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TALKING POINTS

A Recap of November 2006

The Economy

The data continue to signal a persistent economic expansion even as the economy becomes increasingly bifurcated between great strength in the services sector and relative weakness in housing and manufacturing. Real GDP growth for Q3 was revised upward from the originally estimated 1.6% to 2.2%, due to higher estimates of net exports and inventory accumulation. The services sector continues to thrive, with the most recent reading from the ISM Non-Manufacturing Index at 58.9, a surprising move up as most analysts had assumed, pessimistically, that if the broad economy was to slow that the service sector would feel weakness too. The strength of the services sector suggests pessimism is not the right outlook for the broader economy, even though housing is in the midst of a serious correction. Falling residential investment subtracted 1.2% from Q3 real GDP. With housing starts down 14.6% in October, it appears that Q4 will see a similar negative impact. Manufacturing continues to be mediocre, with the ISM Manufacturing Index dipping below 50 in November for the first time since early 2003, but the Philadelphia Fed index rebounded. Overall, the data tend to confirm our view that the economy continues to grow even though some sectors (housing and autos) continue to experience hard times.

Real GDP (Revised)	Housing Starts (y-o-y)	Retail Sales Ex-Gas (m/m)	ISM Manufacturing	ISM Non-Manufacturing
2.2% (Q3)	**-14.6%** (Oct)	**0.2%** (Oct)	**49.5** (Nov)	**58.9** (Nov)
1.6% (Q3E)	4.9% (Sep)	0.5% (Sep)	51.2 (Oct)	57.1 (Oct)
⇧	⇩	⇩	⇩	⇧

The Stock Market

The three major indices were up in November with the DJIA, S&P 500 and Nasdaq Composite returning +1.6%, +1.9% and +2.9%, respectively. Small-cap stocks, as measured by the Russell 2000 Index, gained 2.6%. Some of the top performing S&P 500 groups in November were as follows: Office REITs (+11.7%); Construction & Engineering (+11.0%); Homebuilding (+10.4%); IT Consulting & Services(+9.3%); Construction Materials (+8.9%); Oil & Gas Drilling (+8.5%) and Integrated Oil & Gas (+8.4%). In November, the dividend-payers (382) in the S&P 500 (equal weight) posted a total return of 2.28%, vs. 3.50% for the non-payers (118), according to Standard & Poor's. Y-T-D through November, the payers gained 15.67%, vs. 12.96% for the non-payers. For the 12-month period ended November 2006, payers gained 16.60%, vs. 13.62% for the non-payers. The number of dividend increases (S&P 500) year-to-date totaled 267, slightly lagging the 277 registered over the same period in 2005, but still above the 247 increases registered in 2004. The dividend yield on the S&P 500 was 1.79% at the end of November. The reason why dividend increases in 2006 are slightly behind 2005 levels has to do with a rise in the volume of stock buybacks. Stock buybacks involving the companies in the S&P 500 surged 35% year-over-year in the third quarter and were 140% higher than in the third quarter of 2004, according to Standard & Poor's. Companies spent $110 billion on buybacks in the third quarter – second all-time to the $117 billion spent in the second quarter of 2006. Technology companies represented 25% of all buybacks. For the 12-month period ended September 2006, buybacks totaled a record $431 billion.

U.S. Dollar (U.S. Trade-Weighted Basket)	*AAII Sentiment Index*	*Short Interest (NYSE)*	*Margin Debt (NYSE)*
-1.5% (Nov)	**40.2% Bullish** (11/30)	Nov: **9.65B** (-1.0%)	Oct: **$244.4B** (+3.1%)
-0.5% (Oct)	51.3% Bullish (10/31)	Oct: 9.75B (+0.1%)	Sep: $237.1B (+4.7%)
			$278.5B in March 2000
⇩	⇩	⇩	⇧

The Bond Market

The yield on the 10-Yr. T-Note fell 14 basis points in November closing at 4.46% – three basis points lower than on November 30, 2005. The returns on seven Lehman Bros. benchmark indices were as follows (November & **Y-T-D**): ***U.S. Treasury: Intermediate*** (0.78% & **3.99%**); ***GNMA*** (30-yr.) (0.95% & **4.73%**); ***Municipal Bond (22+)*** (1.32% & **7.36%**); ***U.S. Aggregate*** (1.16% & **4.94%**); ***U.S. Corporate High Yield*** (1.68% & **10.63%**); ***Global Aggregate*** (2.44% & **8.07%**); and ***Emerging Markets*** (1.91% & **10.54%**). Private-equity firms have announced more than $600 billion worth of takeovers this year, and that is impacting the outlook for investment-grade corporate bonds, according to Bloomberg. Two-thirds of the financing for a typical LBO comes from borrowed money. If debt levels get high enough, the credit ratings assigned to existing debt can fall resulting in downward pressure on bond prices. Since LBO activity remains robust, the investment-grade niche of the corporate bond market is now regarded as the riskiest segment. Floating-rate corporates (senior loans) are considered the best opportunity given their attractive yields and low industry default rate of 0.94% (S&P LCD).

Key Rates as of November 30th

Fed Funds	5.25%
2-Yr. T-Note	4.61%
10-Yr. T-Note	4.46%
30-Yr. Mortgage	6.09%
Bond Buyer 40	4.57%

Key Yield Spread

The spread between the Merrill Lynch High Yield Master II Index and the 10-Yr. T-Note was 354 basis points on Nov. 30. The yield on the index was 8.00%. The spread was 396 basis points on Nov. 30, 2005, when the yield was 8.45%.

2006 Debt Issuance through October

(Source: Thomson Financial)

Debt Category	$ Amount	% change over '05
Corporate	$1.2 Trillion	+16.3%
Convertible	$7.7 Billion	+119.1%
Asset-Backed	$1.4 Trillion	-4.9%
Municipal	$293.0 Billion	-12.9%

The Investment Climate

Net cash inflows to equity funds totaled $12.2 billion in October, up from $6.6 billion in September, according to the Investment Company Institute. Bond funds reported inflows totaling $10.6 billion, up from $4.6 billion in September. Money funds reported inflows totaling $32.5 billion, vs. inflows totaling $15.4 billion in September. Y-T-D through October, net cash flows into equity funds totaled $136.7 billion, vs. $45.7 billion for bond funds.