



Market Update

Asset Consulting Group, Inc.

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Monthly Report

June 2004

The Economy

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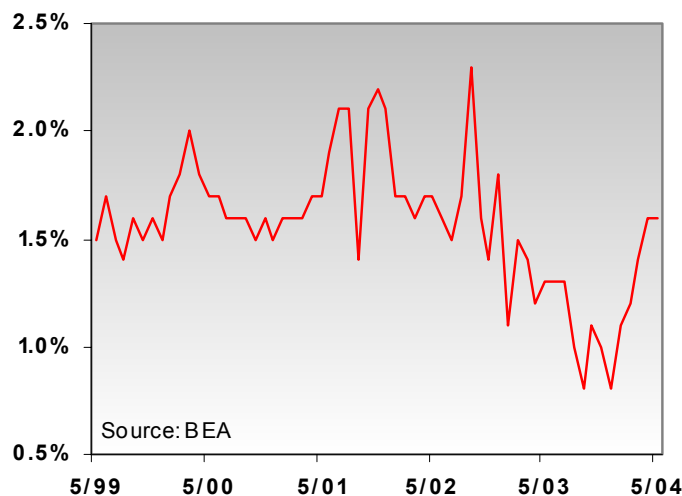
Citing "solid" economic expansion and "improved" labor market conditions in its accompanying statement, the Federal Reserve raised the federal funds rate by 0.25% to 1.25% on June 30, the first increase in more than four years. The Fed suggested that further rate increases are likely in the months ahead, but at a pace "that is likely to be measured." Noting that it believes "a portion of the [inflation] increase in recent months appears to have been due to transitory factors," the Fed is hoping that the recent decline in energy prices will ease inflationary pressures, allowing the central bank to continue to raise the fed funds rate in 0.25% increments. The Fed also noted that if inflation continues to strengthen, it is prepared to act more aggressively to "fulfill its obligation to maintain price stability." Given the Fed's statements, the pace of further fed funds rate hikes is likely to be determined by the level of incoming inflation

data. Growth in the Fed's favored inflation measure, the personal consumption expenditures price index excluding food and energy, known as the core PCE price index, has been trending higher, but is still at a moderate 1.6% year-over-year rate (see chart). In step with the Fed's view of "solid" growth, economic indicators have remained generally strong in recent weeks, particularly in the consumer sector. Despite rising mortgage rates, sales of new homes surged 15% higher in May to an annualized rate of 1.369 million homes, the highest level on record. Personal spending jumped 1% in May, the biggest increase since October of 2001, supported by year-over-year personal income growth of 5.8%, the fastest rate of growth in nearly four years. The jump in consumer spending coincided with a surge in the Conference Board's consumer confidence index to a two-year high of 101.9. In a reading that disappointed

economists, following three month's of stellar job creation averaging more than 300,000 jobs per month, the U.S. economy added a more moderate 112,000 jobs in June, while the unemployment rate held steady at 5.6%. Overall, the economy has averaged 211,000 new jobs per month in 2004, an annual pace that has not been sustained since 1999.

"...the pace of further fed funds rate hikes is likely to be determined by the level of incoming inflation data."

Core PCE Price Index, Year-Over-Year Growth



Equities

With a sharp drop in oil prices and a lack of surprises from the Federal Reserve, the S&P 500 rose for the second consecutive month returning 1.94% in June and bringing its year-to-date return to 3.44%. The S&P 500 Barra Value index returned 2.17%, outperforming the Barra Growth index by 0.46%. Small-cap stocks continued to outperform their large-cap counterparts as the Russell 2000 index surged 4.21%, more than doubling the return of the S&P 500. Crude oil prices on the New York Mercantile Exchange rose above \$42 per barrel in early June following oil-related terrorist attacks in Iraq and Saudi Arabia in

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Equities (cont'd)

Fed Funds Rate Increases		
Month of First Rate Increase	Next 12 Months	
	Total Rate Increase	S&P 500 Total Return
Jun-99	1.75%	7.25%
Feb-94	2.50%	7.37%
Mar-88	3.25%	18.08%
Dec-86	1.00%	5.23%

Source: Bloomberg, ACG Research

May that weighed on investor confidence and helped send stock prices lower. With a pledge from OPEC in June to raise its daily crude oil output by two million barrels per day, crude prices fell more than 10% by the end of the month, tempering investor concerns that record oil prices might hinder U.S. corporate earnings growth. Concerns over higher interest rates also waned as Federal Reserve Chairman Alan Greenspan told the Senate Banking Committee on June 15th that "inflationary pressures are not likely to be a serious concern in the period ahead," solidifying market expectations that Fed rate increases will be modest

and gradual. Historically, fed funds tightening cycles have produced below average, but positive equity returns during the first year of the cycle. During the twelve calendar months following the first month of each of the last two major Fed tightening cycles, the S&P 500 returned approximately 7% in both cases (see table). While equity returns over the next year are, as always, uncertain, history suggests that the onset of a new Fed tightening cycle does not necessarily equate to poor stock market performance.

Fixed Income

The Lehman U.S. Aggregate index returned 0.57% in June as a mid-month drop in interest rates reversed a nearly 1% decline in the index during the first two weeks of the month. After stronger-than-expected economic data pushed the ten-year Treasury yield to a two-year high of 4.89% on June 14, the yield plunged 0.20% to 4.69% the day after Federal Reserve Chairman Alan Greenspan's testimony before the Senate Banking Committee. The Chairman reassured investors that the Federal Reserve would still take a "measured" approach to raising interest rates. With the Fed's June rate hike fully priced into the bond market heading into the Fed's June 30th meeting, the ten-year yield fell to 4.62% following the rate hike announcement, producing a monthly price gain for the Lehman Aggregate index. Investment-grade corporate bond yield spreads over similar-duration U.S. Treasury securities were relatively unchanged for the month as the Lehman Credit index failed to produce excess returns over benchmark Treas-

ury securities. Lower-rated securities performed better as the Lehman U.S. High Yield index jumped 1.43% in June, outperforming similar-duration Treasury securities by 1.04%. The Lehman 1-10 Year Blend Municipal index, with a duration similar to that of the Lehman Aggregate, returned 0.29% in June. With a yield of 3.28%, the 1-10 Year Blend Municipal index is providing an investor in the 35% tax bracket with a 5.05% pre-tax yield, 0.37% above the current pre-tax yield of the Lehman Aggregate.

International

The MSCI EAFE index returned 2.23% in June as a modestly stronger U.S. dollar subtracted 0.27% from the index's local-currency return. Returns were positive across all major regions, as only three of the 23 countries in the MSCI World Ex-US index fell. The MSCI Japan surged 5.39% as strong economic data pushed the yen to a two-month high versus the U.S. dollar, adding 1.35% to the

index's 4.04% local-currency return. Japanese exports rose to a record level in May, while the Bank of Japan's Tankan survey revealed that Japanese business confidence is at a 13-year high. Despite the longest economic expansion in Japan since 1997, pricing power has yet to emerge. Bank of Japan Governor Toshihiko Fukui, speaking at a meeting of central bankers in Switzerland in late June, said that the Japanese economy is a "long way" from escaping deflation. Reflecting relatively weak economic growth in Europe, the European Central Bank (ECB) elected to leave its benchmark rate unchanged at 2% on July 1, a day after the U.S. Federal Reserve increased its benchmark rate for the first time in four years. The Organization for Economic Cooperation and Development in Paris is forecasting real economic growth for the euro region this year of just 1.6%. Citing Italy's failure to control its fiscal deficit, Standard & Poor's downgraded the government's credit rating from AA to AA-. The MSCI

Emerging Markets index returned 0.46% in June, rebounding slightly from May's losses. The Lehman Global Treasury Ex-U.S. bond index returned 0.18% in June as currency gains helped offset a modest price loss.



Private Equity

Private equity performance continues to improve as liquidity and exit opportunities (ability to sell or refinance) increase. The primary drivers have been improving economic conditions and the continued recovery of public equity and IPO markets. In venture capital, M&A activity marked its fifth straight quarter of improvement after two years of decline and illiquidity due to a closed IPO market and disinterested corporate buyers. According to Thomson Venture Econom-

ics and the National Venture Capital Association (NVCA), venture-backed mergers & acquisitions generated 75% more capital in the first quarter of 2004 than in the prior quarter. IPO activity in the second quarter of 2004 was more than double than in the first quarter and marked the third consecutive period in which the total offering amount exceeded \$1 billion. In buyouts, performance has continued to improve with the support of

improved corporate operating results, increased lending capacity and decreasing loan spreads, which have combined to provide a liquid exit environment. Default rates have dropped to the lowest levels since 1999. Corporate acquirers have completed their cost cutting and, with a lift from improving economic conditions and renewed capital spending, are resuming expansionary postures. In addition, total leveraged loan volumes have reached a two-year high as loan spreads continue to

compress further. The result has been a surge of M&A activity either through sales to strategic corporate buyers, IPOs, or leveraged recapitalizations with dividend payments. It appears that the private equity investment cycle has ceased its decline and begun an upturn, but most observers remain cautiously optimistic. Private equity valuations continue to remain attractive relative to historical levels and with the recent increase of M&A activity, the outlook remains positive.

Indices Report

Periods Ending June 30, 2004

Index Name	Style	Returns							
		Month	Qtr	YTD	3 Qtrs	1 Year	3 Years	5 Years	10 Years
<u>Domestic Equity Indices</u>									
S&P 500	Large Cap Core	1.94%	1.72%	3.44%	16.04%	19.10%	(0.69)%	(2.20)%	11.83 %
S&P Equal Weighted	Large Cap Core	3.09%	2.37%	6.29%	22.26%	28.77%	5.87%	5.47%	13.52 %
DJIA	Large Cap Core	2.55%	1.24%	0.80%	14.30%	18.62%	1.89%	0.90%	13.41 %
Russell 1000	Large Cap Core	1.80%	1.40%	3.33%	16.01%	19.48%	(0.32)%	(1.65)%	11.83 %
Russell 1000 Growth	Large Cap Growth	1.25%	1.94%	2.74%	13.44%	17.88%	(3.74)%	(6.48)%	10.11 %
Russell 1000 Value	Large Cap Value	2.36%	0.88%	3.94%	18.68%	21.13%	2.96%	1.87%	12.64 %
Russell Mid Cap	Mid Cap Core	2.77%	1.45%	6.67%	21.57%	29.39%	6.42 %	6.51%	13.49 %
S&P Mid Cap 400	Mid Cap Core	2.28%	0.97%	6.09%	20.07%	27.99%	6.59 %	9.05%	15.47 %
Russell 2000	Small Cap Core	4.21%	0.47%	6.76%	22.27%	33.37%	6.24%	6.63 %	10.93 %
Russell 2000 Growth	Small Cap Growth	3.33%	0.09%	5.68%	19.08%	31.55%	(0.23)%	(0.46)%	7.15 %
Russell 2000 Value	Small Cap Value	5.08%	0.85%	7.83%	25.47%	35.17%	12.16 %	12.82 %	13.91 %
NASDAQ Composite	Broad Equities	3.07%	2.69%	2.21%	14.59%	26.18%	(1.78)%	(5.29)%	11.23 %
Wilshire 5000	Broad Equities	2.14%	1.34%	3.99%	16.91%	21.24%	0.79%	(1.03)%	11.54 %
<u>International Equity Indices</u>									
MSCI World	Broad Global	2.10%	1.05%	3.79%	18.71%	24.58%	1.35%	(1.34)%	7.55%
MSCI World Ex US	Broad International	2.31%	0.10%	4.35%	22.09%	31.96%	4.25%	0.62%	4.63%
EAFE	Developed Markets Intl	2.23%	0.44%	4.86%	22.80%	32.85%	4.25%	0.40%	4.37%
EAFE Growth	Developed Markets Intl Growth	1.30%	(1.26)%	2.71%	18.84%	26.79%	2.06%	(3.01)%	2.04%
EAFE Value	Developed Markets Intl Value	3.13%	2.10%	6.98%	26.77%	39.01%	6.38%	3.62%	6.61%
MSCI Emerging Markets Free	Emerging Market	0.43%	(9.63)%	(0.97)%	16.65%	33.15%	12.92%	3.16%	1.15%
IFCI Composite	Emerging Market	0.00%	(8.81)%	0.67%	18.28%	35.08%	14.85%	5.04%	1.87%
MSCI Japan	Japanese	5.39%	(3.82)%	10.74%	20.01%	46.22%	1.36%	(1.65)%	(3.31)%
<u>Domestic Fixed Income Indices</u>									
Treasury Bills	Cash	0.07%	0.24%	0.48%	0.73%	0.98%	1.71%	3.30%	4.29%
Lehman Intermediate G/C	Intermediate Govt/Credit Bonds	0.30%	(2.52)%	(0.10)%	(0.04)%	(0.06)%	6.21%	6.75%	6.89%
Lehman Intermediate Aggregate	Int. Core Bonds	0.53%	(1.98)%	0.25%	0.67%	0.85%	6.01%	6.73%	7.06%
Lehman Aggregate	Core Bonds	0.57%	(2.44)%	0.15%	0.47%	0.32%	6.36%	6.95%	7.38%
Citi Broad Investment Grade	Core Bonds	0.59%	(2.44)%	0.18%	0.54%	0.37%	6.37%	6.96%	7.39%
Lehman Govt/Credit	Govt/Credit Bonds	0.41%	(3.17)%	(0.19)%	(0.21)%	(0.72)%	6.73%	7.10%	7.43%
Lehman Long Govt/Credit	Long Govt/Credit Bonds	0.81%	(5.27)%	(0.46)%	(0.74)%	(2.68)%	8.35%	8.17%	8.92%
Lehman Government	Government Bonds	0.41%	(2.97)%	(0.12)%	(0.56)%	(1.35)%	6.12%	6.72%	7.16%
Lehman Mtg Backed Securities	Mortgage Bonds	0.88%	(1.13)%	0.77%	1.71%	2.23%	5.60%	6.60%	7.29%
Lehman Muni 3 Yr	3 Yr Municipal Bonds	0.18%	(1.22)%	(0.30)%	(0.47)%	0.62%	3.88%	4.61%	4.86%
Lehman Muni 10 Yr	10 Yr Municipal Bonds	0.33%	(2.38)%	(0.81)%	0.54%	0.41%	5.53%	6.10%	6.46%
Lehman U.S. Credit Index	Corporate Bonds	0.42%	(3.42)%	(0.26)%	0.23%	0.09%	7.54%	7.54%	7.95%
Merrill Lynch High Yield	High Yield Bonds	1.46%	(0.88)%	1.33%	7.25%	9.96%	8.88%	5.39%	7.67%
Merrill Lynch Conv US	Convertible Bonds	1.23%	(0.67)%	3.33%	10.89%	13.50%	6.96%	6.79%	N/A

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