Market Update

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Monthly Report April 2005

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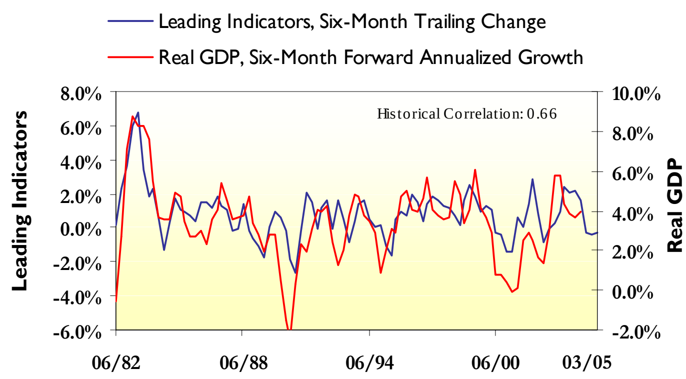
The Economy

Concrete signs of an economic slowdown have begun to emerge, while inflation indicators have continued to strengthen, placing the Federal Reserve in a precarious position. As we have been anticipating, and in line with recent leading economic indicators, economic growth has begun to decelerate towards a level closer to long-term averages. Real U.S. GDP growth moderated to an annualized 3.1% in the first quarter, the slowest pace in two years, on weaker business investment and a soaring trade deficit. Business investment in equipment and software rose at an annualized rate of 6.9%, the lowest level in two years, while the trade deficit subtracted 1.5% from final GDP growth. An $80 billion surge in inventories during the first quarter, the highest in nearly five years, suggests weaker production in the months ahead as the level of sales catches up with the acceleration in inventory growth. Weaker growth has continued into the second quarter, as indicated by a new 21-month low in the Institute for Supply Management's (ISM) manufacturing index of 53.3 in April, suggesting continued but slower expansion in the manufacturing sector. A historical trend analysis and the ISM manufacturing index's 9-point decline over the last year suggest a significant probability that the index may fall below 50 and the manufacturing sector may contract at some point before the end of 2005. Other indicators also suggest that slower growth will continue. March unfilled orders for durable goods, a gauge of future manufacturing production, declined 0.5%, the largest drop in 28 months, while non-defense capital goods orders excluding aircraft, an indicator of future business investment, plummeted 4.7%, the most in 16 months. Eight of the ten components of the Conference Board's leading indicators index fell in March as the index lost 0.4%. Over the last six months, the leading index has declined 0.3%, a level historically consistent with an annualized GDP growth rate of 2.5% over the next six months (*see chart*), suggesting a near-term slowdown, but not a recession. Economists have revised their growth forecasts lower in response to recent indicators. In Bloomberg's early May survey of economists, the consensus GDP growth forecast for the second quarter fell to 3.2% from April's forecast of 3.7%, while the growth forecast for all of 2005 fell to 3.4%. The forecast for average 2005 consumer inflation rose 0.2% to a level of 2.9%, reflecting a strengthening in recent inflation data. The March consumer price index (CPI) jumped 0.6%, while the core CPI (prices excluding food and energy) rose 0.4%, the largest increase since August 2002. The core personal consumption expenditures price indicator, a measure watched by the Federal Reserve, increased a more-than-expected 0.3% in March. The Economic Cycle Research Institute's Future Inflation Gauge, a composite of leading inflation indicators, hit a two-year high of 119.7 in April, suggesting continuing inflationary pressures in the economy in the months ahead. Changes in inflation tend to lag changes in economic growth, and, at some point, a continued slowing in the economy should lead to a stabilization in the rate of inflation. The Federal Reserve is charged with finding the balance between these two variables. After raising the fed funds rate by another 0.25% on May 3, the Fed stated that "recent data suggest that the solid pace of spending growth has slowed somewhat," but that "pressures on inflation have picked up in recent months." Thus far, the Fed appears to be more worried about inflation than slowing economic growth, and further rate hikes are expected. The fed funds futures market, a proxy for expected future fed funds rates, has modestly scaled back expectations for future fed rate hikes. The December 2005 fed funds futures implied rate has fallen to 3.72% from 3.99% at the end of March, implying three more 0.25% rate hikes this year. If incoming inflation data begins to reflect the slowdown in economic growth, the Fed may pause its current rate tightening cycle by early fall.



Data Sources: Commerce Department, Conference Board

Equities

Reflecting softer economic data, increased inflationary pressures, and a downward trend in earnings growth expectations, the S&P 500 lost 1.90% in April, bringing its year-to-date return to –4.00%. The decline was led by continued weakness from cyclical sectors, including Basic Materials (-7.04%) and Consumer Discretionary (-6.49%). For the year, the largest price declines are in the Consumer Discretionary (-12.00%) and Technology (-11.13%) sectors (*see chart*). The Russell 2000 index of small-cap stocks plummeted 5.73% in April, trailing large-cap stocks by nearly 4%. On a year-to-date basis, the Russell 2000 is down 10.76%, more than 6.50% behind the S&P 500. While the S&P 500's first-quarter operating earnings growth has been coming in significantly ahead of expectations, consensus second-quarter earnings growth expectations have fallen from 8.7% at the beginning of April to 7.2% currently, which would represent the slowest quarterly operating earnings growth in three years. Market breadth remained solidly negative in April as 320 of the 500 stocks in the S&P 500 fell. For the year, 344 of the 500 stocks in the S&P 500 have declined. Market breadth is an indicator of the conviction and near-term sustainability of a market shift.

S&P 500 Sector Price Changes

S&P Sector	April	Year-to-Date
Healthcare	3.36%	2.31%
Technology	(3.96%)	(11.13%)
Utilities	2.92%	7.49%
Consumer Staples	(1.06%)	(0.91%)
Consumer Discretionary	(6.49%)	(12.00%)
Energy	(5.32%)	10.84%
Financials	(0.18%)	(7.12%)
Industrials	(3.05%)	(5.02%)
Basic Materials	(7.04%)	(5.86%)
Telecom	0.14%	(8.48%)

Data Source: Bloomberg

For instance, in the 1999 run-up to the S&P 500's peak in the year 2000, more stocks in the index fell than rose, despite a 21% return for the entire index. With more than two-thirds of the stocks in the index down this year, the stock market's decline has been broad-based and is not concentrated in a single sector, suggesting the decline has been driven by fundamental macro factors.

Fixed Income

Driven by a swath of weak economic indicators, bonds overcame firmer inflation data and other potentially negative non-economic factors to finish April at significantly lower yields. The ten-year Treasury yield declined 0.29% to end the month at a ten-week low of 4.21%. Treasury yields declined in the face of stronger-than-expected CPI and PCE deflator inflation indicators, suggesting a bond market that, in contrast to the Federal Reserve, is currently more concerned with the potential for weaker economic growth than stronger inflation. Yields rose only slightly in late April amid rumors that China would soon let its currency rise, an event that would reduce the country's need to hold U.S. Treasury securities, theoretically placing upward pressure on yields. In early May, the U.S. government announced it was considering reissuing 30-year Treasury bonds for the first time since their discontinuance in 2001. Following a brief rise in longer-term yields, rates settled back down close to their pre-announcement levels, failing to rise on the heels of an event that would normally send yields higher. The prospects for further Fed tightening limited declines in short-term interest rates in April as the two-year Treasury yield fell 0.14% to 3.66%. Combined with the larger decline in the ten-year Treasury yield, the yield difference between the ten-year and two-year Treasury yields narrowed 0.15% to just 0.55%, a four-year low. The spread between the two yields is within 0.20% of levels that have historically only occurred during periods of time heading into recession or during periods of financial market distress, such as the 1998 Russian debt default. If the Fed continues to raise short-term rates in the coming months as the futures market expects, then either longer-term interest rates must come under pressure to rise, or the Treasury yield curve will invert (higher short-term yields than long-term yields). Historically, inverted yield curves have been indicative of impending recessions with a fairly high degree of forecasting accuracy. The current and potential shapes of the Treasury yield curve over the coming months highlight the difficulty of the Fed's current task – striking a fairly precise balance between non-inflationary short-term rates and a continuation of the current economic expansion. The drop in ten-year rates in April pushed the Lehman Aggregate to a solid 1.35% return, despite significant underperformance from major spread sectors. The Lehman Credit index trailed duration-matched Treasury securities by 0.58% in April as the index's option-adjusted yield spread (OAS) over U.S. Treasury securities widened 0.10% to an 18-month high of 0.96%. The Lehman MBS sector underperformed benchmark U.S. Treasuries by 0.10%. Lower-credit quality issues performed worst as the Lehman High Yield index lagged benchmark Treasury returns by 2.62% on a 0.61% increase in the index's OAS to an eight-month high of 3.90%.

International

In step with U.S. equities, the MSCI EAFE index lost 2.24% in April on a US-dollar basis, as a 0.48% return lift from a modest decrease in the value of the U.S. dollar failed to offset significant local equity market losses. The dollar rose 0.3% versus the euro and declined 2.2% versus the yen, which rallied in late April on rumors that China was about to ease its currency peg to the U.S. dollar, a move that would likely result in a stronger Chinese currency versus the U.S. dollar. The Chinese central bank denied these rumors in a statement. Euro-region economic data remained weak, particularly in Germany. On April 4, the European Commission cut its 2005 growth forecast for Germany to 1.5% to a level of just 0.8%, placing Germany as the country with the lowest forecasted 2005 growth among all 25 nations in the European Union. In line with reduced growth forecasts, German business confidence fell to a 19-month low in April. The March weakness in emerging market equities continued into April as the MSCI Emerging Markets index fell 2.67% on a US-dollar basis, bringing its year-to-date return to –0.78%. Despite China's efforts to slow its economy's rate of growth, first-quarter GDP growth jumped 9.5% from the same period a year earlier, matching the country's 2004 growth pace. Chinese officials are targeting a growth rate of 8% for all of 2005.

Hedge Funds

Macro-economic factors drove stock prices in the first quarter of 2005 as the prospects for higher interest rates, rising inflation, and surging energy prices caused concerns for investors. Returns were generally flat to negative across all hedge fund strategies for the quarter. The only strategies that were able to post positive returns were Merger Arbitrage up 0.18%, Equity Market Neutral up 0.14%, and Distressed up 0.06%. At the other end of the spectrum, Emerging Markets (-1.77%) suffered due to thin liquidity as investors sold into a declining market. Convertible Arbitrage (-1.64%) continued to underperform as the lack of convertible bond issuance has caused managers and traders to leave the strategy, driving prices down. A large amount of capital has been redeemed out of Convert Arb as strategy specific managers have closed and multi-strategy managers have dramatically reduced their exposure to the strategy.

"Returns were generally flat to negative across all hedge fund strategies…"

The HFRI Fund of Funds Composite Index, a broad measure of all hedge fund of funds, declined 0.57% in the first quarter. The HFRI Conservative Fund of Funds Index, a measure of low volatility hedge fund of funds, fell 0.17%. The HFRI Equity Hedge Index, a measure of long/short managers, lost 1.09%.

A Credit Suisse First Boston (CFSB) report on investment banks indicates that hedge funds account for between 40% and 50% of the daily turnover on the New York and London stock exchanges, 70% of convertible bond trading volume, 82% of trading volume in the US distressed market, and 70% of U.S. ETF trading volume. This amount of volume may be one of the reasons the SEC has become more involved in regulating hedge funds.

Rules that expand the SEC's oversight of the hedge fund industry went into effect on February 10, 2005. These rules require hedge funds with U.S. clients to become registered investment advisors and subject themselves to periodic examinations. Though managers are not required to complete their registration with the commission until February 1, 2006, managers must maintain books, records of performance, and rates of return for periods ending after February 10 of this year.

Indices Report

Periods Ending April 30, 2005

Index Name	Style	Returns							
		Month	*Qtr*	*2 Qtrs*	*3 Qtrs*	*1 Year*	*3 Years*	*5 Years*	*10 Years*
Domestic Equity Indices									
S&P 500	Large Cap Core	(1.90)%	(1.61)%	3.28%	6.42%	6.34%	4.25%	(2.94)%	10.26 %
S&P Equal Weighted	Large Cap Core	(3.09)%	(2.30)%	3.98%	9.10%	9.53%	8.26%	6.81%	12.78 %
DJIA	Large Cap Core	(2.81)%	(2.27)%	2.79%	2.19%	1.83%	3.03%	0.97%	11.12 %
Russell 1000	Large Cap Core	(1.84)%	(1.23)%	4.04%	7.58%	7.20%	4.75%	(2.67)%	10.43 %
Russell 1000 Growth	Large Cap Growth	(1.90)%	(2.67)%	1.14%	3.18%	0.40%	1.51%	(10.75)%	7.71 %
Russell 1000 Value	Large Cap Value	(1.79)%	0.07%	6.72%	11.75%	13.93%	7.76%	5.05%	12.25 %
Russell Mid Cap	Mid Cap Core	(3.19)%	(0.98)%	6.81%	13.81%	14.62%	10.06 %	5.83%	12.81 %
S&P Mid Cap 400	Mid Cap Core	(3.89)%	(1.76)%	5.68%	10.26%	9.74%	6.77 %	6.79%	14.46 %
Russell 2000	Small Cap Core	(5.73)%	(6.87)%	(0.15)%	6.05%	4.71%	5.62%	4.08 %	9.54 %
Russell 2000 Growth	Small Cap Growth	(6.36)%	(8.64)%	(1.98)%	3.67%	(0.55)%	2.50%	(5.84)%	4.94 %
Russell 2000 Value	Small Cap Value	(5.16)%	(5.27)%	1.52%	8.22%	9.80%	8.28 %	14.06 %	13.34 %
NASDAQ Composite	Broad Equities	(3.88)%	(6.82)%	(2.70)%	1.82%	0.08%	4.41%	(13.03)%	8.57 %
Wilshire 5000	Broad Equities	(2.21)%	(1.80)%	3.69%	7.44%	7.10%	5.28%	(2.00)%	10.18 %
International Equity Indices									
MSCI World	Broad Global	(2.11)%	(0.88)%	5.97%	11.21%	10.94%	7.41%	(2.06)%	7.28%
MSCI World Ex US	Broad International	(2.55)%	(0.53)%	8.39%	16.03%	15.63%	10.93%	(0.16)%	5.33%
EAFE	Developed Markets Intl	(2.24)%	(0.51)%	8.95%	16.17%	15.42%	10.96%	(0.20)%	5.10%
EAFE Growth	Developed Markets Intl Growth	(1.85)%	(0.36)%	8.50%	15.06%	11.70%	8.10%	(5.27)%	2.46%
EAFE Value	Developed Markets Intl Value	(2.61)%	(0.67)%	9.39%	17.24%	19.08%	13.76%	4.88%	7.63%
MSCI Emerging Markets Free	Emerging Market	(2.67)%	(1.09)%	13.62%	28.22%	24.04%	17.86%	6.05%	N/A
IFCI Composite	Emerging Market	(2.24)%	(0.65)%	13.79%	29.37%	24.98%	19.08%	7.92%	5.22%
Domestic Fixed Income Indices									
Treasury Bills	Cash	0.23%	0.63%	1.16%	1.54%	1.82%	1.49%	2.74%	4.02%
Lehman Intermediate G/C	Intermediate Govt/Credit Bonds	1.14%	0.06%	0.01%	2.54%	3.24%	5.27%	6.99%	6.59%
Lehman Intermediate Aggregate	Int. Core Bonds	1.14%	0.23%	0.62%	3.19%	4.27%	5.12%	7.07%	6.76%
Lehman Aggregate	Core Bonds	1.35%	0.24%	0.98%	4.06%	5.26%	5.79%	7.49%	7.13%
Citi Broad Investment Grade	Core Bonds	1.40%	0.24%	0.99%	4.17%	5.37%	5.84%	7.52%	7.16%
Lehman Govt/Credit	Govt/Credit Bonds	1.50%	0.12%	0.75%	4.15%	5.14%	6.36%	7.71%	7.22%
Lehman Long Govt/Credit	Long Govt/Credit Bonds	2.86%	0.32%	3.49%	10.17%	12.32%	10.18%	10.13%	9.14%
Lehman Government	Government Bonds	1.60%	0.55%	0.86%	3.86%	4.87%	5.50%	7.08%	6.95%
Lehman Mtg Backed Securities	Mortgage Bonds	1.11%	0.45%	1.44%	3.99%	5.62%	4.82%	7.04%	6.96%
Lehman Muni 3 Yr	3 Yr Municipal Bonds	0.51%	(0.12)%	(0.34)%	1.10%	1.62%	2.94%	4.51%	4.62%
Lehman Muni 10 Yr	10 Yr Municipal Bonds	1.94%	0.41%	1.30%	4.90%	6.75%	5.85%	6.92%	6.49%
Lehman U.S. Credit Index	Corporate Bonds	1.34%	(0.51)%	0.58%	4.53%	5.52%	7.50%	8.58%	7.64%
Merrill Lynch High Yield	High Yield Bonds	(1.04)%	(2.37)%	0.00%	5.19%	6.45%	9.47%	7.17%	7.28%
Merrill Lynch Conv US	Convertible Bonds	(3.34)%	(6.35)%	(3.33)%	(1.17)%	(2.54)%	6.12%	0.36%	N/A

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