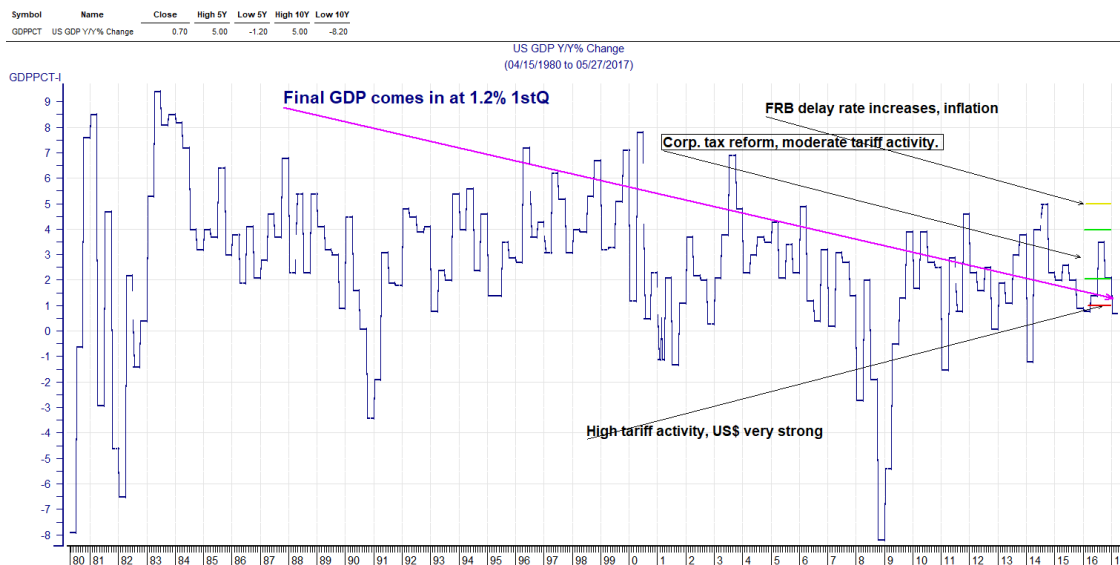


GDP or Gross Domestic Product is one of the most important gauges of economic activity than any other variable. It is the culmination of all economic activity bundled into a single measure. This measure has also been one of the least understood and many times abused, especially during political campaigns.

You hear constantly that everyone desires a GDP in excess of 3%, really? This level would be nice, but a 3% GDP when unemployment is running near 4% could be very inflationary. Full employment is reached at an unemployment level of 3%. Frictional unemployment, people changing jobs, is approximately 3% in an average economy. This means unemployment above 3% is truly unemployed. If only 1% to 2% are truly unemployed, when GDP increases, products and services are in higher demand, inflation can appear.

As a comparison, we were at 2.1% GDP at this time last year. The economy has cooled slightly in the first quarter from a year ago, but confidence is high. The consumer confidence measurement increased to 97.1 which was an increase of 2.5% from this time last year. Capital expenditures are running 11.4% higher than last year in non-residential products and housing is doing well.



A real boost for future GDP may be coming from the corporate profits side which finished the quarter at 11.9% better than last year. The revised GDP number for the 1st quarter is well within our forecast and at the lower end. The probability that the economy will do better is high and move closer to the middle of our forecast.

The market has moved close to 110% Fv which reflects a strong level of optimism in future values. This can materialize as profitability catches up to expectations. (When Fv is greater than 100%Fv, expectations are higher than current market fair value.) Our concern is that expectations move ahead at a more rapid rate than the market can deliver. We would like to see the %Fv move back to near 105%Fv. This can be accomplished by increases in Fv due to higher profitability or the market could slow down and let the current level of profitability catch up. Either version would be fine.