

The economy is showing signs of strength. Entering the third year of recovery, the rate of GDP growth is accelerating to the 4% to 5% level. Despite higher energy prices, housing and the consumer sector, which represent over 70% of GDP, are in great shape. In fact, even the jobs picture is brightening. The March employment report showed a gain of 308,000 jobs, almost three times expectations. Upward revisions to January and February brought overall payroll up 653,000 from a year ago. Commodity prices have been surging due to demand from China, India, and Europe. However, overall consumer and producer price indices remain benign. Certainly, huge increases in productivity and the subsequent easing of unit labor costs are to blame. The substitution of capital for labor continues unabated.

The market environment during the first quarter was mixed with small caps outperforming large caps. The S&P Small Cap 600 was up 6.0% while the S&P 500 was up only 1.3%. The Dow and Nasdaq were down 0.9% and 0.5%, respectively. Value stocks, as measured by the S&P Barra Value Index, outperformed growth stocks, measured by the S&P Barra Growth Index, 2.8% to -0.3% for the quarter.

#### Sector Returns

Consumer Discretionary	2.3%
Consumer Staples	5.4%
Energy	5.2%
Financials	4.5%
Health Care	0.0%
Industrials	-.8%
Technology	-2.3%
Materials	-1.6%
Telecom	4.2%
Utilities	3.8%

Source- Standard and Poors

As can be seen from the table above, Consumer Staples and Energy were the winners while Technology and Materials took a breather. This was a counter trend correction and explains minor underperformance in your portfolio. We are currently structured to take advantage of surging earnings in Technology, Materials, and Industrials, where we see earnings exceeding expectations and valuations very reasonable.

The correction we experienced in March was triggered by terrorism fears starting with the tragic train bombing in Madrid. The underlying fundamentals remain strong. Earnings are projected to be up 16% this year and P/E multiples are reasonable given the low levels of interest rates, inflation, and tax rates. Markets can go up during periods of fear. In 1953, the Soviets exploded their first hydrogen bomb and the nuclear arms race took off. School children were taught to hide under their desks in case of attack. I can remember doing this in elementary school. Until the breakup of the Soviet Union on

Christmas Day, 1991, we lived in constant fear of attack. From 1953 through 1991, the market went up 1500% .

Our strategy will be to stay the course. As earnings reports come through this month there will be new opportunities to analyze. We will be looking at earnings and sales surprises within industries and sectors to reposition the portfolio in the strongest stocks which represent good value. We are confident that this approach, based on the fundamentals of cash flow and asset value, will serve you well over the long term.

Sincerely,