

VTL Associates, LLC

Economic Report

January 2006

Presented by



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Capital Markets Overview

THE U.S. ECONOMY

- The Federal Reserve increased rates once again in December 2005. However, it dropped the phrase “measured pace” from its communication to the public. The Federal Reserve replaced the language with the following: “some further measured policy firming is like to be needed”.
- VTL Associates views the new Federal Reserve statements to mean that interest rate increases are nearing an end. The action and language utilized by the FOMC on January 31st will likely provide investors insight to the rest of the year for short-term interest rates. As a result, we believe this will be a real positive for equities in the United States.
- Core interest rate increases remain moderate with lowering energy prices and productivity rising above 4% will be major factors in stabilizing the intermediate and long yield curve.
- The 4th Quarter GDP came in at 1.1%, much below the estimate, as growth in the economy seems to be slowing. Slowing auto sales in October was the main contributor to this low number.
- The unemployment rate came in at 4.9% as U.S. employers added 108,000 workers in December. Despite rising energy prices and the negative impact of Hurricane Katrina, the economy added 2 million jobs for the year
- In November, the U.S. trade deficit widened to a record \$68.9 billion in October. An increase in imports from crude oil, automobile and televisions outweighed a rise in exports.
- Prices of goods imported into the U.S. fell more than expected in November as a result of oil and natural gas prices backing off for the month.
- U.S. factory orders increased in November bolstered by surging aircraft orders. This offset a large decline in business equipment. The decline in business equipment suggests companies delayed investment as consumer spending slowed in the last quarter.
- Asian manufacturers led by Toyota Motors won a record 36.5% share of the U.S. vehicle market in 2005.

- Sales for General Motors and Ford were down 10% and 9% respectively as Toyota increased 8.2%. Total domestic auto sales came in at 13.5 million annual unit rate. The total domestic and foreign sales came in at 17.2 million annual units.
- Home sales declined by 2.5% as the Federal Reserve continued to target a higher short-term discount rate.

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Capital Markets Overview

THE U.S. STOCK MARKET

- U.S. stocks had modest gains for the 4th quarter 05 and the year ending 05
- The broad US stock market appreciated in the fourth quarter of 2005, with a solid, but unspectacular 2.09% return for the S&P 500
- For the year, Energy stocks were the overwhelming best performers 31.74%.
- Consumer Durables, with a -17.55% return, were the worst-performing sector..
- Although the fourth quarter saw large cap stocks outperform smaller issuances, 2005 overall rewarded the small stocks more than larger stocks.
- Growth stocks were favored over value in the 4th quarter 05
- Not surprising given sinking crude oil prices, Energy issues were the worst performers -7.30%
- Auto manufacturers Ford and General Motors hurt the consumer durables sector with their continuing woes.
- The major U.S. equity market indices posted respectable returns for the fourth quarter of 2005, primarily driven by strong returns in November.
- For the year, mid-cap stocks continued to lead the equity market parade, as they have in recent years.
- Buoyed by a pullback in energy prices, continued confidence among consumers, and tame inflation data, each of the major indices finished the fourth quarter, and 2005, in the black
- Energy-related stocks were the dominant theme throughout most of the year.
- Domestic Automobile manufacturers continued to struggle against the competition and, collectively, were the worst performing group in the S&P 500 for the year.

The Market Environment

December 31, 2005

	Last Quarter	Last 2 Quarters	Last 3 Quarters	Last Year	Last 5 Years
MARKET INDEX RETURNS					
Standard & Poors 500	2.09	5.76	7.20	4.89	0.54
Wilshire 5000	2.21	6.33	8.80	6.38	2.11
Dow Jones Industrial	2.07	5.58	3.86	1.72	2.00
SB Broad Inv Grade	0.65	-0.03	3.09	2.56	5.93
LB Govt/Credit	0.59	-0.38	3.04	2.34	6.11
MSCI EAFE (Net)	4.08	14.88	13.72	13.53	4.55
S B World Govt Bond	-1.92	-3.02	-4.41	-6.87	6.93
91-Day Treasury Bill	0.91	1.74	2.47	3.06	2.34
Consumer Price Index	-1.00	1.18	1.81	3.42	2.37
S & P 500 SECTOR PERFORMANCE					
Consumer Non Durables	1.16	1.47	1.82	0.89	-0.36
Consumer Durables	-4.00	-9.47	-6.30	-17.55	1.22
Materials and Services	5.53	9.20	4.82	2.42	4.46
Capital Goods	4.24	5.76	0.58	-1.52	-0.12
Technology	1.36	7.86	10.74	4.03	-4.20
Energy	-7.30	9.74	11.84	31.73	9.58
Transportation	12.48	21.58	12.43	4.76	5.92
Utilities	-3.13	0.81	7.06	5.09	-3.49
Finance	8.13	9.02	13.89	7.02	3.99

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Capital Markets Overview

THE U.S. BOND MARKET

- The year finished with the yield curve technically inverted as measured from two to ten years.
- During 2005, a Two-year Treasury had a total return of 1.37%, while a BBB-rated Corporate bond returned 2%.
- The Five-year Treasury returned just .63%, topping a BBB-rated Corporate, which returned .45% for 2005.
- The Ten-year Treasury had a total return of 2.70% for 2005, besting a BBB-rated Corporate bond, which returned 2.13%
- Thirty-year Treasuries had one of the best returns of 9.32% for 2005. Only Federal Home Loan 30-years and FNMA 30-years bested the 30-year Treasury.
- The markets are beginning to lower their expectations of a March 2006 rate increase. Most market participants believe that the Federal Reserve will again raise rates in January.
- The bond market responded positively to the Producer Price Index.
- Economists expected a 2.8% gain in the Gross Domestic Product (GDP) in the 4th quarter, according to a median estimate of 72 estimates in a Bloomberg survey. The GCP actually gained 1.1%.
- The 10-year Treasury yield fell to 4.48% following the surprise drop in GDP growth for the 4th quarter 2005.
- The 4th quarter drop in the GDP was attributable to a severe drop in auto sales in October.