



Market Update

Asset Consulting Group, Inc.

www.acgnet.com

Monthly Report

March 2005

The Economy

As March's incoming economic data indicated a continuation of solid economic activity in recent months, the financial markets and economic commentators remained focused on rising interest rates and inflation data last month. Inflation indicators remained stronger than expected, pushing interest rates higher across all points on the Treasury yield curve and contributing to a notable shift in the Federal Reserve's assessment of the inflation environment. Despite seven straight Federal Reserve interest-

Federal Reserve's fed funds rate increase to 2.75% on March 22, many were surprised by the shift in the Fed's language in its accompanying statement. In a change of tone, the Fed's official statement at its March meeting was decidedly more hawkish than recent meetings' statements, setting the table for additional rate hikes. Breaking from its mantra that inflation is "well contained," the Fed noted that "pressures on inflation have picked up in recent months." In addition, the committee stated that "with appropriate

leading indicators, economists have begun to revise their U.S. economic growth projections lower for the second-half of 2005. In Bloomberg's latest monthly survey of 64 economists, the median projected economic growth for the second half of 2005 fell to 3.50% from 3.65% in the previous survey. This would represent a slowdown from projected economic growth of 3.85% in the first half of the year. Inflation expectations for all of 2005 increased from 2.50% in the previous survey to 2.70% in the latest survey.

Asset Consulting Group, Inc.
7700 Bonhomme Avenue
Suite 650
St. Louis, Missouri 63105
TEL 314.862.4848
FAX 314.862.5967

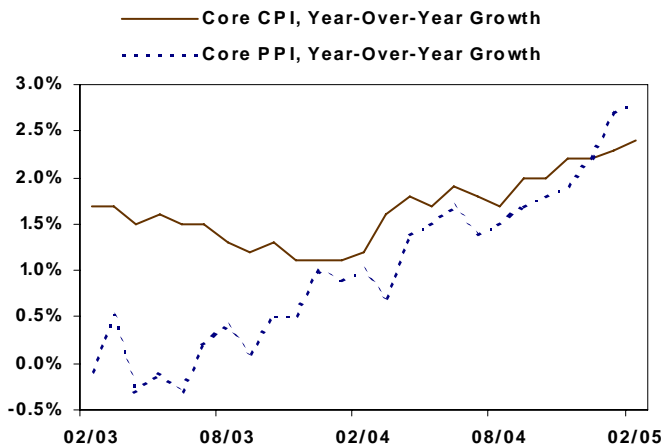
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- March 31, 2005



Data Source: Bureau of Labor Statistics

rate hikes, core inflation measures have continued to slowly gravitate higher. Year-over-year growth in core consumer prices (CPI less food & energy prices) reached a 30-month high of 2.4% in February, while core producer price growth hit 2.8%, the highest level since 1995 (see chart). Recent inflation data suggests that inflationary pressures are building in non-energy related segments of the economy, while business pricing power is increasing. Companies have begun to pass higher labor and raw materials costs on to consumers. While very few economists were surprised by the

monetary policy action, upside and downside risks to the attainment of both sustainable growth and price stability should be kept roughly equal." In February, the Fed had stated that the upside and downside risks were already equal. The language change suggests that the Fed has migrated from raising rates to prevent a possible pickup in inflation to raising rates to "contain" a pickup in inflation that has already begun. In light of the Fed's more aggressive stance, rising interest rates, a continued flattening of the yield curve, higher oil prices, and a moderation in the growth of

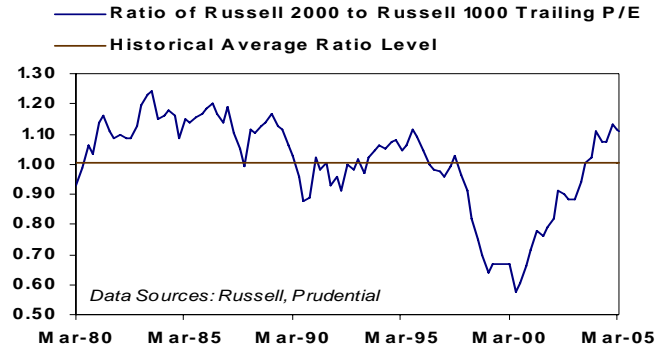
Equities

Surging oil prices, concerns over inflation, and higher interest rates all weighed on the S&P 500 as the index lost 1.77% in March. After reaching a new 2005 high in early March, the index's gains quickly evaporated as the price of oil rose to a new all-time high of more than \$56 per barrel and incoming inflation data was higher than expected. Just two of the ten broad S&P 500 sectors, Utilities and Industrials, recorded positive returns. The Financial (-4.02%) and Energy (-3.65%) sectors posted the largest price declines. The Wilshire All Growth index, a broad measure of the performance of large-cap and small-cap growth stocks, fell 1.58% in March, outperforming its Value counterpart by 0.29%. Year-to-date, the Wilshire Growth index still trails the Value index by 3.28%. Small-cap stocks continued to lag large-cap stocks as the Russell 2000 index tumbled 2.86%, trailing the S&P 500 for the fourth straight month for the first time since 1998. In recent months, general equity valuations have shifted in favor of large-cap stocks relative to small-cap stocks. At 18.23, the price-to-earnings ratio (P/E) of the (cont'd on page 2)

Equities *(cont'd from page 1)*

large-cap Russell 1000 index is well below the small-cap Russell 2000 index's P/E of 20.17. Historically, the ratio of the small-cap index's P/E to the large-cap index's P/E has averaged 1.00. This ratio has shifted above one in recent quarters for the first

time in eight years (see chart), suggesting more favorable large-cap equity valuations. Year-to-date, the Russell 2000 index is trailing the Russell 1000 index by 3.43%. Large-cap stocks have underperformed small-cap stocks in every calendar year since 1998.



Fixed Income

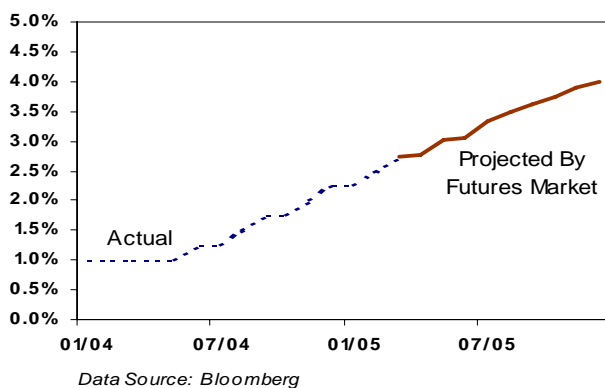
A more hawkish Fed and rising inflationary indicators pushed the ten-year Treasury yield 0.14% higher in March to finish at

4.50%. Following the Fed's rate hike on March 22, the ten-year yield rose to a nine-month high of 4.64%. The Treasury yield curve continued to flatten as the two-year Treasury yield jumped 0.21% to 3.80%, bringing the

yield gap between the two-year and ten-year Treasury yields to just 0.70%. The futures market is pricing in a continued rise in short-term interest rates, as measured by the fed funds rate, through year-end (see chart). The rise in interest rates and widening credit spreads contributed to a decline in the Lehman Aggregate index of 0.51% in March. Following specific negative headlines regarding a few high profile companies and in step with weaker equity prices, the rise in interest rates coincided with flight-to-quality trades in the credit sector that pushed investment-grade credit yield spreads over U.S. Treasuries to their highest levels since last

August. All major non-Treasury sectors of the Lehman Aggregate underperformed similar-duration Treasury securities in March, paced by -0.86% of excess return for the Lehman U.S. Credit index, as well as CMBS (-0.30%), Agencies (-0.15%), ABS (-0.13%), and MBS (-0.07%). Lower credit-quality bonds performed the worst as the Lehman U.S. High Yield index trailed similar-duration Treasuries by 2.60% in March, the worst relative performance for the high-yield index since September of 2002. The Lehman High Yield index's option-adjusted yield spread over Treasuries widened 0.70% to a five-month high of 3.29%.

Fed Funds Target Rate



International

Driven by a significantly stronger U.S. dollar, 21 of the 23 non-U.S. country indices within the MSCI World index posted negative US-dollar total returns in March. The MSCI EAFE index tumbled 2.47%, with most of the loss attributable to currency shifts. The dollar saw strength on the outlook for higher short-term interest rates in the U.S., which was bolstered by the Federal Reserve's statement accompanying its March rate hike. The euro and the yen also weakened on a fresh round of disappointing economic data from Europe and Japan. After the European Central Bank (ECB) decided to leave its benchmark rate unchanged at 2% on April 7, ECB President Jean-Claude Trichet noted that "recent data and survey indica-

tors have been mixed," pointing "to ongoing economic growth at a moderate pace in the short-term, with no clear signs yet of a strengthening in the underlying dynamics." The ECB cut its estimate for 2005 economic growth to 1.6% from a previous estimate of 1.9%. Weakness in the euro region has persisted across most segments of the economy. French business confidence dropped to a 15-month low in March, while German industrial production fell 2.2% in February. High unemployment rates in Germany and France have pressured consumer spending as euro-region retail sales have fallen for three straight months. Reflecting the expected economic growth differential between the U.S. and Europe, German ten-year government bonds are now yielding 0.91% less than ten-year U.S. Treasury

bonds, nearly the widest the gap has been since the year 2000. The Bank of Japan voted to leave interest rates near zero and maintained its outlook that the Japanese economy was still in the early stages of recovery, despite another round of weak economic data. Japanese retail sales fell 2.7% in February as household spending declined 4.1%. Emerging market equities and debt plunged in March on a reduction in investor risk appetites following a spike in U.S. interest rates and the Fed's more hawkish tone. The MSCI Emerging Markets index lost 6.59%, bringing its year-to-date return down to 1.94%. The greatest losses were in emerging Europe and Latin America. The Lehman Emerging Markets index of bonds declined 2.59%, bringing its year-to-date return to -0.76%. China once again



rejected international calls for an immediate end to the yuan's peg to the U.S. dollar, but Chinese Premier Wen Jianbao did state that "work related to exchange-rate reform is in progress," and that the timing of such measures "may come unexpectedly." After the comments, forward contracts for the Chinese currency traded at the highest level since early March.

Private Equity

Private equity investment activity continued to expand in 2004. According to Buyouts newsletter, the volume of buy-out transactions increased over 40% in 2004, reaching \$136.5 billion, up from \$94.8 billion in 2003 and \$44.0 billion in 2002. The increased activity, coupled with low interest rates and in-

creased lending, has led to higher valuations, which are revisiting levels last seen in 1997-1998. Last year also witnessed a surge in venture capital investment activity, reversing a trend that had persisted since the tech bubble burst in 2001. According to a report from Thomson Financial Venture Economics, venture capitalists invested \$20.9 billion across 2,876 deals in 2004, fueled primarily by

a 46% year-over-year increase in follow-on and late-stage financings as well as improving IPO and M&A markets. The venture-backed companies that survived the downturn appear to be receiving the attention and financing needed to position them for an IPO or outright sale. Early-stage venture capital investment activity showed only a slight increase in 2004, with \$3.9 billion going into 841 deals com-

pared to \$3.4 billion into 770 deals in 2003. As the M&A environment and the health of venture-backed companies improves, valuations are recovering. According to VentureOne, median valuations increased for the first time since 2001 and are back at levels last seen in 1997 and 1998.

Indices Report

Periods Ending March 31, 2005

Index Name	Style	Returns							
		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	(1.77)%	(2.15)%	6.89%	4.89%	6.69%	2.75%	(3.16)%	10.79%
S&P Equal Weighted	Large Cap Core	(1.29)%	(2.19)%	9.88%	7.62%	10.18%	8.07%	7.69%	12.86%
DJIA	Large Cap Core	(2.30)%	(2.06)%	5.37%	2.31%	3.58%	2.52%	1.21%	11.89%
Russell 1000	Large Cap Core	(1.58)%	(1.91)%	7.71%	5.76%	7.24%	3.35%	(2.97)%	10.93%
Russell 1000 Growth	Large Cap Growth	(1.82)%	(4.09)%	4.71%	(0.76)%	1.16%	(0.70)%	(11.28)%	8.15%
Russell 1000 Value	Large Cap Value	(1.37)%	0.09%	10.48%	12.18%	13.17%	7.16%	5.19%	12.81%
Russell Mid Cap	Mid Cap Core	(0.79)%	(0.25)%	13.37%	12.42%	14.05%	10.53%	5.49%	13.34%
S&P Mid Cap 400	Mid Cap Core	(1.11)%	(0.40)%	11.71%	9.37%	10.43%	8.02%	6.87%	15.15%
Russell 2000	Small Cap Core	(2.86)%	(5.34)%	8.00%	4.92%	5.41%	8.04%	4.01%	10.43%
Russell 2000 Growth	Small Cap Growth	(3.75)%	(6.83)%	7.23%	0.78%	0.87%	4.01%	(6.60)%	5.79%
Russell 2000 Value	Small Cap Value	(2.06)%	(3.98)%	8.70%	8.86%	9.79%	11.48%	15.41%	14.28%
NASDAQ Composite	Broad Equities	(2.56)%	(8.10)%	5.40%	(2.37)%	0.26%	2.71%	(15.26)%	9.36%
Wilshire 5000	Broad Equities	(1.74)%	(2.22)%	7.75%	5.77%	7.19%	4.31%	(2.61)%	10.70%
<u>International Equity Indices</u>									
MSCI World	Broad Global	(1.89)%	(1.00)%	10.93%	9.93%	11.08%	6.95%	(2.49)%	7.89%
MSCI World Ex US	Broad International	(2.27)%	0.07%	15.22%	15.44%	15.55%	12.13%	(0.70)%	5.98%
EAFE	Developed Markets Intl	(2.47)%	(0.10)%	15.25%	14.99%	15.50%	12.07%	(0.82)%	5.73%
EAFE Growth	Developed Markets Intl Growth	(2.41)%	(0.81)%	14.25%	12.47%	11.06%	8.99%	(6.20)%	3.10%
EAFE Value	Developed Markets Intl Value	(2.54)%	0.60%	16.23%	17.43%	19.90%	15.09%	4.61%	8.25%
MSCI Emerging Markets Free	Emerging Market	(6.59)%	1.94%	19.53%	29.40%	17.02%	19.18%	4.52%	N/A
IFCI Composite	Emerging Market	(6.24)%	1.87%	19.76%	29.60%	18.18%	20.34%	6.07%	5.90%
<u>Domestic Fixed Income Indices</u>									
Treasury Bills	Cash	0.24%	0.57%	1.05%	1.43%	1.67%	1.47%	2.78%	4.04%
Lehman Intermediate G/C	Intermediate Govt/Credit Bonds	(0.52)%	(0.88)%	(0.45)%	2.24%	(0.34)%	5.45%	6.70%	6.60%
Lehman Intermediate Aggregate	Int. Core Bonds	(0.38)%	(0.56)%	0.21%	2.91%	0.88%	5.34%	6.81%	6.78%
Lehman Aggregate	Core Bonds	(0.51)%	(0.47)%	0.48%	3.69%	1.16%	6.00%	7.14%	7.14%
Citi Broad Investment Grade	Core Bonds	(0.55)%	(0.51)%	0.47%	3.75%	1.21%	6.01%	7.16%	7.15%
Lehman Govt/Credit	Govt/Credit Bonds	(0.70)%	(0.67)%	0.13%	3.70%	0.41%	6.52%	7.29%	7.21%
Lehman Long Govt/Credit	Long Govt/Credit Bonds	(1.42)%	0.03%	2.20%	9.09%	3.34%	10.15%	9.27%	9.03%
Lehman Government	Government Bonds	(0.33)%	(0.41)%	0.07%	3.18%	0.11%	5.77%	6.68%	6.92%
Lehman Mtg Backed Securities	Mortgage Bonds	(0.19)%	(0.12)%	1.14%	3.77%	2.60%	5.08%	6.82%	7.00%
Lehman Muni 3 Yr	3 Yr Municipal Bonds	(0.33)%	(0.76)%	(0.57)%	1.32%	0.08%	3.27%	4.41%	4.61%
Lehman Muni 10 Yr	10 Yr Municipal Bonds	(0.88)%	(0.67)%	0.16%	4.31%	1.83%	5.98%	6.40%	6.29%
Lehman U.S. Credit Index	Corporate Bonds	(1.24)%	(1.05)%	0.21%	4.42%	0.84%	7.52%	8.10%	7.67%
Merrill Lynch High Yield	High Yield Bonds	(2.72)%	(1.43)%	2.97%	7.74%	6.80%	10.43%	7.40%	7.64%
Merrill Lynch Conv US	Convertible Bonds	(2.12)%	(5.33)%	0.70%	(0.76)%	(1.43)%	6.85%	(0.22)%	N/A

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