VTL Associates, LLC
Economic Report

August 2005

Presented by

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Capital Markets Overview

THE U.S. ECONOMY

- Fuel prices continued to rise along with increases in the cost of raw materials. To date, this has not caused profit margin pressures within the manufacturing sector.

- Manufacturing and housing, two pillars of the U.S. Economy, showed unexpected strength in June, suggesting growth may accelerate in the second half of the year.

  - Factory orders also rose, adding evidence of an expanding economy. Orders for durable goods rose 1.4% in June.

  - New home sales rose at a record pace in June as job growth and low mortgage rates made housing more affordable. The 4% increase in sales of new single-family homes brought the annual rate to 1.34 million homes.

- U.S. workers filing first-time applications for state jobless benefits fell to 303,000 for the week ending August 19th, the lowest level since April. The initial jobless claims declined by 34,000 in the week ending July 16th. The decline was the largest since December, 2002.

- The U.S. Economy grew at a 3.4% annual pace for the second quarter, making it the ninth straight quarter that U.S. GDP exceeded 3% -- a rate of successive quarterly growth not seen since January, 1983 through March, 1986.

- Americans earned and spent more in June as the job market improved.

  - Personal income rose 0.5%, more than twice the gain in May, with spending increasing by 0.8%.

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Capital Markets Overview

THE U.S. STOCK MARKET

- Year to date, the S&P 500 is down .8%. The materials sector dropped 7.63% for the first six months of 2005. Seven of the ten S&P 500 sectors under-performed in the past two quarters, making it very difficult for active managers to outperform the market index.

- Consumer discretionary, industrials, financials, telecommunications and information technology sectors all suffered setbacks during the first six months of 2005.

- Year to date, the energy sector is up 19.94%, while utilities soared by 15.24%. Both sectors have returned more than 38% for the trailing year. These two sectors have kept value managers in the positive camp all year, as a multi-year trend of value outperforming growth continues.

- Year to date, mid-cap stocks have performed the best, with mid-cap value generating stronger returns than mid-cap growth.

- As uncertainty continues, value stocks may continue to outperform growth stocks a while longer. We do expect an eventual reversion to the mean return for growth stocks in the large-, mid-, and small-cap sectors.

- In the second quarter, the Russell 1000 large-cap growth outperformed the Russell 1000 large-cap value. It is unclear if this is the beginning of a trend that favors growth. In the Frank Russell June 2005 survey of money managers, it was reported that 68% of the managers surveyed were bullish on large-cap growth stocks.

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Capital Markets Overview

THE U.S. BOND MARKET

- Fixed income investments sold off in July in the face of strong economic statistics, Chinese currency revaluations, and the Federal Reserve continuing to raise short-term interest rates.

- With oil prices having risen above $60 per barrel and the U.S. Treasury announcing the return of the 30-year bond, the bond market is beginning to experience price erosion.

- Corporate bonds have outperformed treasuries in recent weeks. The spread products have narrowed the spreads to the lowest in a year.

- The federal funds rate is at 3.5%, with the two-year treasury hovering in the 4.10% range. Meanwhile, the ten-year treasury is climbing toward the 4.40% level. Many believe the Federal Reserve will attempt to invert the yield curve.

- In the United Kingdom, inflation pressure accelerated as oil prices surged beyond $60 per barrel. The Bank of England pared its benchmark rate to 4.5% as economic growth slowed to a 12-year low.

- European bonds remain stable as concerns over higher oil prices dampened recent growth in European countries. In the previous quarter, European bonds declined as Germany and France both reported expanding industrial production.

- In Japan, there is evidence that investors are moving from bonds to stocks as economic growth in that country accelerates. Currently, the Japanese ten-year government bond is yielding approximately 1.45%, the highest since April, 2005.

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Capital Markets Expected Returns
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The following table illustrates expected returns and volatility expectations over the next 3-5 years for six different asset styles within three different asset classes.

Style	Expected Return	Standard Deviation
Cash	**3.5**	**0.6**
Large-Cap Equities	**8.0**	**15.4**
Small-Cap Equities	**8.5**	**19.2**
Intermediate Domestic Fixed Income	**3.9**	**3.5**
High-Yield Fixed Income	**5.5**	**6.2**
International Equities	**9.0**	**17.0**

Additionally, VTL Associates adjusts by tilting assets within the styles of each asset class above. The tilting exercise is designed to enhance a portfolio's total return in excess of the above-estimated expected returns. During 2004, we began advising clients to tilt some of their equity holdings toward both large-cap and small-cap growth. Also in 2004, we began increasing exposure of clients' assets toward international equities.

The rationale for tilting towards large-cap growth is based upon an analysis of the long-term historical spreads between large-cap value and large-cap growth equity styles. Based upon a 20-year return analysis between large-cap value and large-cap growth has been slightly in excess of 200 basis points on an annualized basis. Typically, the spread between large-cap value and large-cap growth returns over a 20-year time frame rarely exceeded 200 basis points on an annualized basis. However, during shorter time periods, this spread may move dramatically higher than 200 basis points. For example, over the past five years, large-cap growth has had an annualized return of –9.71%, versus large-cap value, which has had an annualized return of 7.94%. We believe this is unsustainable over the next three to five years, resulting in a reversion to the mean and therefore increasing opportunity for greater relative returns for both large-cap and small-cap growth.

Furthermore, we believe the strong growth potential in China and surrounding countries will increase returns for international equities over the next three to five years.

<u>NOTE</u>:

VTL Associates believes a risk premium approach to calculating expected returns provides an reliable means of estimating future returns for various asset classes. This belief is based upon the premise that a direct link exists between risk and reward (i.e., over a given period of time, a riskier investment generally will yield a greater return versus an investment with less risk).

Calculating the expected return using a risk premium approach utilizes a risk-free rate, which is the 30-day U.S. T-Bill rate, as a baseline. The risk premium for each type of asset is added to the risk-free rate to generate a nominal expected return for each type of asset. Therefore, the expected return is calculated by adding the historical risk premium to the current risk-free rate of return. The historical risk premium is the amount by which the historical returns of an asset style exceed the historical risk-free rate. Forecast risk is estimated by calculating the standard deviation of the asset classes using historical returns.

With regard to equities, the long-term secular annualized return above the historical risk-free rate (i.e., the historical equity risk premium) has been between 7.0% and 7.5%. As a result, the historical equity risk premium is added to the current risk-free rate to arrive at a nominal expected return for a given asset class or asset style. Additionally, the most recent history of the relationship between the risk-free rate and the particular asset type is analyzed to help determine whether expected returns need to be adjusted higher or lower based upon the current relationship and current market conditions.

With regard to fixed income, VTL utilizes the yield-to-maturity of the respective fixed income benchmark as the expected return. For example, intermediate-term fixed income returns are obtained by utilizing the yield-to-maturity for the Lehman Aggregate Index. VTL uses a high-yield index to help determine expected returns for high-yield fixed income. The same process is utilized for determining the expected return for both short-term and long-term fixed income assets.