

# Capital Market Review • Third Quarter 2005

Mother Nature was undoubtedly the predominant influence on the financial markets during the third quarter, but despite the negative economic impact of hurricanes Katrina and Rita, the domestic equity markets were all positive for the quarter. After an initial negative reaction to the dramatic increase in oil prices, the markets proved their resiliency and made a considerable recovery. The bond market, on the other hand, struggled during the quarter, after a surprising first six months of the year. Treasury Bills returned 0.9% for the quarter, resulting in a net gain of 2.3% for the year through September, still below the 3.2% rate of inflation for the same period. Corporate and non-government debt, represented by the Lehman Brothers Aggregate Bond index, lost 0.1% over the three-month period. For the nine months, the index is up only 1.8%, significantly below the rate of inflation.

## Market Returns

	3 Months ended 9/30	9 Months ended 9/30
T-Bills	0.9%	2.3%
Lehman Bros. Aggregate Bond Index	-0.1%	1.8%
S&P 500	3.6%	2.8%
Dow Jones Industrials	3.4%	-0.3%
NASDAQ	4.6%	-1.1%
Russell 2000	4.7%	3.4%
EAFE	10.4%	9.1%
Wilshire REIT	4.1%	11.2%

## STOCK MARKET

The S&P 500 managed to gain 3.6% in the quarter and a net 2.8% for the nine months. The Dow Jones Industrial Index gained 3.4% for the quarter, but was still negative for the year to date with a return of -0.3%. The NASDAQ had a strong quarter, rising 4.6%, but returned a net -1.1% for the nine months after a disappointing first half of the year. The Russell 2000, a more specific index that tracks small domestic stocks, outperformed all the major U.S. stock market indices, returning 4.7% for the quarter; for the nine months the index was up 3.4%. With the price of oil escalating to an all-time high during the third quarter, it is no surprise that the Dow Jones AIG Commodity Index was the best performing index, gaining 16.6% for the quarter and 22.4% for

the nine months. The EAFE Stock Index, representing foreign stocks, returned 10.4% for the quarter, outperforming all the domestic equity indices except the Dow Jones AIG Commodity Index. The EAFE also outperformed the domestic stock market indices, minus commodities, for the nine months, returning 9.1%. Despite worries of a looming real estate bubble, the Wilshire REIT index returned 4.1% for the quarter and 11.2% for the nine months.

## Investment Styles

All of the major equity style categories posted positive returns for the third quarter. Growth stocks fared better than their Value counterparts, but Value stocks maintained their dominance for the nine months through September in a year when Growth stocks were expected to make a comeback. Based on market capitalization, Large stocks performed better than Small stocks. Only Large Value stocks underperformed the S&P 500 during the quarter, returning 3.5%. Small Growth stocks, returning 5.6%, were the best performing domestic equity style, followed by Large Growth stocks, returning 4.8%, and Small Value stocks with 4.5%. For the nine months, all styles of domestic equities outperformed the S&P 500. Small Value stocks proved to be the best area of the market with the highest return of 5.3%. Large Value and Small Growth stocks followed, both returning 4.0%. And despite many analysts' predictions, Large Growth stocks were the worst performing domestic equity style, returning 3.0% for the nine months.

## Return by Equity Manager Style

	3 Months ended 9/30	9 Months ended 9/30
Large Value	3.5%	4.0%
Large Growth	4.8%	3.0%
Small Value	4.5%	5.3%
Small Growth	5.6%	4.0%
International	11.4%	10.9%
Real Estate	3.3%	8.8%

International Equities outperformed all other equities during the quarter after underperforming the domestic markets in the second quarter. Foreign equity markets returned an impressive 11.4% from the beginning of July through the end of September. As a result, they were the best-performing equity style

for the first nine months of the year returning 10.9%. Real Estate equities gained only 3.3% during the third quarter, falling short of the S&P 500, but with a return of 8.8% were second to only International Equities for the nine months.

## Sectors

The third quarter produced mixed results across the various sectors of the stock market. Energy stocks continued to be one of the best performing sectors as oil prices reached all-time highs. Crude oil prices hovered around the \$60 mark throughout the quarter after topping the \$70 mark early in September. Energy stocks, which gained 21.0% for the quarter and 49.2% for the nine months, dramatically outperformed all other sectors. Utilities continue to be the second best performing sector of the market, returning 23.3% through the first nine months of the year. During the quarter Utilities gained 7.2%. Trailing Utilities, but also managing to outperform the S&P 500, were technology stocks with a return of 4.9% for the quarter. For the nine months, however, Technology stocks lost 1.1% and underperformed the broader market. Health Stocks managed to beat the market for the nine months despite falling short of the S&P 500 for the quarter. The sector gained only 1.5% for the quarter but was the third best performing sector for the nine months, returning 4.9%. Consumer Staples gained nearly 2.8% during the quarter, trailing the broader market, and also fell short of the market for the nine months returning only 2.2%. The worst performing sectors of the market were Raw Materials, Industrials and Consumer Discretionaries. Raw Materials and Industrials both had positive quarters returning 1.7% and 2.9%, respectively, but trailed the S&P 500 for the nine months with returns of -6.3% and -2.1%. Consumer Discretionaries was the worst performing sector, losing 0.8% for the quarter and 7.6% for the nine months.

## Global Markets

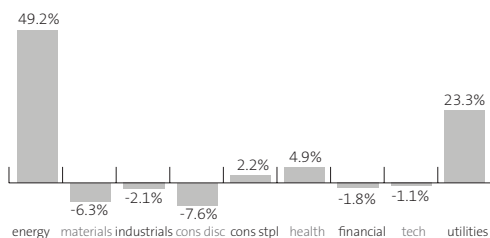
The United States was the worst performing major global market during the quarter. The S&P 500 gained only 3.6% versus a 10.4% gain for the international markets represented by the MSCI EAFE Index. After being down nearly 1% in the first half of the year, a mild recovery by our domestic economy moved the S&P 500 into the positive with a nine-month return of

2.8%, well below the EAFE's 9.1%. The Latin American economies, which do not constitute a portion of the EAFE Index, continued their dominance among the major stock markets of the world. Latin America gained 29.5% during the quarter and 41.1% for the nine months. After being the worst performing market through the first half of the year, Japan returned 19.2% for the quarter and rebounded to outperform all other major markets except Latin America. The Japanese market, which represents roughly 24% of the EAFE Index, was up 12.2% for nine months. The Pacific and European markets continued to beat our domestic stock market for the quarter, as well as the nine months. The Pacific Rim, which represents only 8% of the EAFE Index, returned 9.3% for the quarter and gained 14.7% during the first three quarters. The markets of European countries, which account for roughly 68% of the EAFE Index, returned 7.7% for the quarter. But after being down nearly half a percent through June, Europe is up only 7.3% for the nine months.

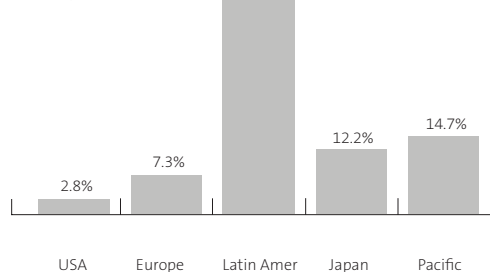
## Stock Market Performance

9 months ended September 30

### by Sector



### by Region



## BOND MARKET

The Federal Reserve continued its measured pace of short-term-rate increases, raising the federal funds rate a quarter of a point twice during the quarter to 3.75%. The rate should reach 4.25% by year end as the Fed nears the top of the tightening cycle, expected to occur during the first quarter of 2006 when rates should hit 4.75%. The yield on Treasury Bills increased from 3.07% as of June 30 to 3.57% as of September 30, an increase of 0.50%

or 50 basis points. The yield on Short-Term Treasuries increased 58 basis points for the quarter from 3.63% to 4.21%. After falling 55 basis points last quarter, the yield on Ten-Year Treasuries rebounded, rising 45 basis points to 4.39%. The bond market experienced what is known as a "flattening" of the yield curve over the first nine months of the year. As of September 30, the spread between the 91-Day T-bill and the Ten-Year Treasury was 82 basis points, or 0.82%, compared to a spread of 2.01% at the end of 2004. Long-Term Government Debt yields, which fell 54 basis points last quarter, also gained some momentum during the period, rising 40 basis points to 4.62%.

With yields on government debt rising during the quarter, the prices of bonds on the long end of the yield curve took a hit. Treasury Bills and Short-Term Government Bonds had positive returns for the quarter of 0.9% and 0.1%, respectively. Intermediate and Long-Term Government Bonds, however, saw their prices drop. Intermediate-Term Government Bonds lost 0.5% while the return on Long-Term Government Debt was -2.6%. Despite some price depreciation in the bond market, Government Bonds of all durations posted positive returns for the nine months ending in September. Treasury Bills returned 2.3%, while Short and Intermediate-Term Government Bonds returned approximately 1.0%. Long-Term Government Bonds continued to outperform the rest of the Government-Issued Debt market significantly, appreciating 5.5% for the nine months.

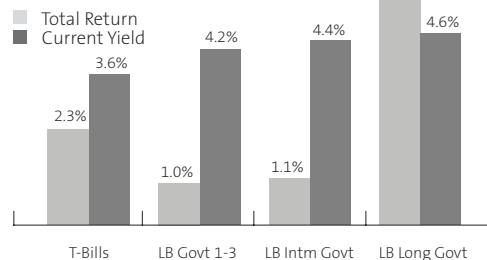
All sectors of the bond market, including Corporate and Global Debt, had negative returns for the third quarter with the exception of High-Yield Debt. Foreign debt, as represented by the Citigroup World Government Bond Index, Corporate Debt and Government Debt all lost roughly 1.0% over the three months. Mortgage-Backed Debt and Municipal Bonds both suffered small losses of 0.1% during the quarter. High-Yield debt was the only sector of the bond market to have positive gains for the quarter, returning only 0.9%. For the nine months, Global Debt was the only bond market in the red with a return of -6.8%. Through the end of September, all of the domestic bond markets had positive returns, but all were below the rate of inflation. Municipal Bonds performed the best, gaining 2.8%, followed by Government and Mortgage-Backed Debt with a return of 2.0%. High-Yield Debt was up only 1.7% for the nine months while the corporate sector was the worst performing market, returning only 1.5%.

Inflation, as measured by the Consumer Price Index, was 2.21% for the third quarter and 4.47% for the first nine months of 2005.

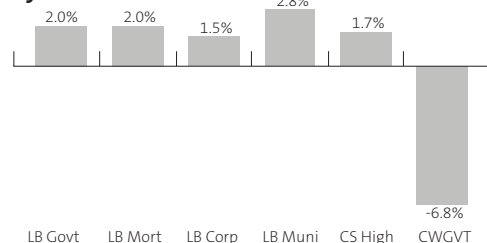
## Bond Market Performance

9 months ended September 30

### by Maturities



### by Sector



## COMMODITIES MARKET

The Dow Jones-AIG Commodity Index gained 16.6% during the quarter, a reflection of the high price of crude oil. Currently, energy makes up 33% of the index. For the nine months the Dow Jones-AIG Commodity Index has outperformed all of the other major market indices with a return of 22.4%. Oil prices rose from \$56.50 to \$66.24 over the course of the quarter; an increase of 17.2%. Prices escalated to more than \$70 per barrel early in September following the devastation caused by Katrina in the Gulf but have since "normalized," relatively speaking. Over the first three quarters the price of oil rose 52.5%. The price of gold increased dramatically during the third quarter from \$435.90 to \$469.00 per ounce, an increase of \$33.10 or 7.6%. For the nine months it rose \$31.50 or 7.2%.

## CURRENCY MARKET

During the quarter the U.S. dollar continued to gain ground over the euro and the Japanese yen. Against the euro, the U.S. dollar increased 0.7% for the quarter and was up 11.4% for the nine months. Against the yen, the U.S. dollar strengthened by 2.4% for the three months and was up 10.8% for the nine months. Against the Canadian dollar, however, the U.S. dollar weakened by 5.1% for the quarter and fell 3.1% for the nine months.