



Market Update

Asset Consulting Group, Inc.

www.acgnet.com

Monthly Report

July 2005

The Economy

Confidence in growth increases...Inflationary pressure remains a concern... Tightening to continue at a "measured pace"...

The recent economic data continued to point to a Goldilocks near-term outlook. Inflation readings were benign, with the core CPI rising just 0.1% in June, lowering YOY growth from 2.2% to 2%. And the "soft patch" story is fading away, with a solid 3.4% Q2 GDP increase and a respectable 0.7% gain in non-auto retail sales, following a solid employment report. The economy seems to have gained visible momentum resulting in another stream of strong corporate earnings reports. Consumption spending is being propelled higher by strong income growth and growing optimism about the future. At the same time, the booming housing market is pushing new construction and home improvement to new highs while generating a powerful wealth effect that is spreading out to consumer spending, hiring, and bonus and commission income. Q2 GDP growth was in line with the consensus. But the details show considerably more strength and a potentially stronger trajectory. Final sales, which excluded inventories, rose almost 6% during the quarter, driven by a sharp pick up in investment and a surge in exports. By contrast, a dramatic narrowing in inventories sliced over 2% from quarterly growth. Productivity growth turned in a solid performance with output per hour of work rising at an annual rate of 2.2% in the second quarter. That was down from a 3.2% gain in the first three months of the year, but remained high enough to guarantee continued increases in living standards and to keep inflation in check. The LEI Index, a gauge of

future economic activity, rose by a strong 0.9% in June to 137.7 after showing no change the month before, the largest increase since December 2003. Industrial production, helped by a jump in utility output, surged in June at the fastest pace in 16 months, providing the strongest evidence yet that U.S. manufacturing is rebounding. Production at factories, mines, and utilities rose by 0.9%, more than double what had been expected and three times faster than a 0.3% rise in May. The ISM's manufacturing index rose to 56.6 in July, the highest level of the year, and an index of Chicago-area business jumped by the most since 1983. The ISM index of non-manufacturing activity, the largest part of the US economy, reached 60.5 last month, remaining close to the three-month high of 62.2 reached in June and suggesting growth may accelerate in the second half of the year. Some of

lows at 5% and should ensure strong income gains and spending even with gasoline prices at a record high. There were also tentative signs of a pick-up in wage growth, lending support to the Fed's upbeat outlook and reaffirming general expectations for the Fed to keep tightening through to the end of the year. Average hourly wages for non-supervisory workers climbed 0.4% to \$16.13, the largest rise since July 2004. Even so, the YOY rate of growth was 2.7% as wage growth for about two-thirds of the workforce covered by the survey failed to keep pace with inflation. Consumer prices in June were well contained for a second month. The PCE index, a gauge of prices tied to consumer spending (excluding food and energy costs) and the Fed's preferred measure for tracking inflation, was unchanged in June, compared to a 0.1% decline in May. Consumer spending advanced a robust 0.8% in June on improved

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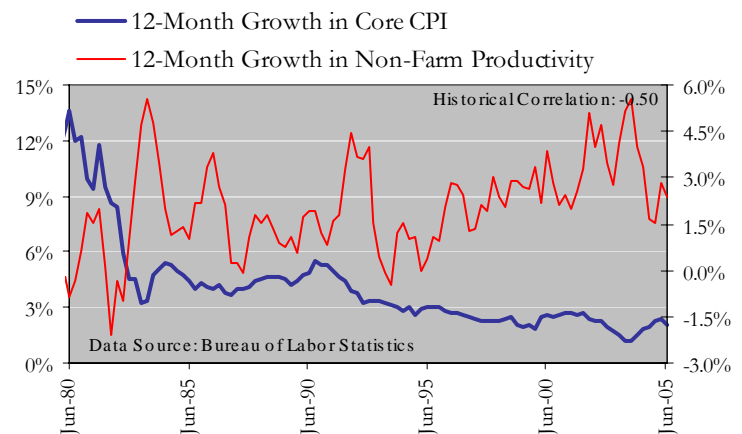
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Indices Report

- July 31, 2005

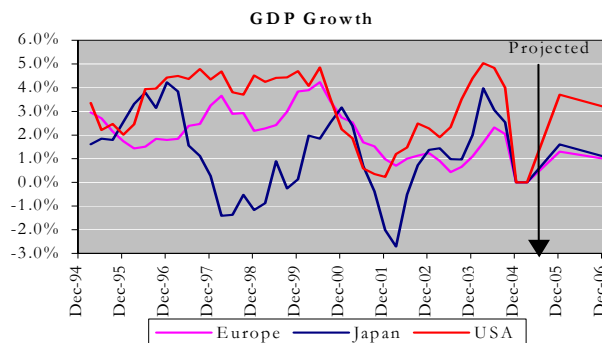


the decline in the index is believed to be a giveback from June, when the gauge rose a greater-than-expected 3.7%. On the job front, the US economy generated 207,000 jobs in July, trumping economist's expectations of about 180,000 jobs and suggesting that the employment recovery is becoming more firmly entrenched. The unemployment rate remained close to its historic

personal income, as shoppers took to auto showrooms to enjoy sales incentives that helped keep inflation in check. The Fed signaled greater confidence in growth and continued concern about inflation as it delivered its 10th consecutive quarter point rate increase to 3.5% and indicated there were more to come. The FOMC reiterated that it saw monetary policy as still "accommodative" and that it ex-

Economy (cont'd.)

pected to continue raising rates at a "measured" pace. "Aggregate spending, despite high energy prices, appears to have strengthened since last winter," said the committee's policy statement. Policymakers highlighted once again froth in the housing market, encouraged by low long-term rates and the knock-on effect on consumer spending. Reports showing that



the economy is gaining momentum have led economists to increase 2005 GDP forecasts. The US GDP growth has been in

a vigorous range of 3.3%-4.3% for the last seven quarters. This quarter, even after 10 rate hikes, most economists estimate that GDP will exceed the top of that range given factors, such as strong car sales and the need for the corporate inventory rebuilding. Inflation, meanwhile, remains a potential threat because of record high crude oil prices, continued lower productivity growth, and higher unit labor costs.

Equities

Equity markets responded positively to better than expected earnings and positive economic reports spanning production, inflation, employment, and consumer confidence. The S&P 500 Index experienced its best month of the year returning 3.72%, enough to bring year-to-date returns back into positive territory at 2.88%. The improved outlook for corporate earnings led to significant out-

performance by growth stocks, with the Russell 1000 Growth Index returning 4.89%, nearly 2.00% higher than its value counterpart. This is only the second month of 2005 in which growth outperformed value, based on the Russell indices. For the year, value maintains a significant advantage over growth, with a total return of 4.71% for the Russell 1000 Value Index vs. 3.08% for Russell 1000 Growth Index. The market advance was broad-based, with all ten S&P

sector indices posting positive returns for the month. Energy stocks continued to perform well as oil prices remained high, returning 5.72%. Outside of Energy, market leadership shifted from conservative Utilities back to the more aggressive Information Technology and Consumer Discretionary stocks, which surged 5.86% and 5.58%, respectively. Although Financials generated a positive return, they were relatively weak as banking and fixed income trading profits

continue to face pressure resulting from a flat yield curve. Year-to-date strength, however, is not as broad-based as it was in July, with the majority of the S&P 500 Index's returns provided by Materials and Utility issues. Small cap stocks experienced their third straight month of significant outperformance as the Russell 2000 climbed 6.34%. Year-to-date small cap returns now exceed large cap issues by 2.12%.

Fixed Income

Following the Fed rate hike on June 30th, the 10-year Treasury yield rose 0.34% during July to end the month at 4.28%. The impact on shorter-term yields was slightly stronger, with the 2-year Treasury yield rising 0.36%, actually leading to a flatter yield curve with a spread of only 0.26%. As a result of strong economic data and an expectation of an additional Fed rate increase on August 8th, both

rates continued to climb in the first week of August, but without a significant increase in the spread between short-term and long-term rates. The risk of inversion has not subsided, as inflation data remains tame while the Fed is expected to continue with rate increases through 2005. While Fed transparency and higher demand for longer-dated Treasuries from both foreign governments and baby-boomers nearing retirement are viable explanations for a flat yield curve, the possibility of inversion

remains a concern. The Treasury will respond to the high demand for longer-dated issues by re-introducing the 30-year Treasury bond in the first quarter of 2006. The Lehman Aggregate Bond index experienced a moderate decline in July, falling 0.91% as yields climbed moderately and option-adjusted spreads remained stable. Year-to-date, the Aggregate Index has returned a modest 1.58%. In spite of an 0.08% spread contraction, the Investment Grade Corporate Index declined 0.99%,

trailing the broad market by 0.23% year-to-date. As investment-grade bonds fell, the Lehman High Yield Index rose 1.75% as high yield spreads contracted for the third straight month, producing an excess return of nearly 3.00% over like-dated Treasuries. This represents the High Yield Index's strongest performance relative to like-dated Treasuries since October of 2003. Year-to-date total return for the high yield sector now stands at 2.88%.

International

The latest Fed rate increase further widened the US dollar's yield advantage over the euro and the yen. Further rate rises look inevitable. But the yield argument no longer seems to be exerting much influence on the FX markets. After June and July gains, the dollar is close to a six month low. Some of the decline may be because of an improvement of fundamentals elsewhere. Some might be caused by the

long-term "inevitable" that will be dollar negative, namely the US twin deficit and possible further yuan revaluations. In spite of the resignation of the reform-minded Mr. Koizumi and next months election, Japan seems to be gaining favor with investors, thanks to an improved performance by the economy and corporate sector. The Nikkei 225 Average is at its best level since April 2004 and Tokyo's broader based Topix Index closed at a four-year high on August 10. Meanwhile, some of

the gloom about Europe dissipated in the face of improved eurozone economic reports, especially for Germany, and the absence of any imminent constitutional crisis. The MSCI EAFE Index performed in line with the US equities in July gaining 3.07% on a US dollar basis as the 3.67% local currency return was partly offset by the dollar appreciation. Much of the strength came as a result of stronger performance by the French and German indices on improved economic prospects. The MSCI EM Index hit

record highs last month, returning 7.08% on a US dollar basis (13.78% YTD) and confirming indications that investors believe in a buoyant global economy. Following weeks of relative stability, Brazilian shares, bonds, and the real slumped as most foreign investors shifted to more defensive positions on the corruption scandal involving President Lula's Workers' Party. The People's Bank of China (PBC) revalued the yuan by 2% and established a peg around a bas-

International *(cont'd.)*

ket of currencies of unspecified weighting, including the dollar, euro, yen, and Korean won. The immediate economic consequences for the US economy stand to be minor. A 2% re-

valuation alone will not shrink the US current account imbalances with China, nor is it likely to have much impact on the PBC's appetite for US Treasuries. Instead, the immediate consequences are likely to be more political than economic, reduc-

ing, at least at the margin, some of the protectionist pressures in the US Congress. If, however, the recent revaluation were to turn into a series of future yuan appreciation, the impact on the US and global economies would be more pronounced. For now,

though, the Chinese authorities indicated they want to keep the currency "basically stable" without any further revaluation steps contemplated in the near future.

Hedge Funds

Performance in the second quarter was a tale of two halves. All strategies suffered losses through the first six weeks of the quarter, followed by a dramatic turnaround in mid-May, which led to positive returns overall in May and an excellent June. For the quarter, returns finished slightly positive across all hedge fund strategies. Emerging Markets, which was the worst performer in Q1, was the best performer in Q2 with a 1.91% increase. This reversal of performance highlights the volatility

of the strategy. The only strategies that had negative returns were Relative Value, which was down 0.27%, and Convertible Arbitrage, which had the lowest return of all the strategies at a negative 2.87%. Outlook on Convertible Arbitrage is mixed, as some managers believe the strategy, as we formerly knew it, will never recover, while others believe the strategy has bottomed out and is poised to improve in the future. As we discussed in May, redemptions from Convertible Arbitrage have caused a downward spiral in prices as forced sellers were desperate for bids. Some manag-

ers have now begun to increase exposure to convertibles by buying attractive securities at extremely cheap prices. The HFRI Fund of Funds Composite Index, a broad measure of all hedge fund of funds, was up 0.40% for the second quarter. The HFRI Conservative Fund of Funds Index, a measure of low volatility hedge fund of funds, was down 0.43%. The HFRI Equity Hedge Index, a measure of long/short managers, was up 1.15%. The SEC lost 2 Directors and its Chairman during the second quarter, all of whom impacted the hedge fund industry during their tenures. Stephen Cutler, Director

of the Division of Enforcement, led the division that acted against hedge fund fraud as well as the enforcement efforts against mutual funds accused of allowing hedge funds to market time. Paul Roye, Director of the Division of Investment Management, was a driving force behind the plan to regulate hedge funds by requiring managers to register as investment advisers. SEC Chairman William Donaldson stepped down at the end of June. His replacement, Christopher Cox was sworn in on August 3.

Indices Report

Asset Consulting Group, Inc. Indices Report Periods Ending July 31, 2005

Index Name	Style	Returns							
		Month	Qtr	2 Qtrs	YTD	1 Year	3 Years	5 Years	10 Years
<u>Domestic Equity Indices</u>									
S&P 500	Large Cap Core	3.72%	7.17%	5.45%	2.88%	14.06%	12.62%	(1.34)%	9.98 %
S&P Equal Weighted	Large Cap Core	5.07%	11.43%	8.86%	5.62%	21.57%	20.21%	9.31%	12.44 %
DJIA	Large Cap Core	3.72%	4.98%	2.59%	(0.07)%	7.27%	9.16%	2.28%	10.63 %
Russell 1000	Large Cap Core	3.89%	8.01%	6.69%	4.00%	16.20%	13.46%	(0.80)%	10.17 %
Russell 1000 Growth	Large Cap Growth	4.89%	9.56%	6.63%	3.08%	13.04%	11.05%	(8.72)%	7.47 %
Russell 1000 Value	Large Cap Value	2.89%	6.52%	6.60%	4.71%	19.04%	15.76%	6.90%	11.96 %
Russell Mid Cap	Mid Cap Core	5.27%	13.28%	12.17%	9.39%	28.93%	21.96 %	8.70%	12.94 %
S&P Mid Cap 400	Mid Cap Core	5.25%	14.18%	12.17%	9.30%	25.89%	19.09 %	9.27%	14.67 %
Russell 2000	Small Cap Core	6.34%	17.67%	9.58%	5.00%	24.78%	21.60%	7.71 %	9.96 %
Russell 2000 Growth	Small Cap Growth	6.99%	18.24%	8.02%	3.15%	22.58%	20.41%	(1.46)%	5.08 %
Russell 2000 Value	Small Cap Value	5.69%	17.09%	10.93%	6.64%	26.73%	22.68 %	16.64 %	14.11 %
NASDAQ Composite	Broad Equities	6.22%	13.70%	5.94%	0.43%	15.77%	18.04%	(10.33)%	8.11 %
Wilshire 5000	Broad Equities	4.14%	8.96%	7.00%	4.19%	17.07%	14.61%	(0.05)%	9.97 %
<u>International Equity Indices</u>									
MSCI World	Broad Global	3.52%	6.40%	5.46%	3.10%	18.32%	15.20%	(0.43)%	7.33%
MSCI World Ex US	Broad International	3.23%	5.11%	4.56%	2.50%	21.96%	17.85%	1.26%	5.50%
EAFE	Developed Markets Intl	3.07%	4.64%	4.10%	2.20%	21.56%	17.66%	1.29%	5.24%
EAFE Growth	Developed Markets Intl Growth	3.05%	4.30%	3.92%	1.53%	20.00%	14.70%	(2.67)%	2.58%
EAFE Value	Developed Markets Intl Value	3.10%	5.00%	4.29%	2.87%	23.09%	20.58%	5.25%	7.80%
MSCI Emerging Markets Free	Emerging Market	7.08%	14.68%	13.42%	13.78%	47.04%	30.70%	10.32%	N/A
IFCI Composite	Emerging Market	6.92%	14.67%	13.92%	14.19%	48.34%	31.35%	12.04%	5.89%
<u>Domestic Fixed Income Indices</u>									
Treasury Bills	Cash	0.24%	0.73%	1.36%	1.53%	2.28%	1.58%	2.58%	3.94%
Lehman Intermediate G/C	Intermediate Govt/Credit Bonds	(0.83)%	0.48%	0.54%	0.74%	3.04%	4.38%	6.53%	6.25%
Lehman Intermediate Aggregate	Int. Core Bonds	(0.71)%	0.54%	0.78%	1.12%	3.75%	4.28%	6.60%	6.42%
Lehman Aggregate	Core Bonds	(0.91)%	0.71%	0.95%	1.58%	4.79%	5.02%	7.02%	6.75%
Citi Broad Investment Grade	Core Bonds	(0.88)%	0.81%	1.04%	1.69%	5.01%	5.15%	7.07%	6.77%
Lehman Govt/Credit	Govt/Credit Bonds	(1.13)%	0.76%	0.89%	1.59%	4.94%	5.59%	7.24%	6.82%
Lehman Long Govt/Credit	Long Govt/Credit Bonds	(2.22)%	1.85%	2.18%	4.79%	12.21%	9.84%	9.71%	8.61%
Lehman Government	Government Bonds	(1.21)%	0.50%	1.05%	1.69%	4.38%	4.22%	6.59%	6.54%
Lehman Mtg Backed Securities	Mortgage Bonds	(0.50)%	0.65%	1.11%	1.64%	4.67%	4.11%	6.58%	6.62%
Lehman Muni 3 Yr	3 Yr Municipal Bonds	(0.23)%	0.46%	0.34%	0.21%	1.56%	2.34%	4.16%	4.38%
Lehman Muni 10 Yr	10 Yr Municipal Bonds	(0.85)%	0.39%	0.80%	1.65%	5.30%	4.92%	6.26%	6.11%
Lehman U.S. Credit Index	Corporate Bonds	(1.00)%	1.18%	0.67%	1.46%	5.76%	7.41%	8.12%	7.22%
Merrill Lynch High Yield	High Yield Bonds	1.56%	5.39%	2.89%	2.81%	10.86%	15.94%	8.01%	7.31%
Merrill Lynch Conv US	Convertible Bonds	2.86%	7.48%	0.65%	(1.64)%	6.22%	12.18%	2.24%	N/A

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