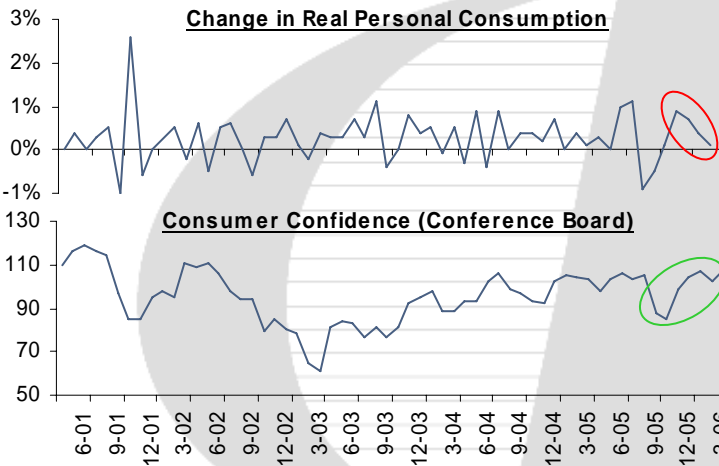


MARKET Recap

The Economy: "Rising Rates Hit Home"

The U.S. economy slowed considerably in the 4th quarter of 2005, a widely expected consequence of the hurricanes. Gross domestic product grew at a 1.7% annualized pace, driven by deceleration in personal consumption; spending on motor vehicles and parts fell 2.9%. GDP was also affected by acceleration in imports, downturn in federal spending, and decelerations in equipment & software and residential fixed investment.

Partially offsetting these negative factors, inventory investments and exports increased, and corporate profits surged 14.4% led by the financial services sector. Keep in mind that GDP is a lagging indicator of economic performance. In fact consensus forecasts for first quarter GDP are quite strong, with a median forecast of 4.7% according to the latest Bloomberg survey; this despite further erosion in personal consumption expenditures in February, which grew at a 0.1% pace. Purchases of durable goods fell 1.8% for the month, with motor vehicles and parts accounting for about half of the decrease.

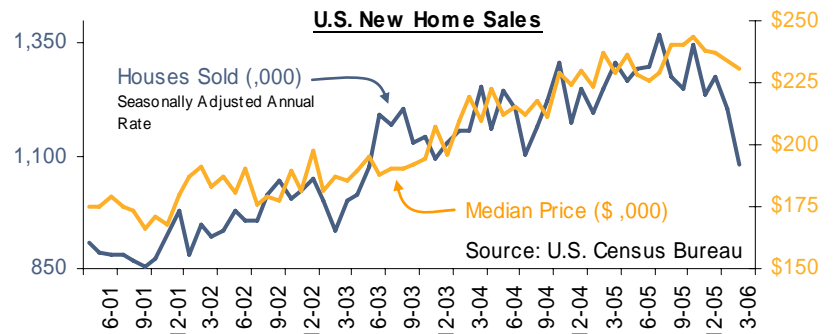


Paradoxically, consumers expressed increasing confidence throughout the past two quarters. In part, declining auto purchases are an inevitable result of below-market financing deals which do not create new economic sales; rather, they accelerate future sales into current reporting periods. Eventually time catches up to such practices, and rising rates will make it increasingly difficult for U.S. automakers to compete using these sales tactics.

Investors and policy-makers focused on the price index associated with the 4th quarter GDP release, which increased 3.7%; excluding food and energy, the index increased 3.2%, compared with an increase of 2.5% in the third quarter. Although there was no particular acceleration in the consumer or producer price indices, the prospect of inflation was clearly in the mind of Ben Bernanke,

the new Federal Reserve Chairman. The Fed's action in raising short-term rates twice last quarter, coupled with a March statement more strongly worded than expected, resulted in the first meaningful rise in long-term interest rates this cycle.

We believe the economy is at a turning point, and it is difficult to predict exactly where we're heading next. One factor everyone is watching is the residential housing market. Sales should soften with rising long-term rates; anecdotally we see much evidence for that on Main Street, and early numbers bear out the trend as well. New home sales fell in February, as did the median sale price for the fourth consecutive month. The sales process is very slow and difficult to measure on a comparable basis, so it is particularly dangerous to project trends. However, the household balance sheet is heavily skewed to real estate, and low rates have allowed consumers to spend otherwise illiquid wealth. The extent to which slowing residential real estate markets impact consumer spending will undoubtedly drive the next phase of the business cycle.



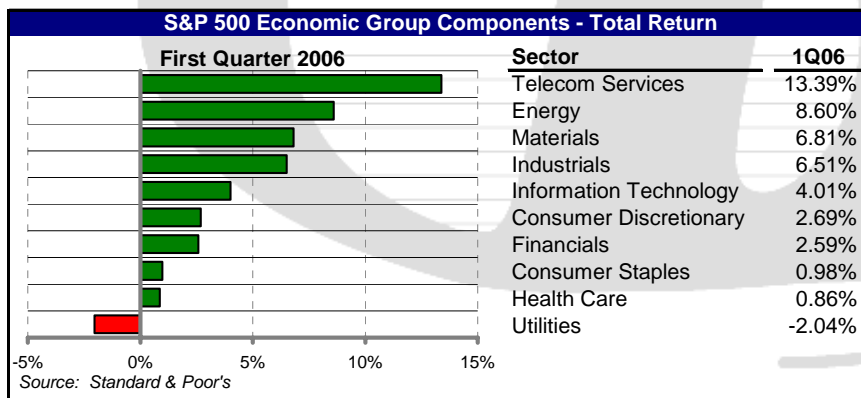
The U.S. Stock Market

Stocks closed a solid quarter despite rising interest rates, a slowdown in the housing market, fears of a spreading bird flu, continued turbulence in the Middle East, and volatile energy markets. As has been the case for several quarters, the market focused its attention on the Fed (and its new chief, Ben Bernanke). While the March 28th rate hike by the Fed was widely expected, the tone of the accompanying release caused a negative reaction in both the stock and bond markets. This extended through the final days of the quarter despite lower oil prices and a round of temperate economic data that would normally lessen concern about inflation or higher interest rates. But the decline was not enough to keep the first quarter of 2006 from being the strongest first quarter in some time. The S&P 500 had its biggest first-quarter gain since 1999, closing at 1,294.83 up 3.8% for the quarter. The Dow had its best first quarter since 2002, closing at 11,109.32 up 3.66% from year-end 2005. The NASDAQ had its best quarter since 2000, closing the quarter at 2,339.79, up 6.10% from 4Q2005.

Stock Indices - Total Return			
	1Q06		1Q06
Largecap Stocks		Midcap Stocks	
S&P 500	4.21%	S&P Midcap 400	7.63%
Russell 1000	4.49%	Russell Midcap	7.61%
Growth	3.09%	Growth	7.61%
Value	5.93%	Value	7.62%
Broad Markets		Smallcap Stocks	
NASDAQ Comp.	6.37%	S&P Smallcap 600	12.84%
Wilshire 5000	5.53%	Russell 2000	13.94%
		Growth	14.36%
		Value	13.51%

While all capitalization ranges had positive returns, small-cap stocks turned in the best results for the quarter, posting double digit returns that seemed more like full-year results than those for a single quarter. Large-caps stocks fared the worst with returns about one third that of small-cap stocks. The strong small-cap performance surprised many analysts who made predictions at the beginning of the year that small-cap stocks would relinquish their market leadership to the large-cap sector. In its seventh year, the current small-cap out-performance is approaching the longest run on record – 8 years. As a result, many small-cap funds have closed to new investors, but money continues to be allocated to this sector through existing investors, hedge funds, and exchange-traded funds.

Growth stocks outperformed value stocks in the small-cap sector for a third quarter, although this trend did not extend to the mid- and large-cap sectors. Another continuing pattern in the first quarter of 2006 was one of reversals. Telecom bounced back from the worst-performing sector in 2005 to the top-performing sector in the first quarter of 2006 driven largely by speculation on acquisition and spin-off deals. The energy sector also reversed its 4Q2005 worst-performing sector status to turn in a strong first quarter (not a surprise to anyone who watched prices rise at the pumps over the



past 3 months). Utilities, one of the sectors most sensitive to climbing interest rates which make dividend payments less attractive, closed the quarter as the worst-performing sector.

One of the biggest surprises was the strong performance turned in by real estate mutual funds. According to Lipper Inc., real-estate mutual funds turned in the best quarterly performance of any U.S. stock-fund category, gaining 14% through March 31, 2006. This was on top of 2005 performance where funds in the sector gained 36% on average. After a

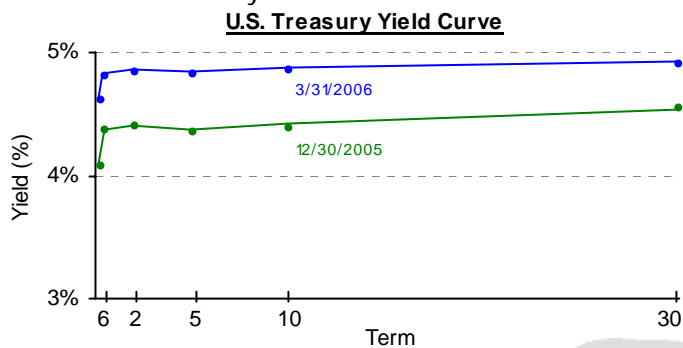
strong 2005, widespread expectations were that the sector would cool in 2006. This may yet happen as the momentum in real estate investment trusts, companies that own and manage portfolios of commercial properties and a large component of many real-estate funds, begins to slow. REIT performance was buoyed last quarter by a number of public funds going private or merging, and getting higher valuations.

As first quarter reports start coming in, corporate earnings are expected to remain solid. According to Thomson Financial, analysts they polled expect growth of 11.3% for the first quarter of 2006 and 12.5% for the full year.

The U.S. Bond Market

Interest rates were a major story in 2005, and they continued to receive attention early in 2006. Once again, bond prices at the close of the quarter were lower, which drove yields higher by about 50 basis points across the curve. In another continuing trend, the yield curve remained flat with only 6 basis points separating the 6-month and 10-year yields. The 3-month bill ended the quarter at 4.60%, up 53 basis points from year-end. The 10-year Treasury ended the quarter yielding 4.86%, up 47 basis points from the last quarter. And, the 30-year Treasury ended the quarter at 4.90%, up only 36 basis points from December, 2005.

Despite a change in chairman, the Federal Reserve did not change its course in the first quarter. As with previous quarters, it raised short-term interest rates twice. The latest increase on March 28 was the fifteenth 0.25% increase in consecutive meetings, and pushed the Federal Funds Rate on overnight loans between banks to 4.75%. Although the increases were widely expected, the markets looked for a change in the accompanying message and were disappointed. In a statement nearly identical to that used after the January 31 meeting (Alan Greenspan's last), it was noted that "some



Source: Bloomberg LP

further policy firming may be needed" to keep sustainable economic growth and price stability in balance. And while "the run-up in the prices of energy and other commodities appears to have had only a modest effect on core inflation," the statement noted that "increases in resource utilization, in combination with the elevated prices of energy and other commodities" still has the potential to increase inflation.

As interest rates reach what many consider to be a "neutral" rate (not too high to slow economic growth, but not so low as to allow excessive inflation), the Fed's cycle of monetary tightening seems like it must be reaching its peak. Most experts

agree, predicting that the next meeting, scheduled for May 10, will be the last time the Fed will raise rates in what has been an unprecedented string of steady, telegraphed actions. But in fact, Fed chairman Ben Bernanke indicated in testimony before Congress in February that in the coming quarters "monetary policy action will be increasingly dependent on incoming data" as the Fed will make "ongoing, provisional judgments about the risks to both inflation and growth." This should not cause the market concern, however, as the statement from the March 28 FOMC meeting pointed to an economy that "appears likely to moderate to a more sustainable pace," with "inflation expectations... contained."

Major bond indices were negative for the quarter except for high yield. While major indices did surprisingly well for full-year 2004 and 2005, it seems that the pressure from rising interest rates is finally taking its toll. With increasing spreads to Treasuries, high-yield bonds did well for the quarter. According to Standard & Poors, high-yield spreads climbed to 388 basis points over Treasuries at the end of 2005, a 59 basis point gain over the 2004 close of 329 basis points. S&P's analysts expect spreads on high-yield bonds to continue to rise in 2006, reaching between 420 and 450 basis points by midyear and as high as 470 basis points by year end, as issuers pay up to keep investors from seeking safer investments.

Bond Indices - Total Return	
	1Q06
Lehman Aggregate	-0.65%
Lehman Intern. Gov't	-0.30%
Lehman Long Gov't	-3.52%
Lehman Intern. Credit	-0.53%
Lehman Long Credit	-3.23%
Lehman High Yield	2.89%

Corporate bond issuance which hit just over \$700 billion in 2005, down over \$27 billion from 2004, appears to be making a comeback in 2006. According to Thomson Financial, high-grade U.S. corporate bond issuance climbed to \$235 billion in the first quarter of 2006 from \$173 billion in the same period a year ago. Junk bond sales totaled \$28 billion in the first quarter of this year, down from \$30 billion a year ago, which equates to a decrease of about 7% - not wholly surprising, given the wider spreads being demanded by investors.

Overseas Markets

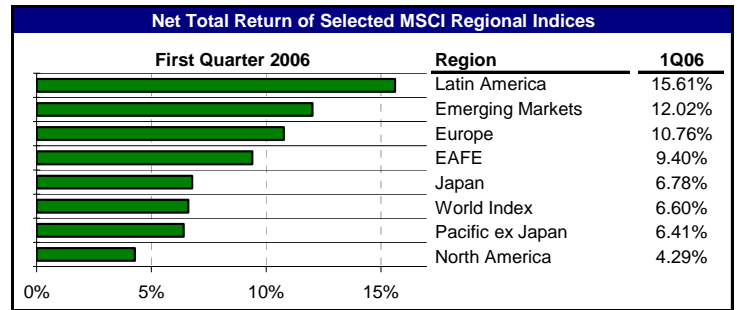
Emerging and developed global market performance strengthened during the first quarter with all geographic sectors posting good results. In Europe, strong performance was seen across the board. In early March, for the second time in three months, the European Central Bank raised short-term interest indicating a concern that recently improved economic activity would drive inflation, which is currently hovering above the desired 2% pace. Unemployment in the euro zone hit a four year low of 8.4% in February. Consensus is that the ECB will continue to raise interest rates to prevent a disparity between U.S. and euro zone markets.

In Germany business sentiment, as measured by the IFO index, unexpectedly climbed to 133.3, a 15-year high. The IFO survey noted that, in addition to manufacturers, retailers are also beginning to see improving economics. The MSCI Germany Index was up 13.8%. In France, the year started on a positive note with an up-tick in production and an increase in household spending on manufactured items. However, the end of the quarter was marked by socio-political unrest as young workers, supported by a strong union bloc, protested a new law that makes it easier to fire young workers. Not surprisingly, this unrest dampened French business confidence which has shown little improvement since late in 2005. The MSCI France Index was up 13.2% for the quarter.

Japan continues to exhibit signs of resurgence. The quarterly Tankan survey of business sentiment showed optimism is improving, though confidence dipped slightly among large manufacturers who were unable to pass higher raw-material costs along to consumers. The index came in at 20, down 1 point from the December survey. Economists had expected a 2-point gain. The quarter closed with reports showing that consumer prices had risen for four straight months, an indica-

tion that the economy would be able to support increased borrowing costs, a hopeful sign that the long period of deflation is coming to an end. Bank of Japan signaled that it may raise interest rates for the first time in 5 years, voting to reduce cash available to the banking system as continued economic growth and easing price declines have taken hold. Core consumer prices increased 0.5% year-over-year, in line with forecasts. In concert with this, the jobless rate fell to 4.1%, the lowest level since 1998.

China continues to attract investor's attention albeit with the expectations of its explosive growth moderating throughout the year. Annual growth in China's GDP is expected to gradually slow from 9.2% in the first quarter to 8.7% in the fourth quarter according to the state-run *China Securities Journal*. The consumer price index is expected to rise to about 2% this year after reaching 1.8% in 2005. Industrial output rose 20.1% in February from the same month a year earlier to 547.3 billion yuan (\$68.2 billion) and the value of goods delivered for export rose 29% year-over-year in February. The MSCI China Index posted a 21.4% return for the quarter.



Latin American emerging markets picked up where they left off in 2005. Both Argentina and Brazil demonstrated strong performance but not without some drama. In Brazil, allegations of corruption by members of Lula da Silva's government surfaced during the quarter. Brazil's Finance Minister Antonio Palocci, widely credited with controlling spending and inflation, was accused of graft and resigned causing the real to fall 2% on concerns relating to the allegations. Simultaneously, Brazilian bond prices were down due to rising yields on U.S. Treasuries, which reduces the relative attractiveness of emerging market debt. Brazilian economists lowered their forecast for year-end benchmark interest rates to 14.25% as slowing inflation will allow additional rate cuts. The MSCI Brazil Index was up 21.3% for the quarter.

In Argentina, the country's credit rating was raised for the second time in a year by Standard & Poor's due to falling debt levels and an increase in investment. The rating was raised to B from B-, with a stable outlook; although the rating continues to be five levels below investment grade. Argentina's economy grew by over 9% in 2006 and has expanded over 25% in the past three years on the strength of commodities and oil exports. In addition, the country paid off its entire debt obligation to the International Monetary Fund. The MSCI Argentina Index was up 27.6% for the quarter.

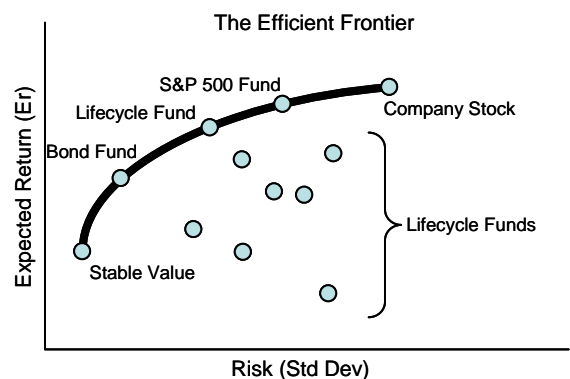
Focus On: *The Default Option Dilemma*

As the retirement landscape continues to evolve plan sponsors are increasingly taking the initiative to help participants successfully fund their retirements. If you have been watching the landscape closely you have observed a progression in the methods that sponsors have utilized to deliver education and advice to participants. The latest installment is automatic enrollment – the concept has been around for a few years, but it's currently gaining momentum. Auto-enrollment is just what it sounds like; participants are automatically enrolled in the company's retirement program and must "opt out" in order to not participate. With automatic enrollment comes an obligation by the plan sponsor to select a default investment option which will receive contributions should the employee not make an election. In other words, if a participant does nothing, 100% of his or her contribution automatically goes to the selected default option.

Potential default options span the risk spectrum from relatively safe stable value and money market funds to highly volatile company stock. In between are a host of other choices. As plan sponsors struggle with the decision of what the "right" default option is, the lifecycle fund has become a silver bullet for many industry vendors. While many vendors rightfully extol the virtues of lifecycle funds, unfortunately many also attempt to use fear-based sales tactics to drive sponsors to their recommended solution over more conservative options such as stable value or money market funds.

In reality, the choice between these approaches is not so clear. Regulatory agencies such as the DOL and IRS have not provided any specific direction on which option is right or what a plan sponsor's liability may be in light of their ultimate decision. Guidance from ERISA lawyers has, as expected, come down on both sides of the issue – select a stable fund so there is no loss of principal, or select lifecycle fund to provide a measure of growth. In the absence of specific direction within legislation or from regulators we see defensible positions for both sides.

Modern portfolio theory offers the efficient frontier to illustrate the trade-off between investor risk and return. For any given level of risk,



there is a portfolio on the efficient frontier offering the highest expected level of return. By the same token, for any level of return, the frontier identifies the lowest risk portfolio. On the efficient frontier, all of the investment choices are equivalent, in that investors receive the maximum compensation offered in the market for the risk taken. Therefore, one can argue that there are no “bad” decisions on the efficient frontier. Of course, the issue for plan sponsors is analyzing the options and determining if they lie on the efficient frontier. That is a question that is relatively easy to determine for a low-risk investment option; for lifecycle funds, whether or not a given mix is “efficient” is difficult to determine, requiring the investor to take a position regarding expected performance, risk, and correlation of performance for various asset classes. Over time, the asset allocation strategy selected by a particular fund manager could prove to be sub-optimal, even if the fund experiences relatively good performance in each asset class.

Proponents of lifecycle default options often argue that investors should have a long-term focus and that as such should be invested predominantly in equities or a blend of equity and other risk assets. The main argument put forward is that in the long run investors should expect equities to outperform due to the existence of an equity premium. While this may be true it does not consider the flip side of the argument that with the increased risk of investing in equities or equity-dominated portfolios the chances of accumulating losses or underperforming the benchmark is also higher. In fact, while the expected average annual return for a risky asset class becomes more stable with time, the final cumulative outcome becomes less stable, making the magnitude of “tail events” such as market meltdowns much more severe. Time does not reduce the severity or potential impact of this risk.

Regardless of which option is selected the plan sponsor still maintains responsibility for on-going monitoring of the fund. Lifecycle funds complicate the monitoring process and entail some additional challenges and concerns. Lifecycle funds are pre-set mixes of stocks and bonds with the allocation between the asset classes set by a portfolio manager based on time horizon to retirement. Typically these funds are structured as “funds-of-funds” meaning that the fund is made up of allocations to other mutual funds to create the stock/bond mix. Further complicating a sponsor’s fiduciary responsibility, all of the underlying funds must be reviewed. These funds are sold as sets to cover several investment time horizons. In our view, this as an attempt by some recordkeepers to re-bundle and recapture market share lost to the proliferation of open architecture solutions in the late 1990’s. Since bundled vendors often offer their own lifecycle funds exclusively a plan sponsor ends up “marrying” the vendor, which may or may not be the best decision for participants.

Plan sponsors confronting this decision should consider all of the available options keeping in mind that risk tolerance and the risk/reward trade-off are highly personal decisions. ERISA compels a plan sponsor to act as a prudent expert, evaluate the available options, have a reasonable basis for the decision, and make decisions in the best interest of participants. ERISA is silent on whether safety of principal or capital growth should be the driving factors considered when making the decision. It is not necessarily a bad decision for a long-term investor to accept lower returns in exchange for low risk and conversely for a short-term investor to seek high returns in exchange for high risk. According to a 2005 Vanguard study of default investment options, nearly 70% of plans utilize a stable value or money market option. Clearly plan sponsors have leaned toward the conservative side of the scale while awaiting guidance from regulators. In our opinion, there are arguments to support and refute the lifecycle decision and the stable value decision.

Things to Consider...	
<p><u>For Stable Value:</u></p> <ul style="list-style-type: none"> • Fee transparency • Potential to lag inflation • Risk level • Possible onerous liquidity restrictions 	<p><u>For Lifecycle Funds:</u></p> <ul style="list-style-type: none"> • Fee stacking • Risks of negative outcomes • Limited choice on platform • Complexity of fiduciary oversight

In the absence of any additional guidance we advise plan sponsors to carefully consider all of their options and don't immediately buy into the fear-based sales tactics of some vendors who are attempting to re-bundle plans through the use of lifecycle funds. Whether the answer is a lifecycle fund, stable value or any other option, which one is right comes down to the needs and circumstances of the employee population and the goals of the plan. Consider the objectives of the plan and select the option which, after careful analysis, best fits with the needs of the plan and the sponsor's fiduciary duty. Most importantly, a plan sponsor needs to continue to try to educate participants and get them to make an affirmative election or reallocate from the default option into a portfolio which best suits their needs.