



# Market Update

Asset Consulting Group, Inc.

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Monthly Report

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## The Economy

The Fed raised its target rate by a quarter point to 4.5% on January 31, 2005 on concerns that inflation may accelerate as the nation's companies endure potential capacity constraints and try to pass through higher supply and energy costs by raising prices.<sup>1</sup> The rate hike led to an inverted yield curve, which in the past typically portended an economic slowdown. However, after the disappointing 4Q05 data, recent economic releases indicate the economic expansion accelerated in January as a result of increases in capital investment and inventory rebuilding as corporations anticipate future growth in demand.

### Economic expansion slows down in the fourth quarter...

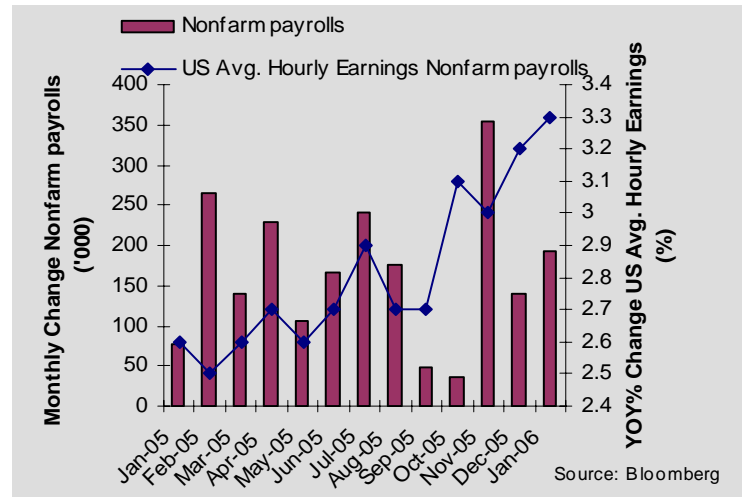
The economic expansion took a rest in 4Q05. The Commerce Department reported GDP growth of only 1.1% for the quarter, well below the long run average growth rate of 3%. The report showed a drop in auto sales from the torrid 3Q05 pace spurred by rebates, a decline in business spending and a slower pace of consumer spending. Consumer and business spending rose at an annual rate of 1.1% and 2.8% respectively as compared to a 4.1% and 8.5% increase in 3Q05. While this data showed signs of a cooling off period, the report also showed pockets of underlying strength, demonstrating the economic expansion remained on solid footing entering into the new year.

### Business momentum tracking strong...

As business fixed investment in equipment and computers slowed, companies redirected capital investment

towards the rebuilding of inventories in anticipation of improved demand. Inventory stockpiles grew at a \$25.7 billion annual rate in 4Q05 after declining at a \$13.3 billion pace in 3Q05. U.S. factory orders rose for a third consecutive month in December, gaining 1.1% on increased orders for autos and industrial equipment. Furthermore, the Institute for Supply Management factory index came in at

over the past 12 months. The expanding payrolls filtered through to consumer pocket books, as U.S. average hourly earnings for non-farm payrolls grew 3.3% YOY in January. Higher incomes seemed to support future consumer expectations. The University of Michigan's consumer sentiment index remained close to a five-year high in January, holding steady at 91.2 vs. 91.5 in December.



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- January 31, 2006

54.8 in January, slightly below the 55.6 reading in December, but still well above 50, indicating continuing expansion in the manufacturing sector.<sup>2</sup>

### Business expansion supporting consumer confidence...

In order to meet growing demand U.S. corporations added to payrolls in addition to expanding operations. Employers added 193,000 workers in January, which resulted in the country's unemployment rate dropping to 4.7%, its lowest level since July 2001. Employers have now added on average 167,000 new jobs each month

### Inflation remains in focus...

Consumer spending, which accounts for roughly 70% of the economy, was the key driver in sustaining the current economic expansion before taking a pause in 4Q05. U.S. corporations appeared to begin taking the reigns last quarter and continued to do so in January. This, in turn, could lead to a rebound in consumer spending as sentiment grows on better job prospects and on increasing personal incomes. However, as companies have ramped up production and services, capacity utilization in December rose to its highest level since November 2000. With capacity utilization rates peaking and companies trying to raise prices, the key question remains whether headline inflation can be contained at current interest rate levels or if the Fed needs to continue to tighten.

## Economy at a Glance

Recent growth indicators	2005			
	Oct	Nov	Dec	Jan
ISM manufacturing	58.1	57.3	55.6	54.8
ISM non-manufacturing	59.2	59.3	61.0	56.8
U. of Michigan Consumer Confidence	74.2	81.6	91.5	91.2
Retail Sales, Less Autos (%m-o-m)	0.7	-0.4	0.2	
Personal Income (%m-o-m)	0.6	0.4	0.4	
Personal Spending (%m-o-m)	0.1	0.5	0.9	

Source: Bureau of Labor Statistics, ISM, Bloomberg

## Equities

U.S. equity markets generally moved higher in January as investors discarded weaker economic data and focused on still robust earnings growth. Major equity benchmark indices rallied higher in the first two weeks of the month with the small-cap Russell 2000 up 5.67% and the

S&P 500 up 3.74%. Stocks retreated somewhat mid-month on reports that the nation's 4Q05 GDP grew only at a 1.1% annual pace, falling below 3% for the first time in 10 quarters. However, the S&P 500 still managed to close the month with its best January performance since 2001, up 2.65% with 67% of the stocks gaining ground.<sup>3</sup> The

gains resulted mostly from robust earnings growth as 394 of the S&P 500 companies reported a market-cap weighted average earnings growth of 17.6% for 4Q05. The S&P 500 energy sector was once again the top-performing sector, rising 13.85%, followed by basic materials, up 4.67%.<sup>4</sup> The large cap value style outperformed its growth

counterpart, with the Russell 1000 Value and Growth indices gaining 3.88% and 1.76%, respectively. After being outperformed by large caps in 2005, small caps reversed course in January as the Russell 2000 rose 8.97%, easily outpacing the Russell 1000's gain of 2.80%.

## Fixed Income

As the Fed raised short-term rates at the end of the month, the two-year Treasury note yield rose to 4.54% while the 10-year notes closed the month at 4.53%, resulting in an inverted yield curve. This latest rate hike has left the difference between the 10-year note's yield and the Fed's target rate the slimmest since 2001. Rising yields left U.S. Treasuries with their first monthly loss since October 2005, as the Merrill

Lynch U.S. Treasury Master index fell 0.28%. Investment grade corporate bonds posted a limited gain in January, with the Lehman Brothers U.S. Aggregate index increasing merely 0.01%. Signals from the Fed that further short-term rate hikes may be needed to contain headline inflation and expectations that corporations, awash with cash from robust earnings growth, might be looking to de-leverage their balance sheets to enhance shareholder value, worked against high grade bonds.

Corporate bond spreads tightened further with spreads between U.S. Industrial AAA and the U.S. Treasury 10-year note falling from 58 basis points at the start of the month to 49 basis points on January 31<sup>st</sup>. On the other hand, low levels of equity volatility, the healthier balance sheets and below average default rates helped sustain a robust appetite for risk within the high yield credit markets. Standard & Poor's reported that the US speculative-grade default rate amounted to only

1.93% in January, significantly lower than its long-term (1981-2005) average of 4.70%. These strong fundamentals of low volatility and stronger balance sheets helped propel the Lehman Brothers U.S. Corporate High Yield index to a monthly gain of 1.60%. The Lehman Brothers Municipal Bond index also eked out a positive gain of 0.27% in January.<sup>5</sup>

## International

Similar to 2005, international equity markets continued their stellar performance in January, registering solid gains in both developed and emerging market equity indices. Of the 24 MSCI developed market national indices, only New Zealand underperformed (-2.01% in USD) the MSCI U.S. equity index (+2.73%).<sup>6</sup> Higher consumer confidence, accelerating economic growth and increasing capital spending supported the Japanese equity market.

The Nikkei 225 index reached a five-year high at the end of January, gaining 3.35% for the month in yen and 4.34% on a USD basis. Higher wages and better job prospects sent Japanese consumer confidence to 49.5 in January, the highest level since June 1990, up from a December reading of 46.5.<sup>7</sup> Japanese consumer spending, which accounts for more than half the economy, rose 0.4% in December, while the jobless rate fell to 4.4% from November's reading of 4.5%. These reports have led economists to forecast that Ja-

pan's expansion should continue into 2006. The MSCI Europe index gained 3.25% in local currency and 6.54% in USD in January amid investor optimism that the European economic recovery is gaining traction heading into 2006 from more than just higher exports due to a weaker dollar that occurred in 2005. The European economy appears to be witnessing an up-tick in business investment from a stimulative monetary policy and higher consumer consumption. The improved data prompted economists to fore-

cast European economic growth of 2.1% in 2006. Overall, the underlying strength in both European and Japanese equity markets contributed to the January MSCI EAFE's gains of 3.53% in local currency and 6.15% in USD terms, as the USD retraced some of the 2005 gains against other major currencies. Emerging market equities continued to surge, with the MSCI Emerging Market index increasing 8.16% on a local currency basis, and 11.23% in USD.<sup>8</sup>

### Footnotes:

All data from Bloomberg except:

1-FOCM January 31, 2005 meeting minutes

2-Institute for Supply Management

3,4-Standard & Poor's

5-Lehman Bros.

6,8-Morgan Stanley

7-Japan Ministry of Finance

## Indices Report

**Asset Consulting Group, Inc.**  
**Indices Report**  
 Periods Ending January 31, 2006

Index Name	Style	Returns							
		Month	Qtr	2 Qtrs	3 Qtrs	1 Year	3 Years	5 Years	10 Years
<b><u>Domestic Equity Indices</u></b>									
S&P 500	Large Cap Core	2.65%	6.57%	4.68%	12.19%	10.38%	16.43%	0.38%	9.00 %
S&P Equal Weighted	Large Cap Core	4.12%	9.52%	6.53%	18.71%	15.98%	23.94%	7.65%	12.00 %
DJIA	Large Cap Core	1.50%	4.73%	3.32%	8.46%	6.00%	12.96%	2.08%	9.36 %
Russell 1000	Large Cap Core	2.80%	6.86%	5.04%	13.46%	12.07%	17.45%	0.98%	9.24 %
Russell 1000 Growth	Large Cap Growth	1.76%	5.83%	3.92%	13.86%	10.82%	14.83%	(4.53)%	6.56 %
Russell 1000 Value	Large Cap Value	3.88%	7.93%	6.20%	13.13%	13.22%	19.96%	6.00%	11.03 %
Russell Mid Cap	Mid Cap Core	5.14%	10.94%	8.28%	22.66%	21.46%	26.74 %	9.20%	12.82 %
S&P Mid Cap 400	Mid Cap Core	5.89%	11.83%	9.05%	24.51%	22.31%	24.71 %	9.37%	14.85 %
Russell 2000	Small Cap Core	8.97%	13.74%	8.50%	27.67%	18.89%	26.86%	8.99 %	10.22 %
Russell 2000 Growth	Small Cap Growth	9.65%	15.68%	10.70%	30.89%	19.58%	25.84%	2.57%	5.74 %
Russell 2000 Value	Small Cap Value	8.27%	11.80%	6.30%	24.48%	17.92%	27.70 %	14.74 %	13.90 %
NASDAQ Composite	Broad Equities	4.56%	8.76%	5.60%	20.07%	11.87%	20.43%	(3.61)%	8.09 %
Wilshire 5000	Broad Equities	3.56%	7.84%	5.75%	15.22%	13.15%	18.73%	2.06%	9.25 %
<b><u>International Equity Indices</u></b>									
MSCI World	Broad Global	4.48%	10.44%	11.51%	18.64%	17.59%	22.26%	3.11%	7.72%
MSCI World Ex US	Broad International	6.33%	14.20%	18.74%	24.81%	24.15%	28.54%	6.31%	7.03%
EAFE	Developed Markets Intl	6.15%	13.84%	18.41%	23.91%	23.27%	28.49%	6.18%	6.76%
EAFE Growth	Developed Markets Intl Growth	6.17%	13.92%	18.82%	23.93%	23.49%	25.11%	3.51%	4.21%
EAFE Value	Developed Markets Intl Value	6.13%	13.75%	18.02%	23.92%	23.09%	31.83%	8.80%	9.19%
MSCI Emerging Markets Free	Emerging Market	11.23%	27.57%	31.53%	50.83%	49.18%	43.56%	18.90%	N/A
IFCI Composite	Emerging Market	10.73%	27.17%	31.09%	50.31%	49.33%	44.39%	21.12%	8.40%
<b><u>Domestic Fixed Income Indices</u></b>									
Treasury Bills	Cash	0.31%	0.96%	1.82%	2.56%	3.21%	1.92%	2.27%	3.83%
Lehman Intermediate G/C	Intermediate Govt/Credit Bonds	(0.02)%	1.05%	0.81%	1.30%	1.36%	2.96%	5.14%	5.71%
Lehman Intermediate Aggregate	Int. Core Bonds	0.12%	1.29%	1.00%	1.55%	1.78%	3.19%	5.20%	5.90%
Lehman Aggregate	Core Bonds	0.01%	1.40%	0.84%	1.55%	1.80%	3.59%	5.53%	6.09%
Citi Broad Investment Grade	Core Bonds	(0.01)%	1.42%	0.85%	1.66%	1.90%	3.71%	5.58%	6.12%
Lehman Govt/Credit	Govt/Credit Bonds	(0.18)%	1.28%	0.57%	1.34%	1.47%	3.68%	5.71%	6.08%
Lehman Long Govt/Credit	Long Govt/Credit Bonds	(0.82)%	2.17%	(0.30)%	1.54%	1.87%	6.29%	7.77%	7.35%
Lehman Government	Government Bonds	(0.17)%	1.21%	0.78%	1.28%	1.84%	2.85%	5.14%	5.85%
Lehman Mtg Backed Securities	Mortgage Bonds	0.32%	1.64%	1.28%	1.94%	2.40%	3.48%	5.18%	6.13%
Lehman Muni 3 Yr	3 Yr Municipal Bonds	0.22%	0.66%	0.89%	1.36%	1.23%	1.74%	3.44%	4.12%
Lehman Muni 10 Yr	10 Yr Municipal Bonds	0.32%	1.86%	1.40%	1.79%	2.21%	4.49%	5.24%	5.61%
Lehman U.S. Credit Index	Corporate Bonds	(0.20)%	1.39%	0.28%	1.47%	0.95%	4.76%	6.49%	6.37%
Merrill Lynch High Yield	High Yield Bonds	1.59%	3.01%	1.62%	7.10%	4.55%	12.69%	7.84%	6.78%
Merrill Lynch Conv US	Convertible Bonds	3.93%	6.75%	5.46%	13.35%	6.15%	10.84%	4.09%	N/A

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