C Y P R E S S

Asset Management, Inc.

MARKET COMMENTARY **January, 2005**

A strong post election market rally brought a positive conclusion to a challenging year for the U.S. equity markets in 2004. As we begin a new year, stocks appear attractively valued given a healthy U.S. economy, low interest rates and record corporate profits. In fact, stocks are actually cheaper today – trading at roughly 17 times consensus 2005 earnings – than they were a year ago since corporate profit growth of 20% considerably outpaced market appreciation in 2004. We look for earnings growth to slow to a more sustainable level of 6-8% during 2005 but believe stocks can perform in line to slightly better than the underlying growth in earnings.

Stocks Are Under Appreciated

While significantly below-average interest rates and inflation support the current market valuation, the historic changes to the tax rates on dividends and capital gains make stocks particularly attractive and under appreciated. Not only are tax rates on dividends and capital gains (15% for both) at the lowest levels since 1941, but according to ISI Group they are 75% and 33%, respectively, below their average rates for the last six decades. We believe that a combination of the favorable tax treatment of equities and the particular suitability of equity investments to the current macro economic environment will spur a multi year trend toward stocks. As aging baby boomers come to grips with the reality of a low interest rate, low inflation, and a productivity driven low nominal GDP economy, companies that pay a good dividend and can grow that dividend over time should become highly prized. High quality stocks may have struggled somewhat in recent years, but over time they should become the investment staple for growth and income seeking baby boomers and outperform other asset classes.

The current market multiple is further supported by both the high quality of current corporate earnings and the extraordinary strength of corporate balance sheets. The latter development, in particular, increases our confidence in the market. The S&P 500 net debt to capital ratio is at its lowest level in decades, down to about 32% from almost 50% in the early 1990's. The underleveraged nature of corporate earnings and balance sheets enhances their intrinsic value. In fact, as discussed below, we believe the corporate liquidity story will prove to be the dominant investment theme in 2005.

Market Balance Sheet Remains Positive

Our Market Balance Sheet (see complete table on page 3) continues to reflect strong underlying fundamentals. To summarize, we see healthy economic growth, albeit at somewhat reduced levels from 2004, subdued inflation, and historically low levels of interest rates during 2005. Economic leadership has shifted from the consumer to capital spending and, as a result, we have been increasing our portfolio weighting in industrials to benefit from this continued strong growth in capital spending.

Significant risks are present, of course, such as the budget and trade deficits, a collapse of the dollar, a resurgence of inflation and resulting spike in interest rates, and a negative geopolitical event. These issues are widely recognized and discussed in the media and, consequently, largely reflected in today's market. It is also possible that some of these issues could resolve favorably and that positive surprises such as tort reform, social security reform, or even some measure of success in the Middle East could boost the market in 2005.

Corporate Liquidity: The 1000 Pound Gorilla

We believe the big story for investors in 2005 will turn out to be strong balance sheets and corporate free cash flow. Corporate liquidity could prove not only a near term catalyst for the market – as dividend increases, stock buybacks, and M&A activity all continue – but a powerful multi year driver for the market. Corporate balance sheets are the strongest in modern history; there is an estimated $1 trillion in cash on the balance sheet of corporate America. In addition, as discussed above, valuations in the market are reasonable and the economic outlook is more stable than it has been at any time since September 11, 2001. As a result, we believe corporations will finally aggressively deploy their bulging cash coffers in 2005. Corporations will do several things with their cash, all positive for shareholders: grow the dividend, increase capital spending, buy back shares, pay down more debt, and finally, initiate a new wave of mergers and acquisitions. All of this activity will support stock prices and fundamentals.

We have been closely tracking these developments and, as you can see from the table below, many of the companies we own are implementing these strategies. In addition, the temporary tax cut that allows the repatriation of foreign profits at a much reduced tax rate and we see the ingredients for cash flow deployment and shareholder enhancing activity on a major scale. The vast majority of this activity will be led by domestic large cap multinational companies, the core of what we own.

We are optimistic that the current environment is salutary for our style of investing. Almost all of our companies are global, already have good balance sheets and have relatively low payout ratios. Our companies are well positioned to benefit from a continued growth in cash flow and will be able to expand their franchises and grow their dividends. As long term investors, we believe we are still relatively early in a powerful trend that should benefit investors in high quality franchise companies for many years to come.

Corporate Liquidity

Capital Expenditures[1]	Mergers & Acquisitions	Dividend Growth[2]	Share Buyback
• + 14% estimated in 2004 • + 11% forecasted for 2005	**Over $750 Billion in major deals[3]** • **Bank of America & Fleet Boston** (@ $47 Billion) • **Bank One & JP Morgan** (@ $58 Billion) • **Cingular (SBC & Bell South) & AT&T Wireless** (@ $41Billion) • **Sears & Kmart** (@ $11 Billion) • **Sprint & Nextel** (@ $35 Billion) • **Johnson & Johnson and Guidant** (@ $24Billion) • **Oracle & PeopleSoft** (@ $10 Billion)	**S&P 500 dividends growing at fastest rate in over a decade** • **100+** Citigroup Intel Lockheed Martin Microsoft • **40+ %** American Intl. Group Pepsi Wal Mart • **20% – 25%** Bank of America Coca-Cola General Dynamics US Bancorp • **10% – 20%** Burlington Resources IBM Johnson & Johnson Kimberly Clark Mellon Financial Pfizer Proctor & Gamble	• Bank of America • Burlington Resources • Chevron Texaco • Cisco Systems • Citigroup • Exxon Mobil • IBM • Intel • Microsoft • Nokia • Pepsi • Target • Viacom

[1] Business Equipment & Software

[2] Reflects dividend growth from 2003 – Present

[3] 2003 To Present

Market Balance Sheet

POSITIVE	NEUTRAL	NEGATIVE
Interest Rates →	→	
Economic Growth/Industrial Production	Liquidity (Monetary Growth)	Budget Surplus/Deficit
Fiscal Policy	Free Trade/Protectionism	Geopolitical Stability
Economic Growth/Consumer Spending →	→	Energy Prices
Valuation	Dollar →	→
Profit Growth/Margins →	→	
Productivity	Inflation	
Demographics	Employment	

POSITIVE

Interest Rates — Still historically low and favorable to equity valuations; while the Fed Funds rate is likely to modestly rise from the current 2.25% to 3.25% in 2005 (assume four 25 bps Fed raises), we still see an accommodative Fed. A gradual rise in rates is actually a positive signal confirming an ongoing economic expansion. We will be watching the dollar, as further declines could pressure the Fed to raise short term rates more than desired.

Economic Growth — Should remain in a healthy 3-4% range for the next few quarters.

- Profits and corporate liquidity are surging, providing the foundation for the next stage of expansion: increased business investment and higher employment; and, for shareholders, a period of rapid dividend growth and share repurchase.
- The economic growth driver has shifted from the consumer to capital spending and industrial production, and toward innovation, small business, and more entrepreneurial activity.

Fiscal Policy — Taxes on dividends and capital gains at lowest levels in over 60 years, not in jeopardy of change prior to 2009. Bush will push hard to make the tax cuts permanent.

Productivity — Continues to drive profit growth and keep the U.S. economy the most competitive in the world; will moderate somewhat as economic expansion lengthens and employment picks up.

Profit Growth/ Margins — Strong, but profit growth will moderate to 5%-10% range during 2005; profit margins at high levels and supported by continued gains in productivity.

Demographics — Baby boomers in the sweet spot of wealth and investing cycle, hungry for growth and income.

Valuation — Reasonable at 17 times estimated 2005 S&P 500 operating earnings, leaves some cushion for a continued moderate rise in rates. Moreover, stocks are significantly cheaper than bonds, where the bellwether 10 year treasury currently yields only 4.25%, and is thus valued at roughly 23 times "earnings" (its coupon).

NEUTRAL

Inflation	Remains low, but over the last year and a half we have seen significant increases in the price of global commodities and industrial materials – worth monitoring. China remains the dragon slayer of inflation, exerting downward pressure on U.S. wages and manufacturing.
Dollar	After remaining stable through most of 2004, the dollar has weakened in recent months. If weakness continues, could lead to higher short term interest rates in order to lend support to the dollar. The weaker dollar helps U.S. multinationals, and we should start to see improving trade balances over the next 18 months.
Liquidity (Monetary Growth)	Money growth is steady but below levels of nominal GDP.
Free Trade/ Protectionism	Muddled state of affairs; a more concerted free trade policy out of both U.S. and Europe would be positive for global growth; "outsourcing" issue a political red herring (remember the U.S. economy is the primary beneficiary of global growth).
Employment	Sixteen consecutive months of job growth reflect a steadily improving employment picture, and the 5.4% overall unemployment rate is relatively low by historical standards. While employment growth has been less robust than in typical recoveries, still see the pace of job growth moderating in 2005.

NEGATIVE

Budget Deficit	A concern at 3.5% of GDP but in an improving trend. Would like to see more spending restraint in 2005. Bigger issue is the persistent growth of medical care costs and the long term liability of retirement in our aging society.
Energy Prices	Oil and gas prices are still high, but down more than 15% from the peak of $55 oil in the second half of 2004. While higher energy prices act as a drag on the global economy, on an inflation adjusted basis, oil prices are well below the peaks seen in 1980 and 1990. We continue to find the sector attractive from an investment standpoint.
Geopolitical Stability	Reconstruction of Iraq is proving challenging and costly; terrorism threat will be with us for some time. Although event risk remains significant, investors are becoming more accustomed to dealing with terrorism, scandals and unforeseen events.