



Marquette Asset Management, Inc.

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Featured

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ECONOMY

The economy has started to transition from the strong, above-trend growth of the past three years to a more subdued level. Real Gross Domestic Product (GDP) during the second quarter of 2006 was recorded at 2.6%, down from the 5.6% growth of the prior quarter. Industrial Production has remained relatively strong at 4.7% year over year growth through August, however, leading indicators point to the likelihood of some slowing in this measure over the upcoming months.

The primary reason for slower second quarter GDP growth was the weakening in consumer spending as a result of slower employment growth, high energy costs, and softness in the housing market. If these conditions persist, the stage will be set for a continued slowdown in consumption growth for a few quarters.

Outside of the housing industry, the economy remains remarkably stable. Early readings on third quarter of 2006 indicate some rebound in activity after the second quarter slowdown. Commercial construction, in particular, is picking up much of the slack from the slowing homebuilding sector. Durable goods orders remain very strong as well.

On the corporate side of the ledger, second quarter results indicate that profits continue to grow and bolster corporate balance sheets. There have now been 17 consecutive quarters of double digit earnings growth. The balance sheets of S&P 500 companies now hold about \$2 trillion of cash assets. However, profit margins are beginning to show the effects of rising input costs and higher labor costs without the ability to completely pass along the increases to the end consumer. More prevalent use of discounts and 'special deals' will also pressure profit margins.

Minutes from the Federal Open Market Committee's August meeting indicated that Fed researchers have lowered expectations for economic growth through 2007.

Global GDP has been growing above 4% for 11 consecutive quarters, making this the strongest global advance in the past 30 years. Any economic weakness in the US will be felt to some degree around the world, however. Japan and Europe, in particular, are finally

ECONOMIC OVERVIEW

John C. Beuerlein
*Managing Director,
Chief Investment Officer*



showing signs of sustainable economic activity. Global monetary conditions remain accommodative despite some recent monetary tightening to curb nascent inflationary pressures.

INFLATION

Headline inflation numbers have started to subside, but remain above levels that the Federal Reserve would like to see. Through August, the Consumer Price Index (CPI) was up 3.8%, and the Producer Price Index (PPI) was up 3.6%.

For the 12 months ending August, Core CPI is 2.8%, and Core Personal Consumption Expenditure deflator (CPE) is 2.5%, its highest reading since 1995. Federal Reserve Chairman Ben Bernanke has stated that he would like to keep the Core PCE between 1% and 2%. It is troubling to the Fed that recent readings for the core inflation measures have moved above the 2% threshold; however, the Fed expects that a slowing economy will ease inflationary pressures.

Much of the recent strength in the core inflation numbers is attributable to gains in the rent component. Most other components remain relatively steady.

With the recent softness in the oil market, the price of crude is 5% lower than last year at this time. Steady to weak energy prices in concert with a slowing economy should allow the headline inflation number to ease in the coming months.

Year/year unit labor costs are growing at the high end
(Continued on page 4)



THE YIELD CURVE

Adam K. Mans, CFA
Vice President

The term structure of interest rates, commonly referred to as the yield curve, has frequently been in the news over the last year. Let's take a moment to discuss what the yield curve is and why it is of interest. The yield curve is constructed by graphing the yield to maturities and the respective maturity dates of a set of fixed-income securities, typically U.S. Treasury bills and bonds. The shape of this graph, and how this shape changes over time, can provide clues as to how Wall Street views the future of the economy.

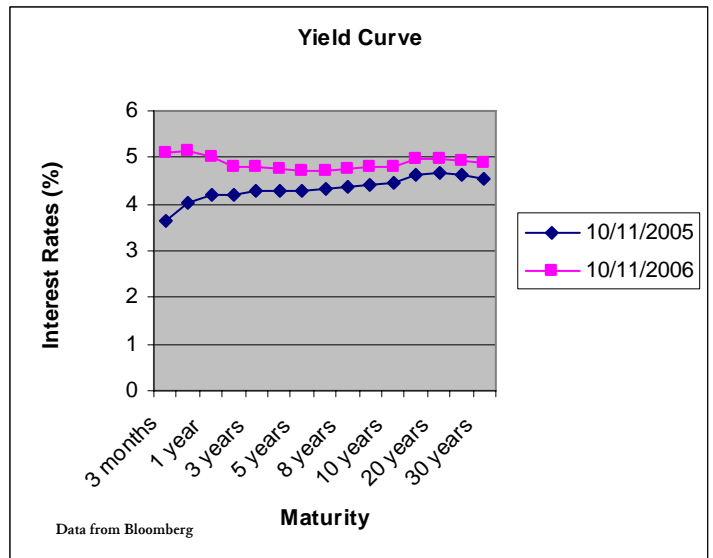
There are three main patterns created by the term structure of interest rates; a normal yield curve, a flat yield curve, and an inverted yield curve. As its name indicates, a normal yield curve typically forms during normal market conditions. It is characterized by higher interest rates for long-term bonds and lower interest rates for short-term bonds. Under these conditions investors generally believe that there will be no significant changes in the economy, such as in inflation, and that the economy will continue to grow at a normal rate. During such conditions, investors receive higher yields for fixed income instruments with long-term maturities that occur farther into the future. In other words, the market prices long-term fixed income securities to offer higher yields than short-term fixed income securities. This is a normal relationship of the market because short-term instruments generally hold less risk than long-term instruments. The farther into the future the bond's maturity, the more time and, therefore, interest rate risk the bondholder faces before being paid back the principal.

A flat yield curve indicates that the market environment is sending mixed signals to investors, who are interpreting interest rate movements in various ways. In such an environment, it is difficult for the market to determine whether interest rates will move significantly in either direction farther into the future. When the yield curve is flat, investors can maximize their risk/return tradeoff by choosing fixed-income securities with the least risk, or highest credit quality.

In the rare instances where long-term interest rates decline, or short-term interest rates increase, a flat curve can sometimes lead to an inverted curve. In such unusual market environments, bonds with maturity dates further into the future offer lower yields than bonds with shorter maturities. The inverted yield curve indicates that the market currently expects short term interest rates to decline over time.

As can be seen in the accompanying chart, we currently have an inverted yield curve. This is consistent with John Beuerlein's expectation that we have seen the end of the Fed's

current tightening monetary policy and could possibly see some easing as we move into 2007. It is interesting to compare the current inverted yield curve with the normal yield curve that existed a year ago. As the Fed consistently raised its Fed Funds target rate over the last year, the three month T-bill yield has increased a full 1.5% while the thirty year bond yield has increased a relatively modest 0.35%.



Maturity	10/11/2005	10/11/2006
3 months	3.64	5.09
6 months	4.04	5.16
1 year	4.21	5.02
2 years	4.22	4.81
3 years	4.27	4.78
4 years	4.30	4.74
5 years	4.29	4.73
7 years	4.33	4.70
8 years	4.36	4.76
9 years	4.42	4.81
10 years	4.47	4.82
15 years	4.63	4.99
20 years	4.69	4.99
25 years	4.63	4.95
30 years	4.56	4.90

Data from Bloomberg



THE INVESTMENT CASE FOR GROWTH STOCKS



James Rovner
*Senior Vice President,
Senior Investment Officer*

Individual equities within the stock market can be divided primarily in two ways; large capitalization versus small capitalization and growth versus value. For extended periods of time, due mostly to valuation and the economic environment, one segment can produce better investment results than another. In this section we will examine the investment case for growth stocks.

First, a definition – growth stocks are generally defined as companies with long-term growth rates that are higher and less variable than the overall market average. Growth stocks tend to be less economically sensitive than value equities. Additionally, growth stocks usually carry a premium, or higher valuation, since investors generally prefer higher growth with lower volatility.

The graph below shows the relative performance of growth versus value. Note the long periods of time where one segment has outperformed another.

We believe the environment now favors growth stocks for the following reasons; steady to falling interest rates, a slowing economy and attractive absolute and relative valuations.

The economy is expected to slow over the foreseeable future as discussed in the economic overview section. Corporate profits are also slowing. In this environment, on a relative basis, earnings of growth stocks should show relatively better performance than value stocks, making them more attractive to investors.

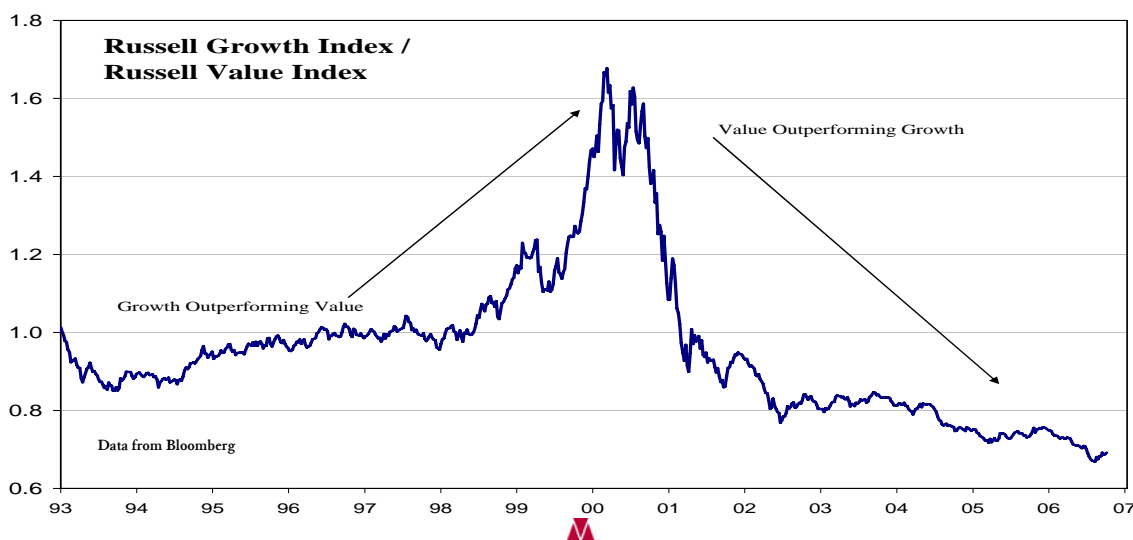
As many will remember, growth stocks became overvalued during the run up in the late 1990's (think technology boom). Today, by most historical valuation metrics, growth stocks

appear very fairly valued. Value stocks, on the other hand, appear overvalued versus historical averages. If you examine the current price to sales ratio for growth stocks it stands at about 2.0. Historically it has averaged twice the ratio of value stocks (currently 1.4 times) which means it could be 2.8 times to be fairly priced.

Growth stock valuations are also very sensitive to changes in interest rates. The higher the growth rate, the higher the impact of interest rate changes on the valuations. Interest rates have been rising for last three years. The Federal Reserve has recently paused after seventeen increases. The pause is in response to data indicating a slowing of economic growth, which should result in less inflation pressures. If this scenario continues, it is likely that interest rates will head lower sometime next year.

Since mid July, growth stocks have outperformed value stocks. Given the current environment, this could signal the beginning of an extended period of outperformance for growth stocks versus value stocks as has played out many times during history.

At Marquette, we provide customized investment management and fiduciary services to individuals, families, and institutions. We believe that diversification and the combination of complementary investment strategies in proper proportions, results in an efficient portfolio that can deliver attractive risk-adjusted returns. Based on our assessment, we believe that equity portfolios should be at least equally weighted with growth and value stocks, with an eye to increasing the weighting to growth given the current economic backdrop.



MARQUETTE ASSET MANAGEMENT NEWS

(Economic Overview continued from page 1)

of their growth range for the past 20 years and, accordingly, are a concern regarding developing inflationary pressures.

Inflationary expectations as measured by the Treasury Inflation Protection Securities (TIPS) market have started to subside as commodity prices have fallen during August.

The Fed is expecting that slower economic growth will reduce demand for commodities as well as relieve any budding wage pressures.

There are more reports of businesses using incentives and discounts to maintain acceptable levels of sales – this, too, will take some of the steam out of upcoming inflation numbers.

Outside the U.S., inflationary pressures are essentially nonexistent. In the G7 countries (ex the U.S.), core inflation is 1.2%. China's core inflation is at 1%, and Japan is still struggling to remain out of deflation.

In hindsight, the low level of inflation that we are experiencing today is most surprising given the increase in commodity prices and overall economic activity of the past 4 years. The implication is that a slowing in the economy should result in decreased inflationary pressures.

EMPLOYMENT

Employment figures have begun to soften. After averaging 165,000 new jobs per month in 2005, the employment gains in 2006 have averaged 140,000 per month for the first eight months of the year.

Year/year payroll growth, which peaked at 1.7% in early 2005, is currently at 1.3%.

CORPORATE PROFITS

Corporate profit growth has remained remarkably resilient with double digit gains for the past 17 quarters. The impact of deteriorating sales growth has yet to pass its way down to the corporate bottom line. History would suggest that if sales continue to weaken, profits are likely to follow. Deterioration in year over year retail sales is a result of the ongoing contraction in liquidity over the past 2 years.

Liquidity, while still contracting, has started to improve. This development, if continued, greatly increases the chances for a soft landing in the economy. Retail sales typically don't start to improve much until liquidity actually expands – and profit growth typically follows the improvement in retail sales. The sooner that liquidity can stop contracting and start expanding, the better for the durability of the economic recovery.

INTEREST RATES

The yield curve is flat/inverted depending upon where you focus. The point is that the longer part of the curve has become less concerned about inflation and is saying that a slowdown in economic growth will likely result in lower inflation. In effect, the back end of the curve is telling the Fed that no further rate hikes are needed. A normally sloping yield curve will only occur when the Fed begins to cut rates and confidence in the durability of the economic expansion is affirmed.

STOCK MARKET

Market volatility will remain elevated until the Fed's monetary policy becomes clearer. The current halt in tightening by the Fed is supportive of equities, but expect volatility to continue until investors begin to reflect expectations of rate reductions. Equity valuations continue to become more attractive as earn-

ings grow at double-digit rates while the market advances at single digit rates. One year forward price/earnings ratios are under 15 which are back to levels last seen in the mid 1990's. Declining bond yields in conjunction with increasing earnings are also providing long-term support to equity prices.

Concerns about economic growth rates may produce some bumps in the road for equities into the late fall, but as long as growth remains positive, equities should fare well once the uncertainties of Fed policy are cleared up and the durability of the expansion is recognized.

FINAL THOUGHTS

Inflationary expectations are peaking and growth is slowing. Under this set of circumstances, it is most likely that the Fed will forego future interest rate hikes. Slowing economic growth should allow inflationary pressures to abate, and as this occurs, talk of interest rate reductions will commence. At this stage, it would require a significant upside move in inflationary pressures and economic growth for the Fed to consider further raising of interest rates. The Fed does not want to risk financial stability by tightening too much, especially with the housing sector under duress.

SPECIAL EVENTS

ECONOMIC PRESENTATION BY:

John C. Beuerlein

CIO of Marquette Asset Management

Chief Economist of Marquette Financial Companies

Breakfast at 7:30 am at Minneapolis Club

Evening at 6:00 pm (5 pm cocktails)

at Interlachen Country Club

R.S.V.P. by November 3rd to Lisa Jacobson

612-661-3728 or lisa.jacobson@marquetteam.com

OUR GUIDING PRINCIPLES

Integrity	The core of who we are and the way we live
Expertise	Knowing our profession and practicing it with passion
Advocacy	Being active champions of our clients' financial interests
Communication	Listening to understand and responding with clarity
Confidentiality	Ensuring client privacy

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