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JANUARY NEWSLETTER

Executive Summary

Review of 2004 – Stocks rallied during the last quarter of 2004, raising the total return on the Standard & Poor's 500 Average (S&P) to 10.88% for the year. Energy, utility and industrial stocks led the market, while health care and information technology stocks lagged behind. Small capitalization and value stocks outperformed large capitalization and growth stocks.

Review of Bridges' 2004 Top Recommendations – Last year's top picks were Johnson & Johnson, Tyco International, First Data Corp. and a package of energy stocks. Three out of the four had total returns above that of the market, and the average total return of the four was 22.3%.

Outlook for 2005 – We expect solid but slower growth in GDP and corporate profits in 2005 versus 2004 and modest increases in interest and inflation rates. As a result of multiple compression in 2004, we believe equity valuations are reasonable, especially for large capitalization growth stocks. We are currently finding a number of companies in the health care, financial services, and industrial sectors that have strong franchises, excellent long-term growth prospects, and attractive valuations.

Investment Committee's Top Recommendations for 2005 – include American International Group (AIG, $65.86), Omnicare (OCR, $30.99), and Tyco International (TYC, $36.00).

Review of 2004

The U.S. stock market ended 2004 with a strong rally that enabled the popular stock indexes to report respectable returns for the year despite difficulties during the first three quarters. The Standard & Poor's 500 Average (S&P) had a total return (price appreciation and dividends) of 10.88%, the Dow Jones Industrials Average had a total return of 5.31% and the NASDAQ Composite Average had a total return of 9.15% during 2004. Through much of the year, investors were worried about the uncertainty of the election outcome, the rising price of petroleum, continuing problems in Iraq and the threat of terrorist attacks. However, once oil prices peaked in October and reversed course and the U.S. elections were held, investors evidently decided they were comfortable buying stocks again. At September 30, 2004, the S&P was virtually unchanged from the December 31, 2003 ending value and nearly all of the year's return was earned in the final quarter.

Corporate profits were strong in 2004 and actually exceeded the price gains posted by the S&P. The environment was also positive from the standpoint of inflation and interest rates, as inflation remained relatively subdued despite much higher energy prices, and the yield on the 10-year U.S. Treasury Bond finished the year essentially unchanged at approximately 4.25%.

As shown in Exhibit 1, the returns were unevenly distributed across the major economic sectors during 2004.

EXHIBIT 1

S&P Sector	2004 Total Return	2004 Earnings per Share Growth
Energy	31.5%	48%
Utilities	22.7%	-2%
Industrials	18.1%	20%
Consumer Discretion	13.5%	25%
Telecommunications	13.0%	-9%
Materials	12.9%	80%
S&P 500	**10.9%**	**19%**
Financials	10.3%	12%
Consumer Staples	8.2%	10%
Information Technology	2.6%	45%
Health Care	2.5%	12%

Source: Baseline

Energy stocks were by far the market leaders as the prices of oil and gas rose much higher than expected due to strong demand (particularly from China and other Far East developing countries) and limited new supply. Utilities also performed well due to a recovery from the energy trading meltdown and independent power glut in prior years and due to investors looking for higher yields. Industrials also outperformed the market as strong worldwide demand, significant cost reductions and the weak U.S. dollar contributed to strong earnings growth. The weakest sector was Heath Care, which was affected by slowing growth and adverse publicity related to several major drugs. Information Technology also had relatively poor returns after a market-leading 46% return in 2003, due to concerns about slowing demand in 2005.

Investors once again favored small and mid-capitalization stocks over large companies in 2004. By manager style orientation, the “value” style outperformed the “growth” style by quite a margin.

EXHIBIT 2

Stock Index	2004 Total Return
S&P 500	10.9%
S&P MidCap 400	16.5%
S&P SmallCap 600	22.7%
Russell 2000	18.4%
Russell 1000 Growth	6.3%
Russell 2000 Growth	14.3%
Russell 1000 Value	16.5%
Russell 2000 Value	22.3%

Source: Bloomberg

Review of Bridges' 2004 Top Recommendations

In our January 2004 newsletter we identified our top four recommendations: Johnson & Johnson (JNJ, $62), Tyco International (TYC, $35), First Data Corporation (FDC, $41) and a package of energy stocks. The returns for 2004 are presented in Exhibit 3.

EXHIBIT 3

Security	12/31/03 Price	12/31/0 Price	2004 Total Return	2004 EPS Growth
Johnson & Johnson	$51.66	$63.42	24.9%	17%
Tyco International	$26.50	$35.74	35.4%	31%
First Data Corp	$41.09	$42.54	3.7%	14%
Energy Package				
Anadarko Petroleum	$51.01	$64.81	28.2%	30%
Apache Energy	$40.55	$50.57	25.4%	38%
ChevronTexaco	$43.20	$52.51	25.1%	53%
BP plc	$49.35	$58.40	21.8%	37%
Average Energy Package			25.1%	40%

Source: Baseline

If we treat the energy package as one stock, then three out of the four recommendations had a total return above that of the S&P, and the average total return of the four was 22.3%, which was about double the S&P's return. Please note that this performance data represents past performance and is not an indication of how these or our other recommendations will perform in the future.

Outlook for 2005

We expect the investing climate in 2005 to be characterized by the following factors: 1) continued solid economic growth with GDP growing around 3.5%; 2) continued positive corporate earnings growth, although growth is likely to slow from the strong pace experienced in the Q3 2001 through Q4 2004 time frame; 3) higher interest rates, as we expect the yield on the 10-year Treasury to finish 2005 around 5%, up from 4.3% currently; 4) higher inflation primarily due to higher energy prices; and 5) greater equity price volatility (2004 was a remarkably nonvolatile year, but we expect as the economy and earnings growth slows in the second half of 2005, increasing stock price volatility is a good bet).

Equity valuations seem to be reasonable given our expectation of continued solid corporate earnings growth in 2005 (we expect a 7%-8% increase over 2004 earnings for the S&P 500 companies). We believe that if interest rates on the 10-year Treasury remain at or below 5% during 2005, fair value for the S&P 500 would be about 18-20x estimated earnings of $70 per share, or a range of 1260-1400. The midpoint of that range would be 1330, about 10% above the year-end S&P level of 1211. The average P/E for the S&P 500 over the past decade, excluding 1999 and 2000, which were outlier years for equity valuations, was 19x. The average 10-year Treasury yield over the 1994-2004 time frame was 5.5%, so in a sense, the market's valuation entering 2005 seems to be discounting a rise in interest rates during the year. If interest rates stay below 4.5% during 2005, equity returns could be better than the 7%-9% the consensus currently expects.

In 2004, energy, utilities, and industrials were the best performing sectors in the market; smaller and mid-cap stocks significantly outperformed larger companies, and value materially outperformed growth as an investing style. Consequently, equity valuations within the market seem compressed toward the middle in terms of market capitalization, quality, earnings growth, and style. Over the past 5 years, the Russell 1000 Value Index had a total return of 29.28%, versus a 38.60% decline in the Russell 1000 Growth Index. In 2004, the Russell 1000 Value Index advanced 16.49%, versus a gain of 6.30% for the Russell 1000 Growth Index. Our sense is that companies with above-average long-term growth potential are currently valued at very reasonable levels over a three to five-year horizon, and we are currently finding a number of companies in the health care, financial services, and industrial sectors that have strong franchises, excellent long-term growth prospects, and attractive valuations.

Large capitalization growth stocks generally underperformed the broader equity market in 2004 despite solid earnings growth; consequently, absolute valuations for that segment of the market seem reasonable, and relative valuations are toward the low end of historic ranges.

We remain committed to owning strong companies with excellent long-term growth prospects and attractive valuation characteristics in our clients' portfolios.

EXHIBIT 4

S&P Sector	Estimated Earnings Growth 2005	2006	Five Year	2005 Price/Earnings
Consumer Discretion	12%	16%	14%	18.6
Consumer Staples	10%	11%	11%	18.2
Energy	-3%	-7%	8%	12.9
Financials	10%	10%	11%	11.9
Health Care	8%	10%	13%	17.4
Industrials	18%	16%	12%	17.9
Information Technology	15%	16%	15%	21.3
Materials	23%	11%	9%	14.7
Telecommunications	6%	6%	7%	16.0
Utilities	13%	8%	5%	14.7
S&P	6%	7%	6%	16.7

Source: Baseline

Investment Committee's Top Recommendations for 2005

Based on our investment strategy and our knowledge of specific company fundamentals, here are the top recommendations from our Investment Committee for 2005.

American International Group, Inc. (AIG, $65.86)

American International Group (AIG) is one of the largest insurance holding companies in the world. Its subsidiaries provide property and casualty, individual and group life, annuity, endowment, and accident and health insurance. AIG also provides variable annuities, mutual funds and investment asset management services. The Company has been recognized as one of the best managed and fastest growing insurance companies. During the past five years, revenues and earnings have increased at annual rates of 20% and 14%, respectively.

However, on October 14, 2004, New York Attorney Elliot Spitzer filed a lawsuit against Marsh & McLennan (MMC, $31.09) alleging bid rigging and challenging the use of contingent commissions. AIG was also named in the suit, and two of its employees pleaded guilty to participating in the bid rigging. Separately, the SEC and the Department of Justice (DOJ) alleged that AIG participated in two different transactions with PNC Financial and Brightpoint, Inc. that were used by those companies to manipulate their financial statements. AIG settled the complaints from the SEC and the DOJ regarding PNC Financial and Brightpoint, Inc. for $126 million (or $0.05 per share). Mr. Spitzer is also investigating the insurance industry regarding the potential use of insurance policies to manipulate earnings. AIG is cooperating with the authorities on both of these matters, and while AIG could be required to pay significant fines and settlements, it should not have long-term adverse consequences on the Company. We are also satisfied that the bid rigging was isolated to a few employees, who since have been terminated, and that the executive team has high ethical standards.

The uncertainty of these matters caused AIG's stock price to tumble from $72 to $55. The stock price has since recovered to $65, but it is still well off of its 2004 high of $76. AIG's earnings are estimated by analysts to increase 19% in 2005 to $5.22 and average 14% annual increases over the next five years. The price/earnings ratio based on the 2005 estimate is only 12.6 times at the current stock price, which is equal to a 25% discount to the S&P 500 P/E of 16.7 times. This value appears to be very attractive when compared to other companies with similar quality and growth potential and compared to AIG's history of often trading at a premium to the S&P 500 P/E.

Omnicare, Inc. (OCR, $30.99)

Omnicare is the largest institutional pharmacy in the U.S. The company provides pharmaceuticals and related services to long-term care facilities such as skilled nursing facilities, retirement homes, and assisted living facilities.

The institutional pharmacy business has good long-term growth prospects, based primarily on the strong underlying demographic trend in the U.S. toward a growing percentage of elderly persons within the population base. Elderly persons are living longer and are relatively larger consumers of pharmaceutical products and services.

Omnicare is the largest of the four public institutional pharmacy companies, serving 1.05 million beds through 178 pharmacies in 47 states. The next largest competitor serves about 250,000 beds.

Omnicare has successfully leveraged its size to become the low-cost provider in the industry; as Medicare reimburses pharmacies at the same rate for a drug, Omnicare can drive higher profit dollars per drug through its relatively large volume, cost synergies achieved over time, and through acquisition of smaller players in the market. Omnicare also benefits from a significant trend that shows more people are taking more drugs at the same time; increased efficacy of drugs over time results in a virtuous cycle as patients live longer and continue to take more medicines over time.

Growth drivers for Omnicare include an aging population (the over-65 population is expected to grow at 1.8% per year versus 0.7% growth in the total population between the years 2000 and 2020), growth in the census at elder-care facilities, growth in drug utilization, and growth in life expectancy of those within the over-65 segment of the population. These factors alone should drive high single-digit growth for Omnicare; further, the company should benefit from continued growth through new customer wins, customer expansions, continued drug price increases, and additional opportunities for mergers as the industry consolidates over time (the 40% of the industry share not held by Omnicare and its three main competitors is spread across 2,000 local and regional pharmacy players).

Omnicare faces several risks. First, it is seeking to close an acquisition of Neighborcare, one of its largest competitors (annual revenues of about $1.5 billion). The acquisition should be accretive to Omnicare; if the deal falls through it would be a negative for Omnicare. Second, a significant portion of Omnicare's revenues are derived from government reimbursement; while current trends are favorable, OCR could be hurt if significant changes are made to the reimbursement system. Third, price competition within the industry can intensify from time to time, pressuring margins.

Omnicare's valuation appears to be very attractive given its leading position in the industry, low cost provider status, and the growth prospects of the business given the growth likely in the elder-care market over the next decade. At present, OCR trades at 12.3x estimated 2005 earnings of $2.50, compared to an historic range of 6x-45x over the past 6 years. We believe that Omnicare should trade at least at a market multiple, given its much higher historic earnings growth rate (net income is up 10-fold over the past 9 years versus aggregate earnings growth of 75% for the S&P 500 over the same period); a market multiple of 18x on $2.50 per share earnings in 2005 would imply a $45 target price for OCR, or appreciation potential of 50%. Finally, a dividend discount model approach to valuation, using inputs of a 4.25% 10 year Treasury yield, a 4.5% risk premium, and a 13% long-term growth rate (versus a current consensus long-term earnings growth estimate of 14.5%) indicates that fair value for Omnicare is currently $39, about 30% above its current price.

<u>Tyco International, LTD (TYC, $36.00)</u>

In a bit of a departure from previous years, we are selecting a stock for the second straight year. Tyco posted very good earnings gains in 2004 and is poised to continue that strength in 2005. Three out of four of Tyco's major divisions had at least double digit earnings growth in the most recent quarter, while the company as a whole posted 31% earnings growth for the year. Expectations are for the company to continue its turnaround with 15% earnings growth in 2005. Management has done a commendable job of "righting the ship" at Tyco; the balance sheet is in very good shape, net debt continues to decline, and the credit rating is back to a solid investment grade rating of BBB+. Earnings growth is evident across the board in the company's various segments, and cash flow is also experiencing very good growth, resulting in the recent dividend increase which pushed the yield to just over 1%.

While we do not expect the stock price to perform as well as it did in 2004, if the stock performs as well as we expect the earnings to grow, we will be pleased with the investment for yet another year. Earnings are expected to be $1.96 per share for fiscal 2005, followed by $2.29 and $2.61 for 06 and 07, while free cash flow is expected to grow to $3.75 per share by fiscal 2007. The stock trades at a slight (1.04x, year end 04) premium to the S&P 500 even though it is expected to grow earnings at 2.67 times as fast as the market. We do not expect multiple expansion to move the stock higher, but rather expect earnings growth to propel the stock price higher over the next several years, and we would continue to recommend purchase of these shares.

These companies represent only three out of the 20 to 40 stocks that we typically hold in a client's equity portfolio and the 90 stocks that currently are on the Company's Comprehensive Approved List. The Investment Committee has chosen the above companies as their top recommendations because they believe that they offer the most compelling combination of strong long-term fundamentals and an attractive current price. However, that does not mean that these stocks will be placed in every client portfolio. Because of the unique requirements of each account due to differing client objectives, tax issues, and existing security or industry concentrations, we may decide not to own some of these securities in certain accounts. Consequently, a recommendation in this letter does not assure the inclusion of that company in your portfolio.

Edson L. Bridges II, CFA
Edson L. Bridges III, CFA
Randall D. Greer, CFA
Brian M. Kirkpatrick, CFA
Douglas R. Plahn, CFA