



# Market Update

Asset Consulting Group, Inc.

www.acgnet.com

Monthly Report

June 2005

## The Economy

After soft readings for many economic indicators in May, most of the June data released to date have improved dramatically. Although still choppy in certain areas, the recent releases support the stronger economic story. Following disappointing results in

May, net revisions of 44,000 to prior months made up most of the difference. In other positive news, the unemployment rate dipped from 5.1% to 5.0%, the lowest level in nearly four years, while wage growth remained controlled at 0.2%. Consumers'

confidence gained momentum in June, rising to a three-year high, helped by a more optimistic view of the labor market and the strength in equity and house prices, while the effects of higher oil prices were not felt during the survey period. The Consumer Confidence Index rose to 105.8 from a revised 103.1 in May, better than the 104.0 analysts expected. The improvement in consumer's mood suggests that business and labor market activity should continue to pick up over the next several months. While the run up in oil prices could cause confidence to drop, as long as sentiment stays around the 90 to 105 level, it should be consistent with moderate economic growth. US retailers reported stronger than expected sales in June as the belated arrival of hot weather and improving confidence in the economy encouraged spending, offsetting concerns over the impact of high fuel prices. An index of sales at 70 retail chains rose 5.3% for the month, the highest increase since May 2004. The May consumer prices posted the first decline in 10 months with the CPI falling by 0.1% as energy costs staged a sizable retreat. Food prices moderated, posting a tiny 0.1% increase while core inflation was generally well behaved, rising by a minute 0.1% and at an annual rate of 2.4%. While some sources of inflation pressure have eased and there is growing speculation that the rise in inflation may be over, we subscribe to the Fed's view that a significant slowdown in inflation is unlikely given rising labor costs. In addition, core inflation tends to follow persistent up and down trends. While inflation bounces around on a three-month basis, on a YOY basis inflation rarely makes a mid-expansion reversal. Normally, once inflation turns up, it turns down only when a recession kicks in. The Fed saw the new economic data as providing support for the central bank's current course of raising interest

Recent growth indicators	Apr	May	June
Payrolls	292	104	146
ISM Manufacturing	53.3	51.4	53.8
ISM non-manufacturing	61.7	58.5	62.2
Non-auto retail sales	1.4	-0.2	0.7e
Auto sales	17.4	16.6	17.4
Claims	326	335	324

Source: Bureau of Labor Statistics, ISM, Lehman Brothers

May and six consecutive months of slowing growth, the US manufacturing sector expanded at a faster-than-expected pace in June. The ISM Manufacturing Index for June came in at 53.8, far better than the 51.5 reading economists had forecast and up from a reading of 51.4 in May. As noted by the chair of ISM's manufacturing business survey committee "these are the most positive signs that we have seen in several months, and they indicate that we may be through the 'soft patch' that many observers touted." The reading reflected an increased rate of growth in new orders, and a slowing rise in prices paid by manufacturers for raw materials. The ISM index of business activity in the non-manufacturing sector rose to 62.2 in June from 58.5 in May, well above the 58.9 analysts expected, as the improved June sales figures posted by the automotive industry propelled activity in the services area. The latest employment snapshot supported the Fed's view that the economy is in good shape and the labor market is gradually improving despite high energy prices. The June payroll employment picked up, adding 146,000 jobs. While weaker than the 200,000 consen-

labor market and the strength in equity and house prices, while the effects of higher oil prices were not felt during the survey period. The Consumer Confidence Index rose to 105.8 from a revised 103.1 in May, better than the 104.0 analysts expected. The improvement in consumer's mood suggests that business and labor market activity should continue to pick up over the next several months. While the run up in oil prices could cause confidence to drop, as long as sentiment stays around the 90 to 105 level, it should be consistent with moderate economic growth. US retailers reported stronger than

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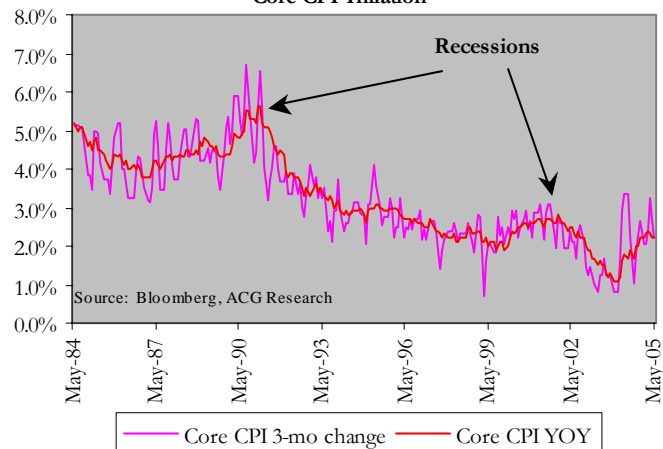
#### Market Commentary

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#### Indices Report

- June 30, 2005

Core CPI Inflation



## Economy *(cont'd from page 1)*

rates gradually to make sure inflation remains contained. The Fed's Open Market Committee raised short-term interest rates as expected to 3.25% at their June meeting. In the accompanying statement, the com-

mittee referred to "elevated" inflation pressure but maintained that longer-term inflation expectations remained well maintained. It also signaled no let-up in the pace of rate rises, repeating that "policy accommodation" can be removed at a pace that is likely to be measured. The low

level of market-determined long-term interest rates and the booming housing market have added to the Fed's resolve to continue raising the Fed funds rate. Policy makers have recently said they expect growth to continue at the economy's trend rate and labor market

conditions to improve gradually, regardless of some recent weaker indicators and in spite of high oil prices. While they will react to changes in the outlook, they are not overly concerned with volatility in the monthly data.

## Equities

The S&P 500 grew a modest 0.14% in June; rising 2.24% in the first half of the month only to give it back during the second half following a mid-month surge in oil prices. For the year, the index remains in negative territory with a total loss of 0.81%. Growth stocks, which finally showed signs of life in May, once again fell out of favor in June. The Russell 1000 Growth Index

declined 0.37% as the Russell 1000 Value Index increased another 1.10%, bringing the year-to-date excess return of value over growth to 3.48%. Not surprisingly, energy and utility issues continued to lead the market with June returns of 5.78% and 5.48%, respectively. Financials and telecommunications issues managed moderate returns of 1.21% and 1.29%, while information technology and consumer discretionary stocks experienced modest de-

clines. Shares in industrial, mining, and paper products companies reacted strongly to the oil price surge and the resulting increase in production costs. As a result, industrials fell 2.91% in June while the materials sector declined 1.99%, bringing the year-to-date total return for materials to -8.83%, the greatest loss of the ten S&P sectors. Consumer staples, traditionally a strong performer in value driven markets, fell 2.11% as margins were squeezed by the rising cost

of raw materials and a diminished ability to pass costs on to customers due to increased retailer strength. Small cap stocks, as represented by the Russell 2000 Index, outpaced their large cap counterparts in June with a return of 3.87%. Although small cap returns exceeded 10% in May and June combined, the index remains down 1.25% for the year, lagging behind large cap issues.

## International

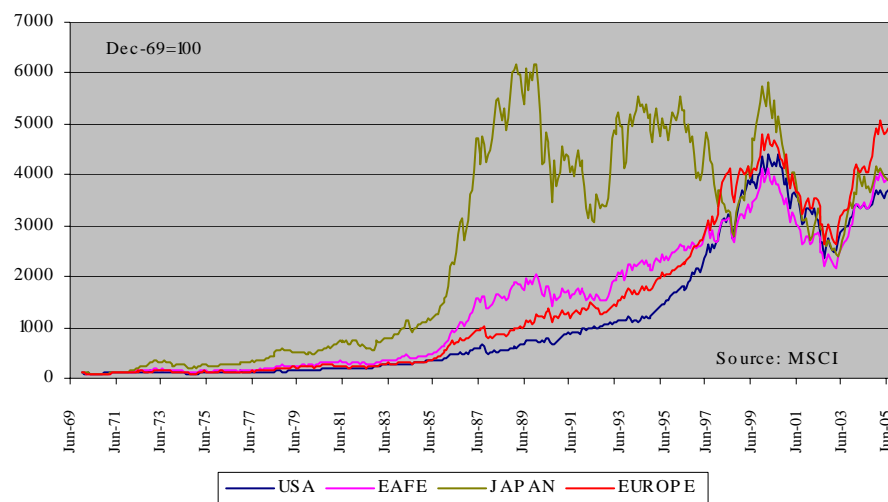
The dollar recently hit a 14 month high against the euro and an 11-month peak against the yen underpinned by the strengthening US economy and the expectations of further interest rate increases by the Fed, while rates in Europe and Japan look more likely to remain flat or fall. The MSCI EAFE Index gained 1.37% on a US dollar basis as the 3.45% local currency return was partly offset by the dollar appreciation. 20 of the 23 non-US country indices within the MSCI World Index outperformed their US counterparts. Much of the strength came as a result of cheaper European relative valuations and the weakness of the euro. An 11% drop in the euro against the dollar this year down to \$1.20 provided a boost to European exports and helped lift the manufacturing prospects in the euro area, removing some of the gloom over the region's economic outlook. Manufacturing in the eurozone contracted less than expected in June as the currency's decline cushioned the effect of record oil prices. A

measure of manufacturing reached 49.9, after dropping to a 22-month low of 48.7 in May, and European business confidence rose for the first time in nine months. The yen continued its slide in June in spite of visible signs of stronger Japanese economy, slipping to ¥111 on worries about the impact of the strong oil prices on country's economy. In spite of residual political noise, emerging markets continued to perform remarkably well. Fueled by a high degree of global liquidity and relatively low re-

turns on alternative assets in high grade markets, the MSCI EM Equity Index posted a 3.5% increase on a US dollar basis (6.6% YOY), with new EU members being the strongest performers. Emerging market debt spreads contracted further in June down to 306 bps from the April 2005 high of 364 bps, while the LB EM Index return continued to accumulate reaching 5.21% YTD. The lack of ripple effects from the crisis involving auto company debt demonstrates the resilience of the

emerging market segment as long as stimulative financial conditions, solid economic growth and limited inflation worries remain intact. China seems to be in the midst of successfully achieving a soft landing as demonstrated by deceleration in credit growth, which has removed part of the fuel for China's investment boom. Many economists argue that a CNY peg change is now mainly a question of timing and expect an adjustment, albeit modest, over the coming months.

MSCI Developed Equity Index Performance (Gross USD)



## Private Equity

Investors continue to move capital into private equity in search of enhanced returns. According to Thomson Venture Economics and the National Venture Capital Association, 48 venture funds raised \$5.3 billion during the first quarter of 2005, far outpacing the \$2.6 billion raised by 49 funds in the first quarter of 2004. The story is similar on the buyout & mezzanine fund raising side. In the first quarter, 38 funds raised over

\$15.7 billion versus \$3.4 billion in the first quarter of 2004. Seed and early-stage strategies accounted for most of the capital committed to venture funds and nearly 40% of total venture capital raised was concentrated in fewer than 5 funds. The largest was a \$1 billion balanced-stage fund. On the buyout side, more than two-thirds of new commitments went to five multi-billion dollar funds. These increased equity fund sizes combined with abundant and relatively cheap debt financing and competition continues to place

upward pressure on valuations. Data is not yet available on venture valuations but, according to Standard & Poor's, purchase price measures as multiples of cash flow (EBITDA) increased by 0.7x for transactions with total values between \$250 million and \$500 million; and by 0.3x for transactions with total values less than \$250 million. Purchase multiples for transactions with total values over \$500 million remained stable at 7.6x EBITDA. Rising valuation multiples cause concern, but only in the context of historical perspective. Valua-

tion multiples have been at relatively low historical levels since 2000, providing an attractive investment environment and returning to levels that existed in the mid 1990s, which is still considered a relative attractive investment period. In conclusion, even though activity is high in the private equity markets, the environment continues to appear attractive relative to historical measures and to alternative asset classes.

## Indices Report

### Asset Consulting Group, Inc. Indices Report

Periods Ending June 30, 2005

Index Name	Style	Returns							
		Month	Qtr	YTD	3 Qtrs	1 Year	3 Years	5 Years	10 Years
<b><u>Domestic Equity Indices</u></b>									
S&P 500	Large Cap Core	0.14%	1.37%	(0.81)%	8.35%	6.33%	8.29%	(2.37)%	9.94 %
S&P Equal Weighted	Large Cap Core	1.44%	2.77%	0.52%	12.93%	10.61%	13.85%	8.29%	12.25 %
DJIA	Large Cap Core	(1.69)%	(1.62)%	(3.65)%	3.66%	0.65%	5.90%	1.71%	10.62 %
Russell 1000	Large Cap Core	0.41%	2.05%	0.11%	9.92%	7.93%	9.19%	(1.89)%	10.16 %
Russell 1000 Growth	Large Cap Growth	(0.37)%	2.46%	(1.72)%	7.29%	1.68%	7.25%	(10.36)%	7.40 %
Russell 1000 Value	Large Cap Value	1.10%	1.67%	1.76%	12.33%	14.06%	11.00%	6.56%	12.03 %
Russell Mid Cap	Mid Cap Core	2.69%	4.18%	3.92%	18.11%	17.12%	15.86 %	7.34%	12.90 %
S&P Mid Cap 400	Mid Cap Core	2.32%	4.26%	3.85%	16.47%	14.03%	13.16 %	8.49%	14.66 %
Russell 2000	Small Cap Core	3.86%	4.32%	(1.25)%	12.66%	9.45%	12.81%	5.71 %	9.90 %
Russell 2000 Growth	Small Cap Growth	3.23%	3.48%	(3.58)%	10.96%	4.29%	11.36%	(4.51)%	5.16 %
Russell 2000 Value	Small Cap Value	4.42%	5.08%	0.90%	14.22%	14.39%	14.15 %	16.11 %	13.89 %
NASDAQ Composite	Broad Equities	(0.54)%	2.89%	(5.45)%	8.44%	0.45%	12.02%	(12.31)%	8.22 %
Wilshire 5000	Broad Equities	0.81%	2.32%	0.05%	10.25%	8.22%	9.95%	(1.26)%	9.97 %
<b><u>International Equity Indices</u></b>									
MSCI World	Broad Global	0.91%	0.61%	(0.40)%	11.60%	10.60%	10.59%	(1.68)%	7.49%
MSCI World Ex US	Broad International	1.63%	(0.78)%	(0.71)%	14.32%	14.54%	12.61%	(0.16)%	5.79%
EAFE	Developed Markets Intl	1.37%	(0.75)%	(0.85)%	14.39%	14.13%	12.51%	(0.18)%	5.56%
EAFE Growth	Developed Markets Intl Growth	0.83%	(0.66)%	(1.47)%	13.49%	11.73%	9.37%	(4.49)%	2.91%
EAFE Value	Developed Markets Intl Value	1.90%	(0.82)%	(0.22)%	15.28%	16.47%	15.63%	4.13%	8.11%
MSCI Emerging Markets Free	Emerging Market	3.45%	4.24%	6.26%	24.60%	34.89%	24.42%	7.68%	N/A
IFCI Composite	Emerging Market	3.37%	4.84%	6.80%	25.56%	35.88%	25.68%	9.46%	5.51%
<b><u>Domestic Fixed Income Indices</u></b>									
Treasury Bills	Cash	0.23%	0.72%	1.30%	1.78%	2.16%	1.56%	2.62%	3.97%
Lehman Intermediate G/C	Intermediate Govt/Credit Bonds	0.42%	2.48%	1.58%	2.02%	4.77%	5.08%	6.87%	6.34%
Lehman Intermediate Aggregate	Int. Core Bonds	0.40%	2.42%	1.85%	2.64%	5.41%	4.95%	6.91%	6.50%
Lehman Aggregate	Core Bonds	0.55%	3.00%	2.52%	3.49%	6.80%	5.76%	7.41%	6.82%
Citi Broad Investment Grade	Core Bonds	0.57%	3.12%	2.59%	3.61%	6.99%	5.88%	7.46%	6.85%
Lehman Govt/Credit	Govt/Credit Bonds	0.65%	3.44%	2.74%	3.57%	7.26%	6.41%	7.71%	6.90%
Lehman Long Govt/Credit	Long Govt/Credit Bonds	1.52%	7.13%	7.17%	9.49%	16.87%	11.13%	10.59%	8.70%
Lehman Government	Government Bonds	0.56%	3.36%	2.93%	3.43%	6.64%	5.41%	7.06%	6.63%
Lehman Mtg Backed Securities	Mortgage Bonds	0.36%	2.28%	2.15%	3.44%	6.14%	4.68%	6.82%	6.69%
Lehman Muni 3 Yr	3 Yr Municipal Bonds	0.51%	1.21%	0.44%	0.63%	2.54%	2.69%	4.37%	4.51%
Lehman Muni 10 Yr	10 Yr Municipal Bonds	0.58%	3.22%	2.53%	3.39%	7.66%	5.69%	6.74%	6.35%
Lehman U.S. Credit Index	Corporate Bonds	0.79%	3.58%	2.49%	3.79%	8.15%	7.76%	8.59%	7.28%
Merrill Lynch High Yield	High Yield Bonds	1.90%	2.70%	1.23%	5.75%	10.65%	13.80%	7.84%	7.27%
Merrill Lynch Conv US	Convertible Bonds	1.77%	1.00%	(4.38)%	1.71%	0.23%	9.44%	0.94%	N/A

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