



Market Update

Asset Consulting Group, Inc.

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Monthly Report

February 2005

The Economy

Amid indications of only a slight moderation in economic growth thus far and additional signs of rising core inflationary pressures, the Federal Reserve appears to be increasingly concerned about the economic stimulus generated by unusually low long-term interest rates. In stark contrast to typical public comments from Fed officials in recent years, which have been geared towards keeping longer-term interest rates low, Alan Greenspan purposefully "talked" longer-term interest rates higher in testimony before the Senate Banking Committee on February 16. Noting that, "by most measures," the fed funds rate remains "fairly low," the Fed Chairman also specifically declared that Fed officials were perplexed by the decline in longer-term interest rates given the 1.5% rise in the fed funds rate over the last year and solid economic growth. While stating that "bond price movements may be a short-term aberration," Chairman Greenspan said that "for the moment, the broadly unanticipated behavior of world bond markets remains a conundrum." Following

following the release of the January consumer spending report. The report's gauge of prices tied to spending, known as the core PCE price deflator (excludes volatile food and energy prices), rose 0.3% in January, the largest monthly increase in two years. The core PCE price deflator is widely purported to be the Fed's core inflation measure of choice. Overall, the ten-year Treasury yield rose 0.22% to finish Febru-

ing average of weekly initial jobless claims fell to 307,000 in February, a four-year low, as the economy added another 262,000 jobs last month. While indicators suggest overall economic activity has remained strong, further signs of an impending moderation have emerged. The Conference Board's index of leading indicators declined 0.3% in January, leaving the index basically unchanged over the last six months. In addition, the aver-

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- February 28, 2005

“ Over the last year, real personal spending has grown a solid 3.4%, while personal income growth has accelerated to 6%, the highest level in four years. “

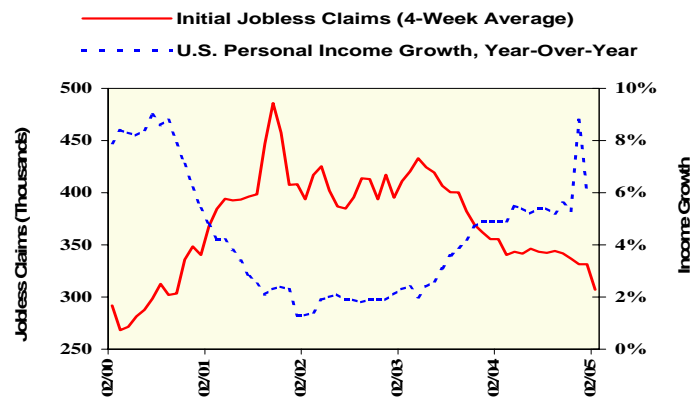
Chairman Greenspan's comments, the ten-year Treasury yield rose sharply from 4.10% in mid-February to 4.27% by February 22. The ten-year yield spiked again to 4.36% on February 28

ary at 4.36%. With the Fed widely expected to raise the fed funds rate again in late March, the two-year Treasury yield jumped 0.30% in February to 3.59%, bringing the yield gap between the ten-year and two-year Treasuries down to just 0.77%. Overall, the January consumer spending report showed solid underlying strength. While personal spending was unchanged in January due to a drop in purchases of autos, spending on other goods remained strong. Over the last year, real personal spending has grown a solid 3.4%, while personal income growth has accelerated to 6%, the highest level in four years (see chart). Income growth has been supported by a continued strengthening in the job market. The four-week mov-

age ISM index value (manufacturing and service sector indices) declined again to a 20-month low of 57.6, indicating a continued moderation in economic activity (a reading below 50 indicates a contraction in activity). With a vigilant Fed and rising interest rates, the level of economic activity may soften moderately from its recent 4% pace as the year progresses.

Equities

U.S. stocks rebounded in February as the S&P 500 jumped 2.10%, bringing its year-to-date return to -0.38%. The Russell 2000 lagged the S&P 500 for the third straight month for the first time since May of 2000, posting a 1.69% return. For the year, the (cont'd on page 2)



Data Sources: US Dept of Labor, US Commerce Dept

Equities *(cont'd from page 1)*

S&P 500 has outperformed the Russell 2000 by 2.17%. Heading into 2005, small-cap stocks had outperformed large-cap stocks for six straight years. On the earnings front, with 96% of the companies in the S&P 500 having reported fourth-quarter earnings growth, operating earnings grew 19.9%, well ahead of the consensus analyst estimate of 15.5% growth at the beginning of the quarter. Wall Street analysts currently expect operating earnings growth to slow to just 7.2% in the first quarter. On March 18, Standard & Poors will begin

the first of two adjustments that will convert all of its major U.S. equity indices to a float-adjusted methodology from the current method, which weights each company by its total market capitalization. To switch to float-adjusted weightings, S&P will exclude the portion of each company's total market capitalization that is held by government entities, current and former company directors, officers, and founders, and holdings of other publicly traded companies and private equity firms. The switch will occur in two stages, with half of the adjustment occurring on March 18 and the

remaining adjustment scheduled for September 16, 2005. S&P estimates that close to 11% of all equity assets under management in the United States are indexed to the S&P 500, suggesting that the shift to a half float-adjusted index in March could potentially produce some increased market volatility across the index's broad sectors, although this volatility may be muted given S&P's public release of the changes and the long-expected shift in assets. According to an analysis from First Call, the sectors with the largest expected percentage declines in indexed assets are the Consumer Staples and Con-



sumer Discretionary sectors, while the largest relative percentage inflows are expected to occur in the Telecom and Utility sectors.

Fixed Income

The Lehman Aggregate index tumbled 0.59% in February on the spike in long-term interest rates brought on by the mid-month comments from Federal Reserve Chairman Alan Greenspan. On a year-to-date basis, the Lehman Aggregate's total

return has fallen to just 0.03%, pulled lower by the -0.09% return of the U.S. Treasury portion of the broad Aggregate index. The Lehman U.S. Credit index led all other major sectors, delivering 0.28% of excess return over similar-duration U.S. Treasury securities in February, followed by the U.S. Agency (+0.13%), CMBS (+0.11%), and

ABS (+0.05%) sectors. Owing to increased interest-rate volatility, the Lehman MBS index recorded a -0.13% excess return relative to benchmark Treasury securities. In step with a stronger equity market, the Lehman U.S. High Yield index rose 1.47% in February, reversing January's decline and bringing its year-to-date return to 1.34%. The

strongest excess returns came from the high yield issues with lower credit quality ratings. The spread between the Lehman U.S. High Yield index's yield-to-worst and the ten-year Treasury's yield has fallen to just 2.43%, less than half of its ten-year trailing average of 5.04%.

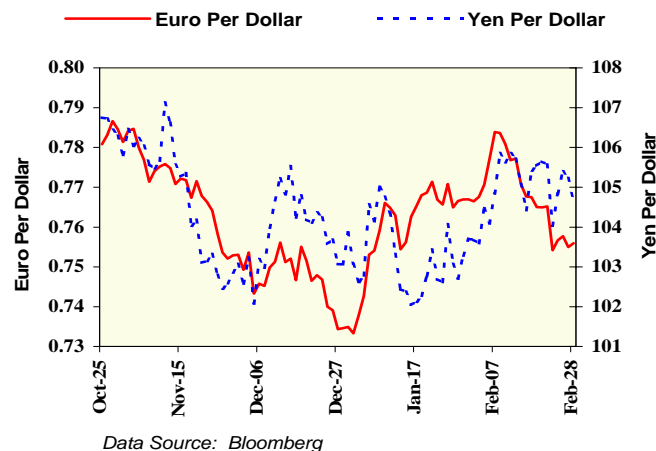
International

Despite another month of generally lackluster economic data in Europe and Japan, the MSCI EAFE index surged 4.34% in February, supported by a weaker U.S. dollar. Real GDP in the region sharing the euro currency grew just 0.6% on an annualized basis in the fourth quarter, as growth in Germany and Italy actually contracted. The European Central Bank lowered its estimate of 2005 economic growth to 1.6% from a previous estimate of 1.9%, while once again leaving its benchmark interest rate unchanged at 2.0%. The recession in Japan continued as the Japanese economy contracted by an annualized 0.5% in the fourth quarter, marking the third straight quarter of negative GDP growth. Providing some support to the yen late in the month and hopes of an end to the recession, economic reports

revealed that Japanese industrial output and retail sales both surged in January, but the yen still lost ground versus the dollar last month. While a weaker yen subtracted from the US-dollar

the MSCI EAFE index. The dollar rallied against the euro early in the month as comments from Federal Reserve Chairman Alan Greenspan suggested that a time "may be approaching....at which

margins," eluding to higher import prices, a contraction of the trade deficit, and increased support for the U.S. dollar. The dollar shifted direction and posted its biggest loss versus the euro in six months on February 22 on indications in a report from the Bank of Korea that it planned to increase reserves in currencies such as the Australian and Canadian dollar. The dollar recovered modestly versus the euro the next day as South Korea clarified its position by stating, along with Japan, that it does not plan to reduce its holdings of the dollar. Despite South Korea's statement, the dollar failed to recover most of its losses from the previous day. Emerging market equities continued to surge in February as the MSCI Emerging Markets index jumped 8.78% on a 7.10% local-currency return and a 1.68% return contribution from a weaker U.S. dollar.



return of the MSCI Japan index, a strong monthly gain in the euro helped currency shifts add 1.44% to the US-dollar return of

exporters to the United States, should the dollar decline further, would no longer choose to absorb a further reduction in profit

Real Estate

Capital continues to flow into real estate strategies and manager queues are swollen. As a result, there is significant liquidity available in the real estate market and valuations for most assets remains high. Transaction levels have expanded for all property types, and cap rates (income yield as % of asset value) continue to compress under the pressure. According to Real Capital Analytics, \$170 billion of commercial property

transactions closed in 2004, representing an increase of more than 40% above the 2003 total of \$120 billion. Capitalization rates for high quality core properties are currently in the 5% - 7% range, or 100 - 150 bps lower than they were 12 months earlier. The residential sector saw record transaction levels in 2004, with transactions totaling over \$40 billion. This represents an increase of approximately 60% over the prior year. Cap rates for multi-family properties continue to compress and currently range from 4.5% to

6.5%. The retail sector, bolstered by strong consumer spending, continued to outperform in 2004. Transaction levels increased approximately 45% to over \$30 billion during the year. Nationally, retail cap rates continued to drop and currently range from 6.5% to 7.5% for strip centers. The office sector also experienced increased activity with an increase in transaction levels from approximately \$46 billion in 2003 to over \$62 billion in 2004. The majority of activity was in major business centers. In response, cap rates

for core business district properties have dropped to the 6% to 7% range, but remain above 7.5% in suburban office markets. In the industrial sector, transaction levels expanded more than 40% to over \$15 billion in 2004. Major port cities, where property is constrained, continue to receive the greatest attention. Cap rates for industrial properties are currently in the 6% to 7% plus range.

Note: Transaction and cap rate data provided by AEW Research.

Indices Report

Periods Ending February 28, 2005

Returns

Index Name	Style	Month	Qtr	2 Qtrs	3 Qtrs	1 Year	3 Years	5 Years	10 Years
<u>Domestic Equity Indices</u>									
S&P 500	Large Cap Core	2.10%	3.01%	9.99%	8.86%	6.98%	4.65%	(0.98)%	11.31 %
S&P Equal Weighted	Large Cap Core	2.13%	2.73%	14.29%	12.40%	10.90%	10.70%	10.08%	13.34 %
DJIA	Large Cap Core	2.92%	3.80%	7.00%	7.40%	3.90%	4.37%	3.26%	12.58 %
Russell 1000	Large Cap Core	2.25%	3.28%	10.82%	9.39%	7.48%	5.31%	(0.94)%	11.39 %
Russell 1000 Growth	Large Cap Growth	1.06%	1.52%	7.67%	2.34%	1.13%	1.05%	(9.71)%	8.66 %
Russell 1000 Value	Large Cap Value	3.31%	4.88%	13.75%	16.43%	13.74%	9.32%	7.94%	13.21 %
Russell Mid Cap	Mid Cap Core	3.09%	4.82%	17.98%	16.44%	14.98%	12.99 %	6.84%	13.75 %
S&P Mid Cap 400	Mid Cap Core	3.36%	4.93%	16.31%	13.11%	12.14%	10.95 %	8.85%	15.47 %
Russell 2000	Small Cap Core	1.69%	0.34%	16.41%	12.56%	9.53%	11.94%	3.20 %	10.94 %
Russell 2000 Growth	Small Cap Growth	1.37%	0.28%	17.56%	8.19%	5.29%	8.31%	(7.95)%	6.50 %
Russell 2000 Value	Small Cap Value	1.99%	0.38%	15.38%	16.80%	13.65%	14.99 %	16.00 %	14.57 %
NASDAQ Composite	Broad Equities	(0.52)%	(2.15)%	11.63%	3.28%	1.08%	5.82%	(15.27)%	9.96 %
Wilshire 5000	Broad Equities	2.20%	3.10%	11.43%	9.95%	7.92%	6.44%	(1.14)%	11.18 %
<u>International Equity Indices</u>									
MSCI World	Broad Global	3.21%	4.79%	15.25%	14.40%	12.52%	9.20%	(0.80)%	8.60%
MSCI World Ex US	Broad International	4.45%	6.71%	21.33%	20.85%	18.83%	14.98%	0.57%	6.87%
EAFE	Developed Markets Intl	4.34%	6.93%	21.28%	20.54%	19.14%	15.02%	0.45%	6.64%
EAFE Growth	Developed Markets Intl Growth	4.03%	5.94%	19.97%	16.75%	13.92%	11.27%	(5.39)%	3.98%
EAFE Value	Developed Markets Intl Value	4.65%	7.91%	22.55%	24.26%	24.35%	18.74%	6.41%	9.19%
MSCI Emerging Markets Free	Emerging Market	8.78%	14.38%	35.36%	39.16%	26.88%	24.32%	6.06%	5.67%
IFCI Composite	Emerging Market	8.39%	14.22%	35.11%	38.24%	28.37%	25.75%	7.76%	6.55%
<u>Domestic Fixed Income Indices</u>									
Treasury Bills	Cash	0.16%	0.54%	0.94%	1.25%	1.51%	1.44%	2.84%	4.07%
Lehman Intermediate G/C	Intermediate Govt/Credit Bonds	(0.55)%	0.32%	0.24%	3.08%	0.96%	5.09%	7.03%	6.71%
Lehman Intermediate Aggregate	Int. Core Bonds	(0.52)%	0.51%	0.76%	3.85%	1.92%	5.01%	7.11%	6.88%
Lehman Aggregate	Core Bonds	(0.59)%	0.96%	1.26%	4.81%	2.44%	5.59%	7.53%	7.26%
Citi Broad Investment Grade	Core Bonds	(0.60)%	1.00%	1.29%	4.94%	2.55%	5.62%	7.56%	7.27%
Lehman Govt/Credit	Govt/Credit Bonds	(0.66)%	1.09%	1.19%	4.85%	2.05%	6.04%	7.75%	7.35%
Lehman Long Govt/Credit	Long Govt/Credit Bonds	(1.06)%	4.00%	4.69%	11.56%	6.28%	9.37%	10.11%	9.29%
Lehman Government	Government Bonds	(0.71)%	0.80%	0.60%	3.94%	1.33%	5.12%	7.12%	7.02%
Lehman Mtg Backed Securities	Mortgage Bonds	(0.46)%	0.77%	1.48%	4.89%	3.25%	4.78%	7.09%	7.07%
Lehman Muni 3 Yr	3 Yr Municipal Bonds	(0.30)%	(0.04)%	(0.13)%	1.84%	0.14%	2.87%	4.58%	4.73%
Lehman Muni 10 Yr	10 Yr Municipal Bonds	(0.63)%	1.40%	1.59%	5.58%	2.15%	5.56%	7.00%	6.53%
Lehman U.S. Credit Index	Corporate Bonds	(0.59)%	1.51%	2.04%	6.17%	3.10%	7.30%	8.55%	7.90%
Merrill Lynch High Yield	High Yield Bonds	1.41%	2.84%	7.32%	12.37%	10.55%	12.33%	7.69%	8.09%
Merrill Lynch Conv US	Convertible Bonds	(1.02)%	(0.99)%	4.46%	2.63%	1.41%	8.76%	(0.34)%	N/A

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