

Corporate Trust Connection

Spring 2005

Outlook for 2005 Markets

The following analysis is provided by U.S. Bancorp Asset Management.

Outlook for Equities

We believe there are three main drivers of equity performance: business fundamentals, valuations and catalysts. For the coming year, the fundamental outlook is solid; the economy continues to expand, inflation remains relatively benign and the interest-rate environment is relatively favorable. Based on this scenario, we anticipate that 2005 earnings growth will continue, though at the substantially reduced rate of about 7%, based on the S&P 500.

From a valuation point of view, we believe the market should sell around 18x earnings. That is not cheap, but not especially dear either, under favorable economic circumstances. Catalysts that could drive the market higher in 2005 are favorable economic and profit outlooks.

Potential negative catalysts we're watching for include a further weakening dollar, continued high trade and budget deficits, and a worsening of the geopolitical situation. Overall, earnings growth plus dividends will

dictate equity returns for the year, which should be in the 8% range.

Going into 2005, large-cap growth is the most favorably positioned asset class as investors concentrate on those companies able to continue to expand in a slowing economy. Small-cap, which has outperformed now for nearly six years running, will feel the impact of rising rates more acutely as the cost of capital increases. High quality will do better than low quality. Dividend payers will continue to attract interest, with the re-election of the Bush Administration suggesting that favorable tax treatment of dividends will continue.

In fact, dividends will account for a significant portion of the total market return in 2005. Dividends on the S&P 500 currently average 1.7%, with a payout ratio (the portion of earnings returned to shareholders as dividends) of 35%. Historically, the payout ratio has averaged 47.5%, supporting our belief that more companies will be

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Did You Know...

Top Municipal Trustee Banks

Full-Year Rankings – Jan. 1 through Dec. 31, 2004

Trustee	Number of Issues	Par Amount (\$US mil)
1 Bank of New York	870	41,071.4
2 U.S. Bank	869	36,642.8
3 Wells Fargo Bank	563	20,498.5
4 J P Morgan Chase & Co	476	21,835.5
5 Wachovia Bank	327	18,091.5
6 SunTrust Bank	126	4,023.7
7 Manufacturers & Traders Tr Co	96	5,019.9
8 Deutsche Bank	95	5,185.6
9 Union Bank of California	84	2,648.1
10 UMB Bank NA	79	1,284.7

Rankings are preliminary and subject to revision. Short-term notes maturing in under 13 months, private placements, dividends sold by private nonprofit electric cooperatives are excluded. Source: Thomson Financial-SDC, 1/16/05.

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INVESTMENT PRODUCTS:
 • NOT FDIC INSURED
 • NO BANK GUARANTEE
 • MAY LOSE VALUE

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“Paperless Legal” May Streamline Transfers

Non-routine transfers – called “legals” – occur when a securities transfer requires certain legal documents to accompany the securities certificate in order for transfer agents to complete the transaction. Rounding up, examining, copying and filing these documents can lead to extra processing time and costs, in addition to delays associated with requesting missing or incorrect documents.

In October 2004, the Securities Transfer Association (STA) and Securities Industry Association (SIA), with the cooperation of the Depository Trust & Clearing Corporation (DTCC), launched a Paperless Legal pilot program to eliminate the processing of most documents that accompany legal transfers. The pilot successfully concluded in December.

Why Change?

Under the current system, transfer agents generally require that certain documents – such as death or birth certificates, affidavits of domicile, corporate resolutions or trust agreements – accompany non-routine securities certificate transfers. These documents may be required even if the securities certificates being transferred bear a medallion signature guarantee (see article below).

However, issuers and transfer agents who accept securities with a valid medallion guarantee are protected under



Uniform Commercial Code Section 8-306. In that case, requiring the documents – in addition to the signature guarantee – may be unnecessary and a duplication of effort.

Adoptees of the Paperless Legal program are expected to save time and money because it:

- Speeds turnaround time
- Eliminates the need to obtain multiple copies of legal documents
- Decreases document filing and storage requirements
- Results in fewer legal transfer rejections and reject fees
- Expedites dematerialization (the move from paper certificates to completely electronic bookkeeping)

The program does have some limitations. For example, transfers valued over \$6 million and restricted securities

of any value are not included and still require full legal documentation to be submitted to the transfer agent.

About the Pilot Program

Twelve New York Stock Exchange (NYSE) firms and eight transfer agents participated in the program. The pilot was successfully completed in December 2004 and is now open to all transfer agents and NYSE Medallion Signature Program users. It is expected that the Paperless Legal program will be expanded to include Securities Transfer Association Medallion Program and Stock Exchange Medallion Program guarantors sometime in 2005.

Financial institutions and other organizations that serve as transfer agents are in the process of reviewing results of the pilot program.

What's a Medallion?

Medallion guarantees are issued by programs such as the Securities Transfer Agents Medallion Program (STAMP) and the New York Stock Exchange (NYSE) Medallion Signature Program (MSP).

Financial institutions that are part of these programs guarantee that, at the time of signing, the signature was genuine, the signer was the appropriate person to endorse the certificate and the signer had the legal



capacity to sign. In addition, the medallion indicates that the financial institution has the power to sell the security and has the

necessary legal documents on file. A medallion imprint or stamp is affixed to the document to certify the guarantee.

Spotlight on the Michigan Offices

The “Motor City,” famous for the auto industry, Motown sound and passionate sports fans, also boasts a dedicated group of U.S. Bank Corporate Trust Services professionals. Along with the Lansing office, the Detroit group serves the corporate trust needs of Michigan municipalities and corporations.

“We have six employees in Detroit and two in Lansing,” says Lars Anderson, vice president and Central Region business development officer. “Most of the staff members have been with us for many years. Nicholas McArthur and Joseph Brassard III recently joined us from National City, and we welcome their experience and expertise.”

High-Profile Municipal Deals

The Michigan group primarily handles municipal trustee work. Wayne County Airport Authority, a customer for more than 20 years, represents one of its major relationships. “We handle 10 to 12 bond issues for them at any one time as trustee,” explains Susan Payne, vice president and manager. “We’re expecting a new, \$650 million deal to finance enhancements for the Northwest Airlines terminal and renovate the rest of Detroit Metropolitan Airport. It’s expected to close by the beginning of the second quarter.

“We have maintained a longstanding relationship with the Authority by providing a high level of customer service,” Payne says.

“We handle very complex transactions over a long period of time for many of our customers,” Anderson adds. “We are able to offer our customers outstanding service, continuity and competitive pricing, and they remain loyal to us. Over the majority of the past seven years, we have been rated as the No. 1 trustee in Michigan.”

A Look at Lansing

The Lansing office is the only corporate trust office in the capital city among the major corporate trust competitors. “That commitment has helped us maintain longstanding and excellent relationships with the student loan and housing authorities of Michigan,” Anderson says. Gary Harvey, director, Michigan Higher Education Student Loan Authority, agrees. “I’ve found over many years that Lorraine Grill and the people at U.S. Bank Corporate Trust Services have been very honest and straightforward in their capacity as trustee on our financings,” Harvey says. “They are enthusiastic and service our accounts in a responsive, team-oriented fashion. I would recommend them to anyone without reservation.”

The Detroit and Lansing teams stand ready to serve the corporate trust needs of Michigan municipal and corporate customers.

Over the majority of the past seven years, U.S. Bank has been rated as the No. 1 trustee in Michigan.



Detroit staff, left to right: Nicholas McArthur, Joseph Brassard III, Susan Payne, Tracey Nawrot, James Kowalski and Lars Anderson.



The Lansing office is the only corporate trust office in the capital city among the major corporate trust competitors.

Lansing staff: Lorraine Grill and Teresa Walter.

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initiating or increasing dividends in the coming year.

Outlook for Bonds

The bond market has confounded prognosticators for the last several years, so why should 2005 be any different? For the record, we are again looking for modest returns from a core fixed-income portfolio, averaging in the low single digits. High-yield bonds should do

somewhat better, with returns in the 5%-6% range. High-yield spreads will widen somewhat in relation to Treasuries, but the default rate should stay low based on reasonable GDP growth (in the 3% range). We may have seen the end of the improvement to corporate credit quality that started in the fourth quarter of 2002. Renewed interest in mergers and acquisitions and share

buybacks indicates that many companies are starting to put the major cash stockpiles to work. While this may stimulate economic activity, it portends a peak in the credit cycle.

The reality is that investors are not being paid to take a lot of risk anywhere in what is likely to be a period in which interest rates rise at a persistent, if modest, rate. We expect to end 2005

with the 10-year Treasury yielding around 4.75%-5.0%, up from 4.22% at year-end. At the same time, the yield curve will flatten as the Fed continues to hike short-term rates and a tame inflation picture supports a less dramatic move on the long end. The dollar and oil prices are still wild cards, and a major dislocation in either could result in a dramatically different picture.

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Where We Stand

U.S. Bancorp Asset Management, Inc.

The Markets

The third year of the market rally should see returns continue to moderate into the mid-to-high single digits, with equities outperforming bonds. We believe the international markets continue to look attractive.

The Economy

The U.S. Gross Domestic Product (GDP) probably expanded by more than 3.5% in 2004. In the coming year, we expect growth will moderate to about 3.0%. Unemployment should stay steady or decline only slightly as growth moderates. We believe oil prices will be relatively stable in 2005.

The Inflation Outlook

Core inflation remained very well contained in 2004, and we expect this trend to continue in 2005. The Fed will likely continue to move the funds rate gradually higher throughout the coming year.

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