data. The Bureau of Labor Statistics released its annual benchmark revisions to payroll employment. This recalibration found 810,000 jobs that went previously unnoticed. At the same time, the federal government reported that tax revenues surged by 11.8% in 2006 and the budget deficit fell to $248 billion. In other words, the economy may not be as weak as it seems. Tax rates are still low, corporate profits are rising sharply and interest rates remain well below levels of the late 1990s. As a result, we do not believe that recent weakness in data is a harbinger of any landing at all.

Real GDP	*Existing Home Sales (units)*	*Retail Sales (Ex Autos)*	*Federal Budget Deficit*	*Initial Claims (Weekly Avg.)*
1.6% (Q3)	**6.18M** (Sep)	**-0.4%** (Sep)	**$248B** (FY'06)	**314,000** (Oct)
2.6% (Q2)	6.30M (Aug)	0.1% (Aug)	$319B (FY'05))	311,000 (Sep)
↓	↓	↓	↓	↑

The Stock Market

The three major indices were up in October with the DJIA, S&P 500 and Nasdaq Composite returning +3.6%, +3.3% and +4.8%, respectively. Small-cap stocks, as measured by the Russell 2000 Index, gained 5.8%. Some of the top performing S&P 500 groups in October were as follows: Consumer Electronics (+22.7%); Steel (+19.7%); Internet Retail (+18.6%); IT Consulting & Services (+15.5%); and Internet Software & Services (+14.0%).In October, the dividend-payers (384) in the S&P 500 (equal weight) posted a total return of 3.72%, vs. 3.12% for the non-payers (116). Y-T-D through October, the payers gained 13.24%, vs. 9.14% for the non-payers. For the 12-month period ended October 2006, payers gained 19.35%, vs. 14.11% for the non-payers. The number of dividend increases (S&P 500) year-to-date totaled 244, slightly lagging the 252 registered over the same period in 2005, but still above the 228 increases registered in 2004. The dividend yield on the S&P 500 was 1.81% at the end of October. Over the past five years, home prices posted an annualized gain of 7.6%, vs. just 2.8% for the S&P 500, according to Edward Jones. Over the long haul, however, stocks have been the better play. Over the past 10 and 20-year periods, the S&P 500 posted annualized gains of 8.9% and 11.4%, respectively, vs. 6.3% and 5.5% for home prices. Sam Stovall, chief investment strategist at S&P, believes that the S&P 500 is currently trading at a discount in the vicinity of 25%. The price-to-earnings ratio on the S&P 500 Index is currently 15.1 based on 2007 estimated earnings of $90.47, according to Thomson First Call. That ratio is below the index's 10- and 20-year averages, according to *BusinessWeek*.

U.S. Dollar (U.S. Trade- Weighted Basket)	*AAII Sentiment Index*	*Short Interest (NYSE)*	*Margin Debt (NYSE)*
-0.5% (Oct)	**52.5% Bullish** (10/31)	Oct: **9.75B** (+0.1%)	Sep: **$237.1B** (+4.7%)
0.87% (Sep)	51.3% Bullish (9/30)	Sep: 9.74B (+1.0%)	Aug: $226.5B (-2.2%)
			$278.5B in March 2000
↓	↑	↑	↑

The Bond Market

The yield on the 10-Yr. T-Note fell three basis points in October closing at 4.60% – five basis points higher than on October 31, 2005. The returns on seven Lehman Bros. benchmark indices were as follows (October & **Y-T-D**): ***U.S. Treasury: Intermediate*** (0.44% & **3.18%**); ***GNMA*** (30-yr.) (0.69% & **3.75%**); ***Municipal Bond (22+)*** (1.00% & **5.96%**); ***U.S. Aggregate*** (0.66% & **3.74%**); ***U.S. Corporate High Yield*** (1.36% & **8.80%**); ***Global Aggregate*** (0.97% & **5.50%**); and ***Emerging Markets*** (1.82% & **8.47%**). Investors have poured over $10 billion into municipal bond funds in 2006 - the largest amount in four years, according to SmartMoney.com. Before taxes, both municipal and taxable bond funds returned around 5.0% annually over the past decade. On an after-tax basis, the taxable bond funds returned closer to 3.1%. If interest rates remain in a tight trading range, which is conceivable if the Fed doesn't have to tighten too much more, municipals would remain attractive, in our opinion. Munis still offer more than a 200 basis point after-tax yield advantage (at the 35% bracket) over a 30-year T-bond. Moody's reported that there were more upgrades than downgrades in the third quarter.

Key Rates as of October 31st

Fed Funds	5.25%
2-Yr. T-Note	4.70%
10-Yr. T-Note	4.60%
30-Yr. Mortgage	6.37%
Bond Buyer 40	4.65%

Key Yield Spread

The spread between the Merrill Lynch High Yield Master II Index and the 10-Yr. T-Note was 357 basis points on Oct. 31. The yield on the index was 8.17%. The spread was 389 basis points on Oct. 31, 2005, when the yield was 8.44%.

2006 Debt Issuance through September

(Source: Thomson Financial)

Debt Category	$ Amount	% change over '05
Corporate	$1.1 Trillion	+12.7%
Convertible	$7.7 Billion	+119.1%
Asset-Backed	$1.3 Trillion	-3.9%
Municipal	$262.7 Billion	-15.0%

The Investment Climate

Net cash inflows to equity funds totaled $6.5 billion in September, up from $5.1 billion in August, according to the Investment Company Institute. Bond funds reported inflows totaling $4.6 billion, down from $6.6 billion in August. Money funds reported inflows totaling $15.5 billion, vs. inflows totaling $42.9 billion in August. Y-T-D through September, net cash flows into equity funds totaled $125.3 billion, vs. $35.1 billion for bond funds.