An annual review of Morningstar Indexes and
relevant market activity affecting Index performance.

Morningstar® Indexes Yearbook 2005

Four years ago, we launched the first set of Morningstar Indexes with the goal of offering superior tools for benchmarking, research, and investment product creation. During the past year we've made significant additions to our indexes, introducing a family of sector indexes based on Morningstar's proprietary sector classifications and adding a set of dividend indexes.

In this issue of the Indexes Yearbook, Don Phillips, managing director at Morningstar, offers his insight on whether market-cap weighted indexes serve investors' best interests. He also discusses the risks associated with today's specialized indexes and what steps providers can take to moderate those risks.

Fund analyst, John Coumarianos, reviews the year's market events and trends and their impacts on Morningstar Indexes. Tricia Rothschild, senior product manager, explains Morningstar's Wide Moat Index and the factors considered when distinguishing good stock performance from exemplary performance. Morningstar director of mutual fund research, Russel Kinnel, examines the role indexing plays in active and passive investing strategies. All too often, he says, the industry uses an incorrect proxy for indexing that can lead to the wrong conclusions.

We hope you enjoy this year's edition of the Morningstar Indexes Yearbook. If you have any questions or if you would like more information about Morningstar Indexes, please call 1 312 384-3735 or e-mail sanjay.arya@morningstar.com.

Sanjay Arya | Director of Morningstar Indexes

2005 Morningstar Index Performance Wrap-up

	Total Returns % 3-Month	6-Month	1-Year	3-Year	5-Year	Best 3-Month Return %	Worst 3-Month Return %	Standard Deviation	Dividend Yield %	Price/ Earnings	Price/ Book	Price/ Sales
Morningstar Style Indexes												
Morningstar US Market Index	2.24	6.35	6.52	16.09	1.42	22.03	–16.96	15.18	1.60	22.05	4.16	3.19
Morningstar Large Cap Index	2.16	5.64	4.87	13.43	–1.06	22.82	–16.62	15.00	1.76	21.38	4.27	3.20
Morningstar Mid Cap Index	2.80	9.01	12.70	23.11	7.83	20.26	–20.76	16.26	1.21	23.88	4.00	3.19
Morningstar Small Cap Index	1.50	6.03	5.76	23.45	9.53	25.04	–28.09	19.56	1.13	24.40	3.53	3.14
Morningstar US Value Index	0.87	4.71	7.81	17.80	6.98	18.79	–20.03	13.06	2.85	15.09	2.51	2.01
Morningstar US Core Index	2.78	6.48	5.19	16.09	2.26	22.89	–17.07	13.20	1.42	20.91	3.96	2.18
Morningstar US Growth Index	3.15	8.04	6.41	14.21	–6.01	31.19	–33.33	23.54	0.53	30.62	6.04	5.43
Morningstar Large Value Index	0.75	4.63	7.04	15.52	4.81	18.78	–20.86	13.33	3.03	14.53	2.58	2.05
Morningstar Large Core Index	2.97	5.97	3.83	13.86	–0.75	24.02	–16.17	13.35	1.59	20.19	4.07	2.02
Morningstar Large Growth Index	2.87	6.43	**3.43**	**10.63**	**–8.48**	33.60	–34.21	23.47	0.62	30.07	6.25	5.61
Morningstar Mid Value Index	1.43	5.10	11.54	23.52	12.23	20.67	–17.81	13.32	2.26	16.26	2.39	1.83
Morningstar Mid Core Index	2.35	8.62	10.05	22.03	11.02	20.83	–23.39	14.64	1.10	23.15	3.90	2.62
Morningstar Mid Growth Index	**4.52**	**13.24**	**16.27**	23.41	–0.12	41.08	–32.47	24.28	0.36	31.84	5.61	5.05
Morningstar Small Value Index	**0.56**	**4.36**	5.12	**24.74**	**16.11**	25.86	–20.25	15.44	2.61	18.70	2.18	2.08
Morningstar Small Core Index	1.87	5.77	6.30	23.28	13.00	21.97	–30.36	17.43	0.74	22.16	3.07	2.47
Morningstar Small Growth Index	2.08	8.20	5.77	22.37	0.14	55.22	–35.30	28.34	0.15	33.49	5.27	4.79
Morningstar Dividend Indexes												
Morningstar Dividend Composite Index	**2.38**	**4.00**	**4.91**	**13.92**	**4.41**	19.59	–17.23	11.84	2.90	17.14	3.34	2.32
Morningstar Dividend Leaders Index	**3.49**	**3.59**	**3.16**	**14.40**	**7.82**	26.50	–20.33	13.80	4.26	15.11	2.61	2.36
Morningstar Sector Indexes												
Morningstar Info Economy Index	0.32	4.48	–1.79	12.45	–7.36	41.29	–35.16	28.56	0.94	26.14	4.38	4.07
Morningstar Software Sector Index	0.83	4.90	–2.65	9.89	–5.70	53.89	–39.35	31.05	0.60	28.51	5.49	6.17
Morningstar Hardware Sector Index	1.13	8.21	2.47	17.69	**–8.49**	47.95	–42.14	37.37	0.48	26.28	4.94	3.78
Morningstar Media Sector Index	–2.55	**–2.37**	**–11.00**	**7.22**	–5.00	37.77	–31.73	24.41	0.65	29.09	3.26	3.83
Morningstar Telecomm Sector Index	0.47	0.65	–2.35	7.90	–7.67	36.16	–25.83	26.30	3.33	18.58	2.41	2.44
Morningstar Service Economy Index	5.40	6.87	7.17	15.48	3.79	21.45	–14.98	12.30	1.62	22.66	3.99	3.65
Morningstar Healthcare Sector Index	1.50	3.73	8.15	10.22	–1.48	23.98	–16.79	12.08	1.17	30.32	5.49	4.88
Morningstar Cons Svcs Sector Index	4.66	1.30	1.95	17.44	7.15	32.24	–18.79	17.18	0.77	23.46	4.20	1.98
Morningstar Bus Svcs Sector Index	**8.89**	**20.37**	15.95	19.32	5.92	24.81	–21.83	18.07	0.73	25.10	5.97	4.68
Morningstar Fin Svcs Sector Index	7.28	8.15	6.75	17.29	5.82	23.93	–20.55	13.70	2.51	17.04	2.46	3.35
Morningstar Mfg Economy Index	–0.97	6.87	11.24	19.68	5.64	17.04	–16.48	13.10	1.98	18.79	4.29	1.94
Morningstar Cons Goods Sector Index	–0.22	3.26	2.14	11.78	5.72	20.99	–18.18	10.47	2.33	19.33	6.56	2.13
Morningstar Ind Mat Sector Index	5.21	8.03	2.87	18.43	3.36	21.75	–19.01	17.28	1.82	20.25	3.52	1.66
Morningstar Energy Sector Index	**–6.86**	11.41	**34.37**	**30.92**	**11.40**	29.58	–19.44	19.26	1.35	16.77	3.47	2.30
Morningstar Utilities Sector Index	–5.79	0.43	14.80	20.97	0.84	33.36	–20.83	15.85	3.42	17.80	3.54	1.45

highest return in group   lowest return in group

Price/ Cash Flow	Earnings Growth History	Book Value Growth	Sales Growth	Total # of Hldgs	Turnover Ratio %	Median Market Cap ($mil)	Top Three Sectors (% of market cap)					
15.02	22.63	14.75	16.78	2,110	5.48	1,774	Financial Svcs	21.10	Healthcare	13.02	Ind Materials	11.44
14.76	22.44	15.19	16.28	295	6.49	20,265	Financial Svcs	20.89	Healthcare	14.10	Ind Materials	11.30
15.37	23.68	13.82	16.89	728	22.65	3,564	Financial Svcs	21.68	Consumer Svcs	11.92	Ind Materials	10.89
16.81	21.64	12.68	21.49	1,087	33.60	986	Financial Svcs	21.57	Ind Materials	14.29	Business Svcs	11.64
9.35	17.66	15.83	12.98	662	22.16	1,806	Financial Svcs	38.74	Energy	15.38	Consumer Svcs	9.55
13.12	19.63	13.82	13.64	735	34.90	1,746	Ind Materials	23.64	Financial Svcs	20.30	Consumer Svcs	13.74
20.43	31.50	14.64	23.92	713	25.45	1,817	Healthcare	24.35	Hardware	18.87	Software	11.10
9.16	18.07	18.21	13.27	94	21.23	18,795	Financial Svcs	38.69	Energy	19.34	Consumer Svcs	9.25
13.11	18.93	13.86	12.55	97	30.43	22,278	Ind Materials	26.43	Financial Svcs	20.51	Consumer Svcs	13.08
19.99	31.28	13.37	23.32	104	27.30	18,921	Healthcare	25.68	Hardware	20.98	Software	12.29
9.59	17.95	9.71	12.34	231	44.94	3,576	Financial Svcs	38.93	Utilities	13.97	Consumer Svcs	11.87
12.77	21.36	13.50	14.91	256	57.15	3,513	Financial Svcs	19.31	Consumer Svcs	16.86	Ind Materials	16.31
21.27	31.83	17.90	23.13	241	44.62	3,614	Healthcare	21.41	Hardware	13.18	Business Svcs	11.99
10.94	10.97	5.64	11.73	337	51.07	999	Financial Svcs	38.72	Ind Materials	16.41	Consumer Svcs	11.08
14.19	22.41	14.34	20.46	382	67.63	974	Financial Svcs	21.07	Ind Materials	17.80	Business Svcs	13.46
22.69	33.58	18.42	31.86	368	58.80	987	Healthcare	20.13	Hardware	15.19	Business Svcs	14.40
11.69	15.84	17.32	12.60	673	15.11	3,277	Financial Svcs	29.16	Ind Materials	14.90	Consumer Svcs	12.34
10.16	1.28	18.65	9.82	98	26.37	2,684	Financial Svcs	43.10	Utilities	18.52	Telecomm	15.10

Price/ Cash Flow	Earnings Growth History	Book Value Growth	Sales Growth	Total # of Hldgs	Turnover Ratio %	Median Market Cap ($mil)	Value %	Core %	Growth %	Lg Cap %	Mid Cap %	Sm Cap %
15.49	29.22	4.26	17.40	368	7.97	1,672	18.45	21.50	60.05	76.86	17.06	6.08
17.89	36.57	–7.51	14.36	82	5.08	1,372	0.58	5.33	94.08	73.89	17.73	8.39
16.45	35.54	8.86	20.85	172	3.87	1,657	10.07	22.51	67.42	75.85	17.37	6.78
15.93	11.82	3.78	21.29	67	16.83	2,533	15.77	36.95	47.28	80.99	15.74	3.27
8.38	13.54	6.38	5.05	47	14.94	1,527	72.59	19.14	8.27	78.79	16.82	4.39
18.42	16.7	17.43	16.72	1,099	5.00	1,723	35.10	34.83	30.07	70.24	22.03	7.73
20.70	19.76	16.86	18.68	222	5.38	1,761	17.79	23.13	59.08	77.75	16.60	5.65
15.85	26.39	15.91	14.83	231	5.39	1,722	11.12	49.62	39.26	63.55	28.04	8.41
17.54	22.84	19.14	22.89	205	9.97	1,498	8.51	50.10	41.38	53.10	32.55	14.35
23.80	9.59	18.04	14.77	441	4.16	1,809	62.28	32.12	5.59	72.75	20.22	7.03
11.82	28.01	17.13	16.50	643	3.63	2,045	42.07	40.29	17.64	74.64	19.42	5.94
13.93	14.54	15.45	10.73	154	2.14	2,119	39.14	43.42	17.44	75.99	19.52	4.49
11.88	28.02	20.03	16.82	281	4.89	1,541	17.16	71.29	11.55	72.58	18.65	8.77
10.76	42.66	20.00	24.46	124	5.62	2,812	58.34	12.42	29.24	79.76	16.51	3.74
9.06	22.91	2.99	7.96	84	3.15	2,661	90.46	2.34	7.20	64.42	29.92	5.66

All data as of 12-31-2005

Indexing Goes Hollywood

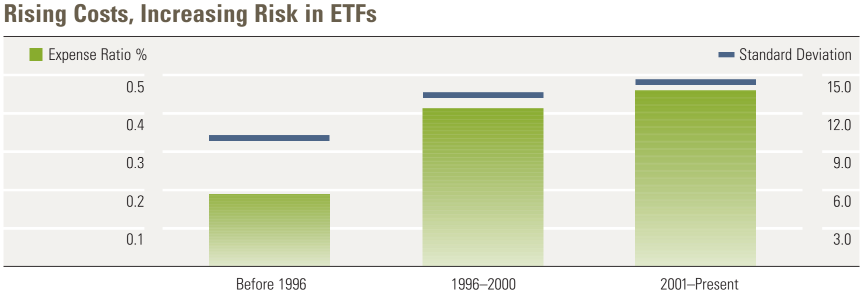
Gone are the days of only stodgy indexes, but are investors really better off?

Don Phillips
Managing Director

The benefits of indexing have been well-publicized in recent years. Lower costs, greater tax and trading efficiencies, and the precision of a disciplined and consistently applied approach have combined to make indexed investments a hugely popular choice among both professional and individual investors. On the whole, indexing has served investors well, but there's a dark side to indexing that investors shouldn't ignore.

By definition, if one uses market-cap weighted indexes, one has maximum exposure to the most overheated parts of the market at the worst possible times. Think energy in 1979, Japan in international indexes in 1989, or technology in 1999. Sadly, as these indexes push to their highest points, the investment vehicles based on them attract more and more assets. Technology-heavy, large-cap index funds took in billions of dollars in 1999—just in time for three straight miserable years of losses. Indexing may be a more efficient way to invest, but if it's simply a more efficient way of producing a bad experience, what's the point?

Rising Costs, Increasing Risk in ETFs



	Before 1996	1996–2000	2001–Present
Number of Funds	2	87	131
Avg Exp Ratio %	0.19	0.41	0.46
3-Year Std Dev	10.23	13.36	14.41

Source: Morningstar® Principia® January 2006

The potential for harm to investors increases as index offerings become more specialized, which is exactly what has happened in the world of exchange traded funds (ETFs). As seen in the chart at the bottom of the page, ETFs have progressively become more volatile and more costly over the past decade.

Part of this specialization is good; the tools available for investors are becoming more numerous and more precise. In the right hands, precision tools can create great things, but in the wrong ones, they can do great damage. Indeed, Vanguard founder Jack Bogle once compared ETFs to a finely honed shotgun that could be used for survival or for suicide. Unfortunately, the evidence suggests that investors don't use more volatile investments well. They pile in at the top and lose faith at the bottom. As seen in the chart at the top of the next page, investors have had much greater success with the lowest volatility funds than they have had with the highest. By going down a path of increased specialization, the index world may be positioning itself to do much damage to investors.

Continuing Bogle's metaphor, ETF providers may take the stance that they are merely weapons manufacturers who bear little or no responsibility for how their products are actually used. That's essentially the stance taken by many mutual fund firms that launched Internet funds in the late 1990s; they were simply meeting a market demand. Sadly, the celebration surrounding the rapid sales of several recent ETF launches seems eerily similar to the euphoria around fast selling Internet funds in the 1990s. But, the real success measure of any investment is not how quickly it raises assets, but how much money it makes for investors over time.

Higher Risk Funds Haven't Served Investors Well

	10-Year Dollar-Weighted Return %	10-Year Total Return %	Success Ratio (DWR/TR) %
Low Standard Deviation Funds	8.53	8.70	98
High Standard Deviation Funds	5.11	8.25	62

High and low standard deviation defined as relative to a fund's category. Group results based on weighted average of the dollar-weighted returns and total returns for each fund, using average assets for the period as the weights. Ten-year period ending 12-31-2005.

How many fund companies who "won big" in 1999 by launching an Internet fund now wish that they had never done so? Indeed, the biggest inflows in the mutual fund industry today go to firms like Capital Research, Vanguard, and Fidelity, who resisted the temptation to launch such funds. Firms that create a bad investor experience eventually pay a price for doing so. Firms that contribute to a better experience ultimately win.

While some members of the index community may divorce themselves from the responsibility for how their products are used, others will seek an alternative to being an arms supplier in constant search of more powerful weapons to sell. Many will embrace educational efforts to promote better use of their tools and, in time, will take strides to make their offerings safer to use and more likely to contribute to better outcomes. While fund companies don't have complete control over how investors use their services, that doesn't mean that they can't exercise any control over their use. Fund companies and ETF providers do control the timing of fund launches, the types of funds they launch, and the promotional campaigns supporting them. Choices made in each area can contribute to a better investor experience.

More Education, Higher Returns

	10-Year DWR %	10-Year TR %	+/– Difference	Success %
DFA Funds	10.81	9.90	+0.91	109
All No-Load Index Funds	7.07	8.65	–1.58	82

Consider the success Dimensional Fund Advisors (DFA) has had in selling its funds through advisors who undergo training on the merits of passive investing and in portfolio construction theory. Consider that over the past decade the dollar-weighted return of all index funds was just 82% of the time-weighted return investors could have gotten with those funds. Yet, the figures for DFA are much better. In fact, the dollar-weighted returns of DFA funds over the past 10 years are actually higher than their time-weighted returns. Suggesting advisors who use DFA encourage very smart behavior among their clients, even buying more out-of-favor segments of the market and riding them up, rather than buying at the peak and riding the trend down, which is usually the case with fund investors.

There's also room for improvement on product development. One way to avoid overexposure to overheated parts of the market that increase index fund volatility is to choose factors other than market cap to weight indexes. There has been much talk about fundamental weighting schemes in recent months, but almost all of it has centered on how to enhance return. An alternative approach would be to use these approaches to dampen volatility and thus produce a smoother ride and one more likely to keep investors on board.

In addition, the ETF industry could take a page from the fund industry's playbook and focus more on creating diversified packages of ETFs, like the life-cycle or target-date funds so popular in the mutual fund world these days. By combining uncorrelated funds, one can take some of the rough edges off performance. Such packaging can also make it easier for an investor to select the right offering for their needs. Both aspects of portfolio-based ETFs could improve the investor experience.

The bottom line is this; the index community is at a crossroads. It's wandered so far from its roots of offering one-stop, broad-based exposure to the market that a return to that simpler approach may not be possible. In creating more complex offerings, the index community has found new revenue sources from hedge funds and other parties seeking very specialized tools, but it has done so at the risk of doing considerable harm to less sophisticated investors. The test of character facing the index community is whether it ignores that risk or steps up and tries to mitigate it.

Year in Review: Our Analysis of the Markets in 2005

More of the same, but with a twist or two.

John Coumarianos
Fund Analyst

Stocks ended 2005 in the black, continuing an equities rally for the third straight year after the bursting of the technology bubble sent stocks reeling from 2000 through 2002. The flagship Morningstar US Market Index rose 6.5% for the year, adding about 2.24% in the final quarter. Meanwhile, all nine Morningstar style indexes finished the year in positive territory, with mid-caps leading the way, and growth stocks finally showing signs of life.

The market shrugged off debt downgrades at automaker General Motors, legal troubles and weak results from major pharmaceutical firms such as Merck and Pfizer, struggling traditional media and newspaper stocks such as Time Warner and Dow Jones, and airlines and auto parts bankruptcies. Difficulties at these businesses meant good news for rivals such as Toyota, Google, and Genentech. Additionally, mergers, acquisitions, and restructurings supported equities. Among the bigger announcements and consummations were SBC/AT&T, Procter & Gamble/Gillette, Chevron/Unocal, and ConocoPhillips/Burlington Resources. Notable spin-offs included Expedia (from InterActiveCorp) and CBS, which divorced from parent Viacom to create two new companies.

While influential financiers sometimes instigated these corporate events, legendary investor Warren Buffett characteristically remained content to leave the managers of his holdings alone. His company, Berkshire Hathaway, picked up shares of brewer Anheuser-Busch, home improvement retailers Home Depot and Kingfisher, computer-printer maker Lexmark, and industrial conglomerate Tyco.

Equity markets also mostly ignored political and macroeconomic problems such as continued difficulties in Iraq, the “twin” budget and trade deficits, surging oil prices, the Federal Reserve’s interest-rate raising campaign, and the destruction wrought by Hurricane Katrina. Bonds, however, finally felt some of the Fed’s pressure as they struggled to eke out gains, with the Lehman Brothers Aggregate Index up a modest 2.5%. Nevertheless, a “flat” yield curve bespeaks bonds’ continued resilience, which is keeping the housing market humming. Alan Greenspan’s successor, Ben Bernanke, will have to manage this as he seeks to curb inflation without halting growth, especially in an era when consumer spending seems to be responsible for economic health.

Surveying the Sectors

Energy surged for the second straight year, leading all sectors and posting a 34% gain. However, the sector stumbled in the fourth quarter, shedding about 7%, as many of the larger exploration and production companies faltered toward the end of the year. In the fourth quarter, ConocoPhillips lost 16.3% and ExxonMobil lost 11.1%, though they gained 37% and 12% for the year, respectively. Energy comprises 19% of the Morningstar Large Value Index, helping to continue its strong multiyear run with a 7.8% gain in 2005. The index has returned 16% annually for the past three years. Still, it’s worth noting that Morningstar analysts have been modeling lower commodity prices for the future than most market participants expect.

Utilities also had a good year, putting up a 15% gain and continuing their strong multiyear run. Utilities comprise 14% of the Morningstar Mid Value Index, and companies such as Allegheny Energy helped power the index to a 12% gain for the year. The index is up a whopping 23.5% annually for the past three years.

Only the media sector posted a double-digit loss for the year, as newspaper and radio stocks lagged. The entire industry is going through several notable seismic changes, and investors have generally soured on the group. However, many notable value investors have been nibbling at these shares, suggesting that the hype around the emergence of new technologies and trends is masking the value of the underlying assets of many media businesses.

Industry Performance

Oil products companies, such as refiner Valero, and oil services companies, such as Schlumberger, finished first and third, respectively, for the year in industry performance. Business and online services companies, which include firms such as Google, took second place. Although Google is now a large-cap company, other Web-based service companies, such as aQuantive and educational software provider Blackboard, are smaller and helped push the Morningstar Small Growth and Morningstar Mid Growth Indexes higher.

Paper companies such as Domtar and Weyerhaeuser brought up the rear, though they had little effect on the Morningstar Large Value and Morningstar Mid Value Indexes, respectively.

Media companies such as radio broadcaster Clear Channel Communications and Sirius Satellite Radio also suffered, but didn't significantly hurt the Morningstar Large Core or Morningstar Mid Cap Indexes.

Interestingly, these trends highlight the fact that much of what worked in 2004 continued to work in 2005. Similarly, a lot of what did not work in 2004 continued to lag in 2005. Indeed, investors continue to bet that many cyclical companies, which have risen strongly in the past few years, will continue to do so. Not only are these companies benefiting from domestic demand, but much of the recent fervor for their shares is a direct result of the belief that emerging economies across the globe will continue to get stronger.

Style and Market Cap Indexes

Value stocks continued their dominance in 2005, and investors responded by continuing to shovel money their way. Interestingly, though, the multiyear run in many of these stocks—combined with the continued sluggishness of growth stocks—meant that the composition of style indexes began to change. It's tough to think back to a few years ago

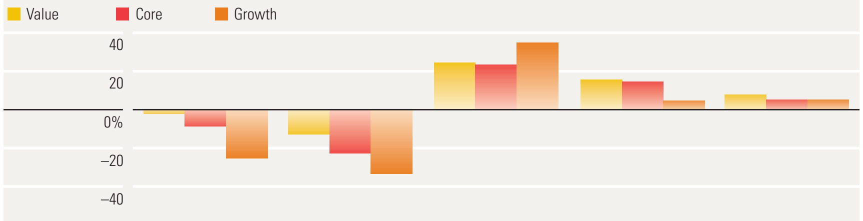
continued on the next page

Morningstar Sectors Trailing Period Returns

	1-Year Returns %	3-Year Returns %	5-Year Returns %
Information Economy	**–1.79**	**12.45**	**–7.36**
Software	–2.65	9.89	–5.70
Hardware	2.47	17.69	–8.49
Media	–11.00	7.22	–5.00
Telecommunications	–2.35	7.90	–7.67
Service Economy	**7.17**	**15.48**	**3.79**
Healthcare	8.15	10.22	–1.48
Consumer Services	1.95	17.44	7.15
Business Services	15.95	19.32	5.92
Financial Services	6.75	17.29	5.82
Mfg Economy	**11.24**	**19.68**	**5.64**
Consumer Goods	2.14	11.78	5.72
Industrial Materials	2.87	18.43	3.36
Energy	34.37	30.92	11.40
Utilities	14.80	20.97	0.84

3- and 5-year returns are annualized.

Morningstar Style Indexes: Five-Year Total Return %



Total Returns %	2001	2002	2003	2004	2005
Value	–0.68	–13.68	29.75	16.85	7.81
Core	–9.31	–21.18	28.63	15.62	5.19
Growth	–26.32	–33.20	34.12	4.37	6.41

and ever imagine that Pfizer would be in a value index or that mutual fund firm Franklin Resources would be in a growth index. But that's just what's happened. And the slide of stocks like Pfizer is exactly why the small- and mid-cap indexes continue to lead the way.

Morningstar US Value Index +7.8%

The Morningstar US Value Index beat its Core and Growth brethren again, but lost ground relative to those peers in the fourth quarter. Still, late-year declines in oil giants ExxonMobil and Chevron and regional bell Verizon didn't hold the index back on an absolute basis. International banks Citigroup, Bank of America, and JPMorgan Chase rallied in the fourth quarter. Other financials such as investment bank Bear Stearns helped push the index higher as merger and acquisition activity increased. REITS such as Boston Properties contributed to the surge, and homebuilders such as Lennar boosted the index as well. These gainers overcame pharmaceutical loser Bristol-Myers Squibb, newsprint producer Bowater, brewer Molson Coors, struggling bank Doral Financial, and embattled mortgage lenders Fannie Mae and Freddie Mac.

Morningstar US Core Index +5.2%

The Morningstar US Core Index, containing stocks that display both value and growth characteristics, rose 5.2% for the year and 2.78% for the final quarter. Industrial conglomerate General Electric was down 1.4% for the year, but tacked on 4.8% for the final quarter. Computer maker IBM dropped 16% for the year, including a 2.7% fourth-quarter surge. Beverage maker Coca-Cola bucked the trend of finishing strong, however, dropping 6% for the final quarter and 0.70% for the year.

As in other categories, oil and oil services led the charge, with production companies Anadarko Petroleum and Apache surging 47% and 36%, respectively. Transportation-related businesses also helped. Airplane-maker Boeing added 38% and railroad Burlington Northern Santa Fe increased 52%. The index also consists of 20% financial stocks, and investment banks Goldman Sachs and Lehman Brothers clocked in with gains of 24% and 48%, respectively.

Morningstar US Growth Index +6.4%

Growth showed some signs of life as the Morningstar US Growth Index added 6.4% for the year, including a strong 3.15% fourth-quarter surge. Top index components Microsoft, Wal-Mart, and Johnson & Johnson were down for the year by 1%, 10.3%, and 3.4% respectively. However, Microsoft gained 1.9% in the final quarter, and Wal-Mart added 7.1% during the same period, vindicating the many value managers who picked up shares earlier in the year. As with other indexes, anything oil- or energy-related tended to help the index. In large growth, drill bit maker and technology provider Baker Hughes added 44%.

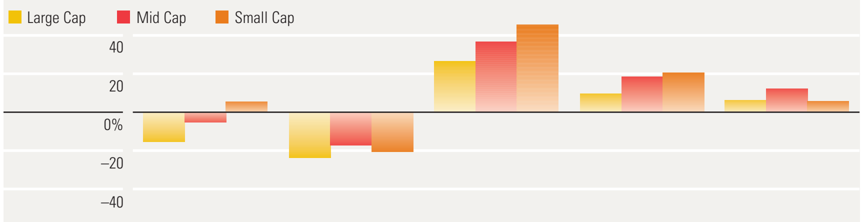
Google was also a strong contributor to the index, posting a whopping 115% gain for the year, as business services outfits—especially those related to the Internet—turned in strong performances. Shares of other Internet-related businesses such as router and networking-equipment maker Cisco suffered losses, however. Finally, biotechs Amgen and Genentech posted strong gains of 23% and 70%, respectively, helping the index.

Morningstar Large Cap Index +4.9%

The Morningstar Large Cap Index finished third from the bottom of all diversified Morningstar Indexes for the year, with a 4.9% gain. However, it made significant gains in the fourth quarter, surging 2.2%. Top index component Procter and Gamble dropped 2% for the last quarter. Another large component, PepsiCo, added 15.2% for the year, including 4.6% in the last quarter. Top component pharmaceutical firms Pfizer, Johnson & Johnson, and Abbott Laboratories turned in poor performances, retreating 11%, 3%, and 14%, respectively. Healthcare makes up nearly 14% of the index.

Embattled component Time Warner posted a 9.8% loss for the year as traditional media companies struggled to retain advertising dollars that are increasingly finding their way

Morningstar Cap Indexes: Five-Year Total Return %



Total Returns %	2001	2002	2003	2004	2005
Large Cap	–15.10	–23.47	27.04	9.54	4.87
Mid Cap	–4.63	–18.06	38.38	19.66	12.70
Small Cap	5.26	–20.36	47.70	20.44	5.76

to the Internet. Oil exploration and production giant ExxonMobil rose, although not as much as its mid-cap and small-cap brethren, as the energy rally moved down the cap scale.

Morningstar Mid Cap Index +12.7%

Mid-caps were the darlings of the market, and the Morningstar Mid Cap Index surged 12.7%. Top component Federated Department Stores rose 16% for the year as the market cheered its acquisition of rival May. Natural resources stocks such as copper producer Phelps Dodge, which added 53% in 2005, also helped the Mid Cap Index. Oil and natural gas driller and top index component Weatherford International surged over 40% for the second straight year in 2005. Pipelines such as Kinder Morgan also helped boost the index.

Additionally, technology stocks surged again as chipmaker Advanced Micro Devices began to make serious inroads into Intel's market share. The number two computer microprocessor maker jumped 39% for its third straight year of torrid gains. The index also got a shot in the arm from top component American Tower, which operates towers for wireless phones and broadcast equipment. Finally, the upward trend of the markets helped top component and discount broker TD Ameritrade as more confident investors placed more trades with the newly formed entity.

Morningstar Small Cap Index +5.8%

The Morningstar Small Cap Index barely outpaced the Large Cap Index for the year, leading observers to wonder if the "rotation" back to the big caps is finally taking place. We've been of the opinion that small-cap stocks are due to cool off and we continue to urge investors not to ignore larger stocks. In any case, top index component Intuitive Surgical, maker of surgical consoles and robots, rose a whopping 193% for the year and 60% for the final quarter. Salesforce.com, which is the second largest component in the index, rose 89% for the year and 39% for the quarter. Top component Walter Industries soared 48% for the year. Walter is engaged in homebuilding, financing, and the manufacture of industrial products such as pressure pipes. Industrial companies such as Walter comprise more than 14% of the Small Cap Index.

Conclusion

Morningstar analysts continue to encourage investors not to neglect large cap stocks, which have had a multiyear period of underperformance versus mid-cap and small-cap stocks. We've heard some of the more talented managers express the opinion that there are now more compelling valuations among large-cap growth stocks than there have been in years. Additionally, Morningstar's own equity analysis shows a disproportionate amount of large-cap, high-quality growth companies attractively priced, such as Abbott Laboratories, Anheuser-Busch, Berkshire Hathaway, Boston Scientific, Coca-Cola, Diageo, Johnson & Johnson, Microsoft, and Wal-Mart. It's difficult to say when large-cap stocks will be in vogue again, and we don't counsel investors to try to time such rotations. However, the temptation among investors is to neglect the category that has performed the worst recently, a fact that often keeps them from outperforming the market in the long run.

On a similar note, it's with mixed feelings that we see investors rush to gain international exposure. On the one hand, we are pleased to see them increase their diversification and gain exposure to markets that have been chronically underrepresented in most portfolios. On the other hand, we can't help but fear that this headlong move into foreign stocks is just another example of performance chasing and that the money pouring in will be yanked out with the first sign of underperformance. We encourage investors to maintain their international exposure over the longer haul.

To Index or Not to Index?

The answer isn't nearly as simple—or complicated—as some would have you believe.

Russel Kinnel
Director of
Mutual Fund Research

For the trailing three years ending 2005, fewer than one-third of small-cap U.S. stock funds beat their respective Morningstar Index. Meanwhile, more than half of large-cap U.S. stock funds beat their respective index. Conclusion: The small-cap market is much more efficient than the large-cap market, so investors should index small-cap and choose an active manager for large-caps.

Okay, I'm being facetious. But I'm amazed at how readily investors and reporters reach the opposite conclusion when the data shows small-cap funds beating their indexes and large-cap funds losing. Much of the reporting on active versus passive strategies does more harm than good. The biggest problem is that reporters often use the S&P 500 as a proxy for indexing and measure all funds against it. But if you're comparing small- and mid-cap funds with the S&P 500 (dominated by the largest companies), you're really comparing market capitalization ranges—not measuring passive investing against active.

Digging into the Numbers

To get a fresh perspective, I compared the average fund returns over the past nine years by category with those of the nine Morningstar Indexes. In addition, I looked at the asset-weighted returns by category to get a sense of what the average investor earned. That means we count the returns of a $5 billion fund five times more than a $1 billion fund in figuring overall returns for a category. I chose the Morningstar Indexes because they are built using the same methodology as the Morningstar Style Box, and thus sync up well with the funds in each category.

However, there are two key differences between the indexes and mutual funds. First, the indexes are essentially pure plays on their slice of the style box, whereas mutual funds

Active vs. Passive, Trailing 3-Years

	Value	Core	Growth
Large Cap	48.4 / 15.5	53.0 / 13.9	83.17 / 10.6
Mid Cap	20.0 / 23.5	25.2 / 22.0	13.6 / 23.4
Small Cap	28.4 / 24.7	32.4 / 23.3	29.1 / 22.4

○ Percent of actively managed mutual funds outperforming their respective benchmarks over a trailing 3-year period

● Index Returns (%) 3-Year Annualized

Data is free from survivorship bias

generally spread their investments across a wider area so that they have a good chunk of assets in two or three of the nine boxes. There's nothing wrong with that—I don't believe in straitjackets for active managers—but it does go a long way toward explaining shorter-term performance for any one category. The other difference is that these are index returns, not index-fund returns, and that means their returns are not docked for costs the way fund returns are. Run them as mutual funds, with servicing and transaction costs taken into account, and some of their advantage goes away.

Indexing is Tough to Beat

After looking at our index return calculations from July 1997 through January 2006, I found that the Morningstar Indexes won in two-thirds of the cases. (See table at the bottom of the next page.) For value and blend funds, the indexes outperformed both the straight average for the category and the asset-weighted average, but in the growth categories the average funds won.

The most likely explanation for this is that value has outperformed growth over that nine-year stretch. The indexes also had the advantage of being cost-free. So, instead of a uniform bias in favor of small-cap funds versus small-cap indexes, there is instead a style bias due to market conditions in the period measured. In short, you won't find anything to back the claim that small caps are less efficient than the large caps in these results. Rather, it simply looks like the average fund is hard-pressed to beat an appropriate index, particularly when its style is in favor.

The Average Investor Beats the Average Fund

At first it might sound like we're on Lake Woebegone, where everyone is above average, but it's true: the average investor in each category received better returns than the average fund in two-thirds of the instances. Here I'm using asset-weighted returns as a proxy for the average investor. In this measure, we multiply returns by assets in the fund, add up the figures from all the funds in the category, and then divide by assets.

With this method you see what return the average dollar invested in a fund has attained, which is pretty much the same as the average investor. In large value, the average investor earned an annualized return of 6.48%, versus 5.84% for the average fund. The average small-value investor earned 11.39%, versus 11.08% for the average fund. In large core, the average investor earned 5.68%, versus 4.39% for the average fund. Interestingly, the Morningstar Large Core Index just barely beat the average investor with an average return of 5.77%. If you were to tack on a Vanguard-like expense ratio of 0.20%, the average investor would have outperformed a fund tracking the Large Core Index.

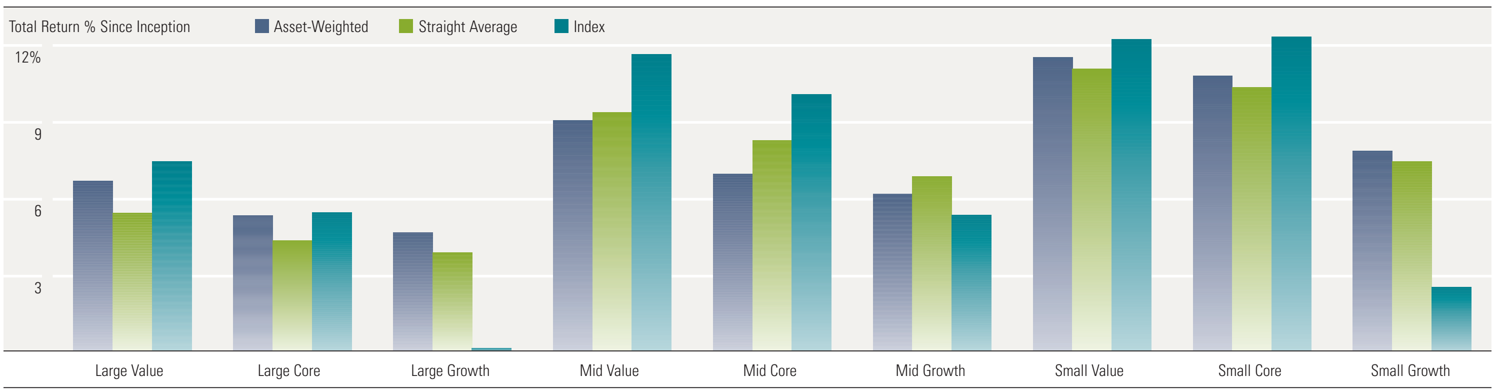
Why did the average investor beat the average fund? I believe it comes down to expenses. The gap in performance enjoyed by the average investor over the average fund is pretty close to the margin between asset-weighted expenses and average expenses. These results are interesting when you consider the article I wrote last year about how investors showed poor timing with volatile funds as opposed to the steady Eddies. Put the two studies together, and it indicates investors do an okay job of picking funds, but a poor job of switching from category to category.

It's the Costs, Stupid!

To summarize the results of this study, cost-free indexes beat the dollar-weighted return averages, which in turn beat the straight averages. Not coincidentally, that's also how the three groups line up when ranked by costs. Too often, reports on active versus passive investing confuse market cap and costs with indexing. Managers with a lot invested in small- and mid-cap stocks have looked like geniuses lately because the S&P 500 has lagged small- and mid-caps, but that's got nothing to do with active management. Nor should you view the choice between active and passive strategies as one of high costs versus low costs. In fact, you can find both high-cost index funds and low-cost actively managed funds.

Our studies have shown that lower-cost funds—regardless of whether they are active or passive—are a good bet. Maybe small caps really are less efficient than large caps despite what these figures show, but on another level, it doesn't really matter. Either way, lower-cost funds are the way to go, and investors ought to do well whether they choose active or passive funds. And of course, investors can do better by focusing on other fundamentals, too, such as management, strategy, and asset size. When choosing an index fund, investors should look for one with low turnover, low costs, and a diversified portfolio.

Performance of the Average Investor vs. the Average Fund vs. Indexes



Returns of the Morningstar Indexes over the past nine years (July 1997 through January 2006) compared with those of the average fund and asset-weighted average returns.

Benchmarking the Yield

Introducing a new benchmark for income investors.

Sanjay Arya
Director of
Morningstar Indexes

Dividend-paying stocks, once considered stodgy and boring, are enjoying renewed interest from investors. It's not hard to see why, considering the bear market that ushered in the new millennium, historically low bond yields, and Congress's 2003 decision to give favorable tax treatment to dividends.

Along with the heightened interest in dividends has come a spate of investment products offering investors exposure to income-producing stocks. As enthusiasm for income-producing equities has grown, so has the need for corresponding indexes and benchmarking tools—which explains the proliferation of dividend indexes. In focusing on dividends, however, several of these indexes have strayed from established principles for what constitutes a good index.

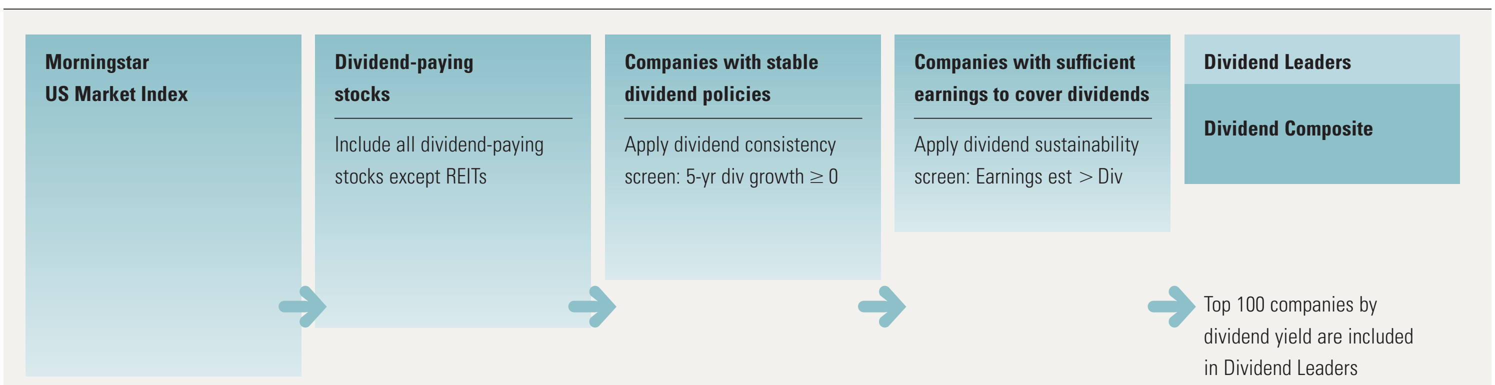
Back to Basics

The two primary applications of indexes are to serve as benchmarks for actively managed funds and to provide investable portfolios for index funds. An appropriate benchmark should be a passive representation of a manager's investment process, incorporating prominent and persistent characteristics of a manager's portfolio in the absence of active management. In other words, a benchmark should contain the securities from which the manager typically selects, weighted in a manner consistent with the manager's investment process. Generally, the more complete the benchmark—the broader and deeper its coverage—the more effectively it represents a manager's universe.

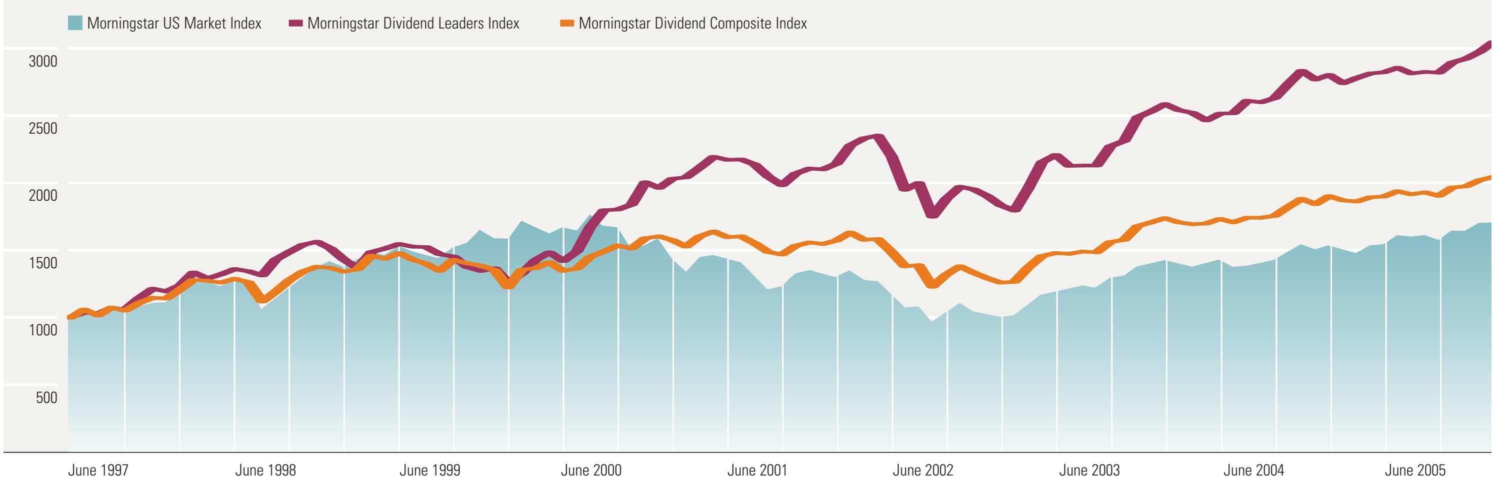
When intended for use as a portfolio for index funds, there are additional considerations for index construction: the index portfolio should represent an investable set of easily replicable constituents; turnover or cost of fund management should be low, and the stock-weighting scheme should be macro consistent.

To meet the needs of dividend-seeking investors, we've seen several new indexes launched in recent years. The strategies applied for developing these dividend indexes, however, have strayed from the principles of index construction: they failed to effectively represent a manager's investment universe, made no distinction between large and small companies, elicited high turnover, and resulted in higher transaction costs.

Dividend Indexes Construction Process



Morningstar Dividend Indexes: Growth of $1,000



A New Approach

In February 2006, Morningstar introduced a set of dividend-based indexes: the Morningstar Dividend Composite Index, which includes all dividend-paying stocks screened for dividend consistency and sustainability, and the Morningstar Dividend Leaders Index, which consists of the 100 highest-yielding stocks of the Composite Index. Like other dividend indexes, both Morningstar indexes focus on dividend-paying stocks.

Because yields, by definition, rise as share prices fall, chasing yields can lead investors toward troubled companies with depressed stock prices. Building a portfolio of high quality stocks is essential. Screening for dividend sustainability helps investors avoid companies whose high yields are largely a function of withering stock prices, as well as companies that are placating investors by paying out inflated dividends that cannot last. Morningstar's sustainability screen is a forward-looking measure, favoring companies expected to have sufficient earnings to cover their dividends. Specifically, Morningstar considers only those companies whose projected 12-month earnings per share meet or exceed their indicated dividend per share. In addition, we require a five-year dividend growth rate greater than zero.

A Weighty Issue

An index is supposed to measure the aggregate availability of investment returns for stocks representing similar characteristics. Because the market consists of all the market value in it—someone out there owns all those shares of stock—most indexes are weighted by the total market value available to the public for investing (share price multiplied by shares outstanding, minus shares held by insiders).

But two companies of similar size can appeal to very different constituencies. Wal-Mart and Bank of America have roughly the same market value, but a lot more investors own Bank of America for income (4.4% yield) than Wal-Mart (1.4% yield).

Instead of weighting each stock by market value, the Morningstar Dividend Composite Index weights stocks by the total dollars of dividend paid. Thus, the components with enormous payouts to shareholders—like Citigroup and Altria—have a substantial impact on index results. By contrast, mega-cap companies like Wal-Mart and IBM have less influence, while giant non-payers, like Cisco Systems, have no weight at all.

Using available dividends as a weighting methodology allows for greater investment capacity for the index vehicles. Focusing on stocks that have an ample supply of dividends better protects investors from supply/demand imbalances that can drive up stock prices.

By these principles, the Morningstar Dividend Composite Index provides a more accurate picture of what's going on in the market for high-income stocks.

continued on the next page

Morningstar Dividend Index Makeup

	Morningstar Dividend Composite	Morningstar Dividend Leaders
Number of Holdings	673	98
Median Market Cap ($bil)	3,277	2,684
Price/Earnings	17.14	15.11
Price/Book	3.34	2.61
Revenue Growth	12.60%	9.82%
Dividend Yield	2.90%	4.26%

Dividend Leaders

There were 673 stocks in the Morningstar Composite Index last December—too many to manage as an investment product. Therefore, we created a subset of the index that can serve as the basis of investment products such as exchange-traded funds. The Morningstar Dividend Leaders Index contains the 100 highest-yielding stocks in the Composite Index. The result is a more manageable portfolio and a higher yield (4.3% as of December 31, 2005).

The emphasis on yield also gives the index a "value bias." When a stock falls, its yield rises, making it more likely to be included in the Dividend Leaders Index. If the stock rallies and becomes more expensive, the yield usually declines—triggering a "sale." Yet the turnover in the portfolio is modest—thanks to the way the stocks are weighted. In addition to the value bias, the index provides exposure to businesses with a large-cap strategy that have size, financial strength, and proven cash generation. (First Trust Advisors launched an ETF based on the index on March 15, 2006.)

The Composite Index outperformed the Morningstar US Market Index 8.34% to 6.07% on an annualized basis since its inception on July 1, 1997. Meanwhile, the Morningstar Dividend Leaders Index trounced the US Market Index and the Composite Index with a 13.41% annualized return—enough evidence to show that solid dividend-paying companies provide superior long-term returns. (See Index Report on page 17 for a detailed view of the Index.)

Choosing the Right Tools

When choosing a dividend—or any other—index, it's important to consider what purpose the index will serve. If the dividend index is intended as a benchmark for performance evaluation of an equity-income fund, then breadth and appropriateness are the important factors. A benchmark index should contain enough names to adequately represent the manager's investment universe, and the benchmark's characteristics should align with those of the fund. If the dividend index is intended as the basis for an index fund, then investability, turnover, and macro consistency are the key considerations.

In the case of the Morningstar Dividend Indexes, the Dividend Leaders Index is a better passive index fund than the Composite Index. The Dividend Leaders Index has a shorter list of names that allows for easier replication, and its higher-yielding stocks can deliver a healthy income stream to investors. The broader Composite Index, on the other hand, would be more appropriate as an equity-income benchmark.

Comparison of Investable Dividend Indexes

	Morningstar Dividend Leaders	DJ Select Dividend	Mergent Dividend Achvs 50	S&P HY Divd Aristocrats
Universe	Morningstar US Market Index	DJ U.S. Total Market Index	Dividend-paying companies	S&P 1500
Dividend Benchmark Index	Morningstar Dividend Composite	None	Mergent Dividend Achievers	None
Number of Stocks	100	100	50	50
Index Inception	June 30, 1997	December 31, 1991	January 29, 1999	December 31, 1989
Transparent, Rule-based Methodology	Yes	Yes	Yes	Stocks in S&P 1500 are selected by committee
Reconstitution Frequency	Annual	Annual	Annual	Annual
Dividend Consistency Screen	5-year dividend growth ≥ 0	5-year dividend growth > 0	Increased dividend each of past 10 years	Increased dividend each of past 25 years
Dividend Sustainability Screen	Earnings est > Dividend	5-year avg dividend ⊕ EPS ≤ 60%	None	None
Weighting Methodology	Available dividend: DPS ⊗ number of shares ⊗ float	Dividends per share	Dividend yield	Dividend yield
Individual Security Capping	Yes; max weight 10%	No	No	No

The Morningstar Wide Moat Index

What is a moat and why is it important? We examine the factors that separate good companies from great ones.

Tricia Rothschild
Senior Product Manager

Pat Dorsey
Director of Stock Analysis

Picture yourself seated on a throne in a medieval castle. Would you feel more secure if your enemies could ride their steeds through the fields and make their way directly onto your land, or if you had a narrow strip of water surrounding your castle to fend off intruders? Better yet, what if you had a wide moat surrounding your castle, one that was very difficult for invaders to traverse?

The Morningstar Wide Moat Index captures this concept. We've borrowed this term from Warren Buffett to describe a company's sustainable competitive advantage that enables it to keep competitors at bay for an extended period. Morningstar has embedded the analysis of a firm's moat within its research process, and the resulting list of wide moat companies includes what are, in our view, the highest-quality companies around. We've created the Wide Moat Index to help investors participate in the above-average profits we expect these firms to earn.

In determining the size of a firm's economic moat, we begin with the premise that all highly profitable firms attract competitors, and only firms that are able to keep competition at bay will earn above-normal profits for a long time. An economic moat—or competitive advantage—allows a company to fend off competitors and earn sustainable excess economic profits. We look at return on invested capital (ROIC) relative to the company's cost of capital to determine profitability. We believe ROIC is the best measure of economic profitability because it shows us the cash return on the capital invested in the business.

Of course, we have to examine ROIC relative to a firm's cost of capital because money isn't free—those who have capital, charge companies for the right to use it, and they charge some companies more than others. A firm that operates pipelines or sells beer has a low cost of capital because it has a stable business, so investors don't ask for much in the way of returns. A small semiconductor or biotech firm would have a very high cost of capital because it's entirely possible that investors might not get their money back, so they ask for a high return to compensate for the higher risk. For example, an ROIC of 14% would be spectacular for a pipeline company relative to its 8% cost of capital, but would barely clear the bar for a small tech or biotech firm.

How Does Morningstar Assign Moat Ratings?

We call the first step "show me the money." We determine whether ROIC has exceeded the firm's cost of capital in the past, and then ask whether it's likely to do so in the future. If the answer is "no" on both counts, then the firm has no moat, no matter how attractive it might sound on the surface.

In the second step, we look for a competitive advantage, because even companies that have posted strong returns on capital in the past might not have a moat if there's no identifiable reason why those high returns will continue. Think about retailers and restaurant chains—switching costs for consumers are extremely low, so companies in these industries need scale, a well-established brand, or some other defensible advantage to give them a moat. Without some advantage, those high ROICs could dissipate quickly. History is full of hot retail or restaurant concepts that have flopped as quickly as they've become temporary hits, which is why 40 of the 122 restaurants and retailers we cover have narrow moats, and only five have wide moats.

continued on the next page

What Advantages Confer Economic Moats?

Type of Advantage	Description	Wide Moat Examples
High Switching Cost	It's tough for customers to switch to a competitor	Bank of America, Stryker
Cost Advantage	Firm contains costs better than competitors	Wal-Mart, Dell
Intangible Assets	Includes patents, trademarks, and regulatory approvals	Harley-Davidson, Johnson & Johnson
Network Effect	Firm's services become more valuable as its user base grows	e-Bay, Chicago Mercantile Exchange

Is the Moat Wide or Narrow?

Finally, if we have evidence of solid returns on capital and confidence that those returns are sustainable, we have to decide whether the firm has a wide or narrow moat. To rate a stock as having a wide moat, we have to be confident that the firm's competitive advantage will persist for quite some time, which means that competitors would have a tough time going up against the company. We're fairly selective about this—only about 10% of the stocks we cover receive wide moat ratings. Here are a few examples:

Case Study #1: Commercial Aircraft

On the surface, making large commercial aircraft might seem like a good business. It's essentially a duopoly between Airbus and Boeing, the barriers to entry are massive, and it requires a ton of R&D to stay competitive. Unfortunately, large jets are something of a commodity when you get right down to it; whichever one costs the least to move X passengers Y distance is likely to get the nod from airlines, since neither has a large technological advantage at the moment. Moreover, airline buyers are a concentrated group, which increases their bargaining power relative to Airbus and Boeing. Coupling this with Boeing's middling returns on capital and an attractive but not fantastic defense business, we arrive at a narrow moat rating.

Case Study #2: Logistics Firms

FedEx and United Parcel Service (UPS) also help illustrate where we draw the line. Although they look similar on the surface, UPS typically posts ROICs in the 15% range, which we think will improve to 20% in time, while FedEx has been posting high single-digit returns on capital that we're projecting to only improve to a bit more than 11%. One reason for this is that planes make up a bigger portion of FedEx's capital base, and planes are more expensive (and less productive) assets than the ubiquitous brown trucks that comprise a big chunk of UPS's invested capital. Second, a larger portion of FedEx's business comes from overnight/time-sensitive package delivery, which is a more competitive market than UPS's bread-and-butter residential package delivery. The bottom line is UPS delivers many more packages with a similar asset base than FedEx, which makes UPS a more attractive business.

Our Staff

Morningstar employs about 90 equity analysts who cover more than 1,700 stocks in 130 industries. We currently provide analyst reports on more than 99% of the market capitalization of the stocks included in the S&P 500 Index. We organize our analysts by industry and they conduct fundamental research to determine the fair value estimate of each stock on their coverage list. Comparing our fair value estimate to the stock's current market price allows us determine the Morningstar Rating for stocks.

Description of the Wide Moat Index

The Morningstar Wide Moat Index consists of the highest-quality companies or stocks that we classify as having wide moats. The index is reviewed as needed but not rebalanced. When a new stock is defined as wide moat, we add it to the index. When a current component no longer qualifies as a wide moat company, we remove its shares from the index. As of December 31, 2005, the index consisted of 155 component stocks with a total market capitalization of $6.58 trillion, representing 49% of the U.S. stock market.

Client Spotlight

CLS Investment Firm, LLC

Scott Kubie
Chief Investment Strategist

CLS offers professional money management services to investors through independent broker/dealers and other financial advisors, as well as 401(k) plan sponsors, across the United States. CLS is a division of Northstar Financial with overall assets under management of $2.7 billion.

CLS calls its unique investment methodology "Adaptive Risk Allocation." A key element of this methodology is the concept of "risk budgeting," which enables CLS to manage an investor's portfolio based on that individual's own risk tolerance. CLS assigns a risk level to each asset class available based on its historical returns, standard deviations and other fundamental factors. Then the firm allocates each client's risk budget to create a diversified portfolio that emphasizes those areas of the market that are most undervalued. According to Scott Kubie, chief investment strategist for CLS, the aim is to be "an expert on the ability to calculate and measure risk, and then control risk in client portfolios."

Exchange-traded funds (ETFs) are a good match for CLS's investment methodology and the fastest growing part of its business. CLS likes the combination of lower cost, higher liquidity, transparent holdings, and disciplined strategies that it finds with ETFs, and has been using them in investor portfolios for the past five years.

A big innovation for CLS was when Barclays Global Investors (BGI) launched nine iShares Morningstar Index ETFs based on the proprietary methodology of the Morningstar Style Box. With the launch of these style-pure funds, according to Kubie, "All of a sudden we had the choices that we needed to implement our methodology with a high degree of precision."

Kubie feels that the more concentrated exposure offered through the Morningstar Indexes is valuable to CLS and its clients. Kubie stated, "Sometimes growth or value can be very attractive and if it is, we want to have as tight of an exposure as possible on those growth or value stocks while still being diversified. Alternatively, we may want exposure to only core stocks. The Morningstar Style Box provides a purer exposure than other style indexes."

In particular, Kubie feels that Morningstar has made an important contribution in developing an index family that carves out the "core"—which includes stocks that demonstrate a mix of value and growth characteristics. Kubie appreciates the ability to hold just those companies in the middle—not necessarily fast growers but also not deep value companies—that have risk characteristics that are more in line with the lower risk parts of each capitalization zone.

Kubie said, "For instance, right now we like mid-cap blend and growth, but not value. iShares Morningstar Core ETFs allow us to avoid value but own the other two. We get the right exposure and better diversification. We think these indexes are an exceptional opportunity and a key advantage that Morningstar has brought to the market."

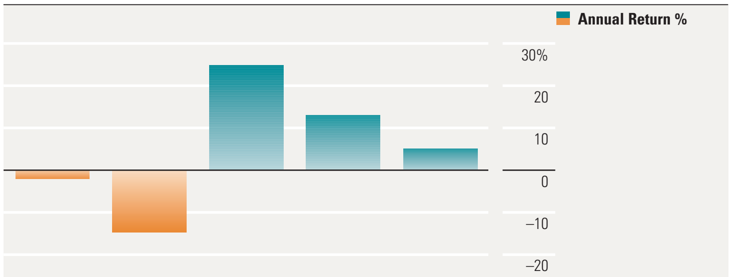
He added, "I believe that the nine iShares Morningstar ETFs offer a unique approach to slicing up the U.S. domestic equity market, with each ETF representing a discrete portfolio building block. This allows financial advisors like us to adapt asset allocation models that align perfectly with the risk allocation of our clients."

The iShares ETFs are not sponsored, endorsed, sold, or promoted by Morningstar, and Morningstar makes no representation regarding the advisability of investing in iShares.

Morningstar Index Reports | Dividends

Morningstar Dividend Composite Index

Ticker	Index Inception Date	Number of Holdings
MDCTR	06-30-1997	673



2001	2002	2003	2004	2005	History
1,558	1,336	1,678	1,883	1,975	Index Value
–2.07	–14.27	25.65	12.17	4.91	Annual Return %
24.23	20.43	20.94	18.30	17.14	Price/Earnings
4.89	3.77	3.90	3.62	3.34	Price/Book
2.60	3.34	2.68	2.69	2.90	Dividend Yield %
12.72	–6.76	12.62	21.08	15.84	Earnings Growth %
14.59	3.93	1.31	11.95	12.60	Revenue Growth %

Trailing Total Returns	%	Grwth $10K
6-Month	4.00	10,400
1-Year	4.91	10,491
3-Year Avg	13.92	14,786
5-Year Avg	4.41	12,413
Since Inception	8.33	19,752

Risk Measures	%
Standard Deviation	11.84
Mean (5-year monthly return)	1.45
Best 3 Mo Ret (Sep 98 to Nov 98)	19.59
Worst 3 Mo Ret (Jul 02 to Sep 02)	–17.23

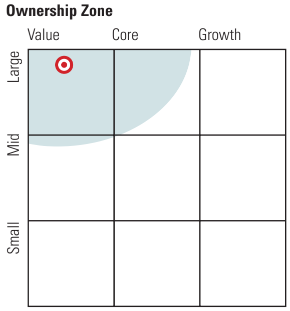
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
General Electric	4.97	–1.43
Citigroup	4.90	4.63
Bank of America	4.32	2.39
ExxonMobil	3.88	11.76
Altria Group	3.51	27.72
Pfizer	3.17	–10.62
J.P. Morgan Chase & Co.	2.61	5.74
Verizon Communications	2.42	–22.18
AT&T	2.29	0.25
Johnson & Johnson	2.12	–3.36

% Weight Top 10 Holdings	34.19
Turnover Ratio %	15.11
Median Market Cap	3,277
Maximum Market Cap	370,344
Minimum Market Cap	408

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	9.87	0.50
Software	0.04	0.01
Hardware	2.66	0.29
Media	0.94	0.25
Telecomm	6.23	2.24
Service	47.12	0.97
Healthcare	11.94	0.92
Consumer Svcs	3.59	0.39
Business Svcs	2.43	0.45
Financial Svcs	29.16	1.38
Manufacturing	43.01	1.36
Consumer Goods	12.34	1.52
Ind Materials	14.91	1.30
Energy	9.00	1.02
Utilities	6.76	2.11

Ownership Zone

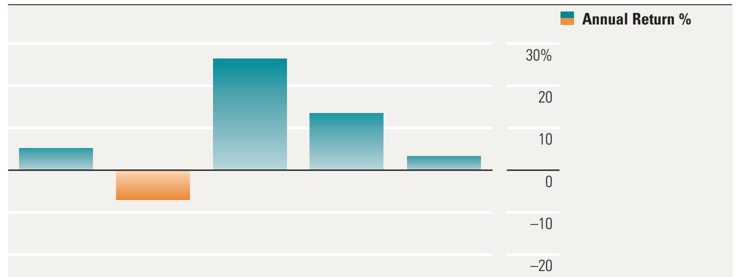


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Dividend Leaders Index

Ticker	Index Inception Date	Number of Holdings
MDLTR	06-30-1997	98



2001	2002	2003	2004	2005	History
2,099	1,946	2,482	2,825	2,914	Index Value
5.03	–7.28	27.53	13.80	3.16	Annual Return %
20.87	18.01	16.91	17.09	15.11	Price/Earnings
2.66	2.47	2.78	2.56	2.61	Price/Book
4.61	5.26	4.05	3.85	4.26	Dividend Yield %
3.91	–22.14	9.43	19.03	1.28	Earnings Growth %
15.40	4.16	–4.12	8.62	9.82	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	3.59	10,359
1-Year	3.16	10,316
3-Year Avg	14.40	14,973
5-Year Avg	7.82	14,580
Since Inception	13.40	29,139

Risk Measures	%
Standard Deviation	13.80
Mean (5-year monthly return)	2.46
Best 3 Mo Ret (Jul 00 to Sep 00)	26.50
Worst 3 Mo Ret (Jul 02 to Sep 02)	–20.33

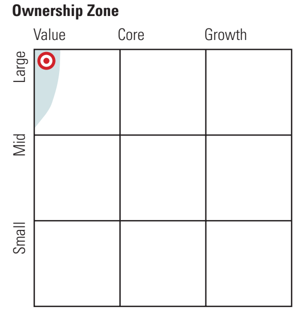
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
Citigroup	9.97	4.63
Bank of America	9.01	2.39
Altria Group	7.63	27.72
J.P. Morgan Chase & Co.	6.17	5.74
Verizon Communications	5.84	–22.18
AT&T	5.61	0.25
Merck	5.16	4.04
Bristol-Myers Squibb	3.98	–6.16
US Bancorp	3.69	–0.46
BellSouth	3.67	1.77

% Weight Top 10 Holdings	60.73
Turnover Ratio %	26.37
Median Market Cap	2,684
Maximum Market Cap	245,512
Minimum Market Cap	529

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	15.11	0.77
Software	0.00	0.00
Hardware	0.00	0.00
Media	0.00	0.00
Telecomm	15.11	5.44
Service	52.86	1.08
Healthcare	9.14	0.70
Consumer Svcs	0.46	0.05
Business Svcs	0.16	0.03
Financial Svcs	43.10	2.04
Manufacturing	32.03	1.01
Consumer Goods	12.23	1.51
Ind Materials	0.24	0.02
Energy	1.04	0.12
Utilities	18.52	5.79

Ownership Zone



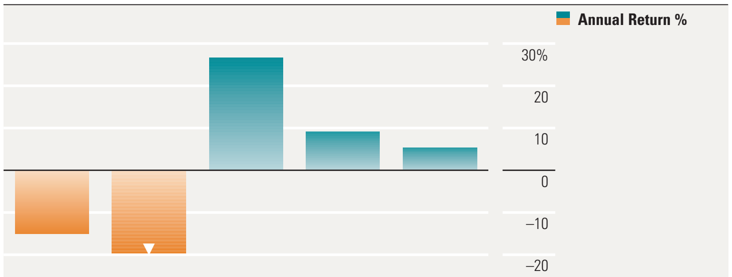
The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Index Reports | Large Cap

Morningstar Large Cap Index

Ticker	Index Inception Date	Number of Holdings
$MLCPT	12-31-1991	295



2001	2002	2003	2004	2005	History
3,184	2,437	3,096	3,391	3,556	Index Value
−15.10	−23.47	27.04	9.54	4.87	Annual Return %
31.99	25.14	26.93	23.22	21.38	Price/Earnings
5.99	4.56	4.76	4.39	4.27	Price/Book
1.29	1.80	1.54	1.62	1.76	Dividend Yield %
12.69	−2.41	18.67	27.20	22.63	Earnings Growth %
15.58	4.74	5.69	15.64	16.28	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	5.64	10,564
1-Year	4.87	10,487
3-Year Avg	13.43	14,593
5-Year Avg	−1.06	9,482
Since Inception	9.48	35,565

Risk Measures	%
Standard Deviation	15.00
Mean (5-year monthly return)	0.02
Best 3 Mo Ret (Sep 98 to Nov 98)	22.82
Worst 3 Mo Ret (Jul 02 to Sep 02)	−16.62

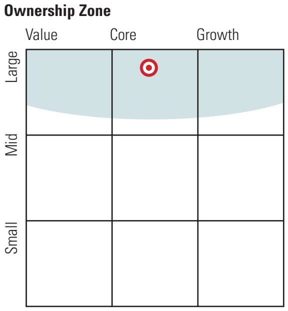
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
General Electric	3.46	−1.43
ExxonMobil	3.33	11.76
Microsoft	2.59	−0.95
Citigroup	2.35	4.63
Procter & Gamble	1.84	7.18
Wal-Mart Stores	1.82	−10.30
Bank of America	1.74	2.39
Johnson & Johnson	1.66	−3.36
American Intl Group	1.65	4.83
Pfizer	1.61	−10.62

% Weight Top 10 Holdings	22.06
Turnover Ratio %	6.49
Median Market Cap	20,265
Maximum Market Cap	370,344
Minimum Market Cap	9,321

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	20.64	1.05
Software	3.98	1.03
Hardware	9.53	1.04
Media	4.19	1.11
Telecomm	2.94	1.06
Service	47.13	0.97
Healthcare	14.10	1.08
Consumer Svcs	8.32	0.90
Business Svcs	3.82	0.71
Financial Svcs	20.89	0.99
Manufacturing	32.23	1.02
Consumer Goods	8.38	1.03
Ind Materials	11.30	0.99
Energy	9.69	1.09
Utilities	2.86	0.89

Ownership Zone

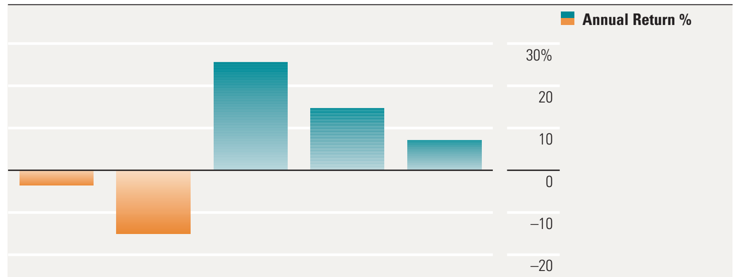


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Large Value Index

Ticker	Index Inception Date	Number of Holdings
$MLVLT	06-30-1997	94



2001	2002	2003	2004	2005	History
1,380	1,172	1,480	1,688	1,807	Index Value
−3.38	−15.05	26.26	14.05	7.04	Annual Return %
22.83	21.33	18.38	15.86	14.53	Price/Earnings
3.33	2.38	3.08	2.63	2.58	Price/Book
2.55	3.29	2.76	2.83	3.03	Dividend Yield %
14.47	−24.86	6.94	32.55	18.07	Earnings Growth %
13.90	−0.45	−1.25	12.26	13.27	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	4.63	10,463
1-Year	7.04	10,704
3-Year Avg	15.52	15,414
5-Year Avg	4.81	12,652
Since Inception	7.20	18,067

Risk Measures	%
Standard Deviation	13.33
Mean (5-year monthly return)	1.62
Best 3 Mo Ret (Sep 98 to Nov 98)	18.78
Worst 3 Mo Ret (Jul 02 to Sep 02)	−20.86

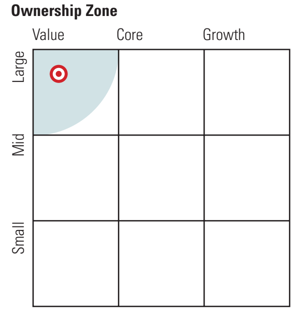
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
ExxonMobil	9.83	11.76
Citigroup	6.94	4.63
Bank of America	5.12	2.39
Pfizer	4.76	−10.62
Altria Group	4.25	27.72
J.P. Morgan Chase & Co.	3.84	5.74
Chevron	3.51	11.51
AT&T	2.64	0.25
Verizon Communications	2.29	−22.18
Wachovia	2.26	4.29

% Weight Top 10 Holdings	45.44
Turnover Ratio %	21.23
Median Market Cap	18,795
Maximum Market Cap	349,512
Minimum Market Cap	9,321

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	11.58	0.59
Software	0.00	0.00
Hardware	2.58	0.28
Media	2.14	0.56
Telecomm	6.86	2.47
Service	48.63	1.00
Healthcare	8.33	0.64
Consumer Svcs	1.15	0.12
Business Svcs	0.46	0.09
Financial Svcs	38.69	1.83
Manufacturing	39.79	1.26
Consumer Goods	9.25	1.14
Ind Materials	3.71	0.32
Energy	19.34	2.19
Utilities	7.49	2.34

Ownership Zone

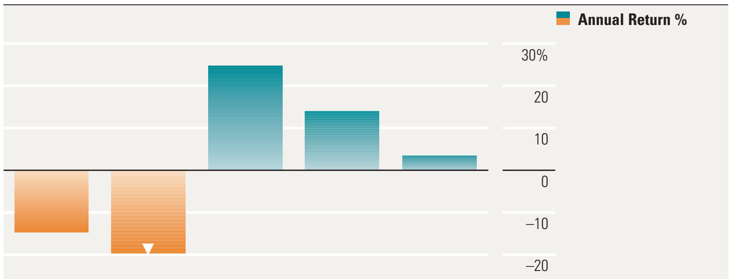


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Large Core Index

Ticker	Index Inception Date	Number of Holdings
$MLCRT	06-30-1997	97



2001	2002	2003	2004	2005	History
1,433	1,091	1,361	1,552	1,611	Index Value
–14.35	–23.82	24.71	13.99	3.83	Annual Return %
29.40	21.23	23.43	21.50	20.19	Price/Earnings
6.99	4.83	5.08	4.65	4.07	Price/Book
1.07	1.69	1.39	1.42	1.59	Dividend Yield %
14.32	3.61	17.98	21.02	18.93	Earnings Growth %
12.76	5.41	6.39	12.53	12.55	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	5.97	10,597
1-Year	3.83	10,383
3-Year Avg	13.86	14,760
5-Year Avg	–0.75	9,631
Since Inception	5.77	16,109

Risk Measures	%
Standard Deviation	13.35
Mean (5-year monthly return)	0.04
Best 3 Mo Ret (Oct 98 to Dec 98)	24.02
Worst 3 Mo Ret (Apr 02 to Jun 02)	–16.17

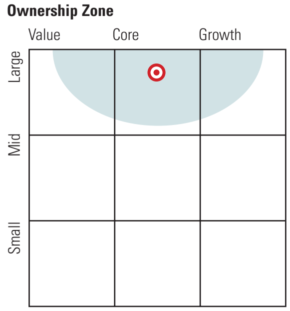
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
General Electric	10.24	–1.43
Procter & Gamble	5.45	7.18
Wal-Mart Stores	5.39	–10.30
American Intl Group	4.88	4.83
IBM	3.61	–15.83
Wells Fargo	2.89	4.47
Coca-Cola	2.67	–0.66
Home Depot	2.39	–4.35
Time Warner	2.12	–9.83
Sprint Nextel	1.81	–4.81

% Weight Top 10 Holdings	41.47
Turnover Ratio %	30.43
Median Market Cap	22,278
Maximum Market Cap	370,344
Minimum Market Cap	9.638

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	11.94	0.61
Software	0.00	0.00
Hardware	5.56	0.61
Media	4.57	1.21
Telecomm	1.81	0.65
Service	48.80	1.00
Healthcare	8.80	0.68
Consumer Svcs	13.08	1.41
Business Svcs	6.41	1.18
Financial Svcs	20.51	0.97
Manufacturing	39.26	1.24
Consumer Goods	10.35	1.28
Ind Materials	26.43	2.31
Energy	2.48	0.28
Utilities	0.00	0.00

Ownership Zone

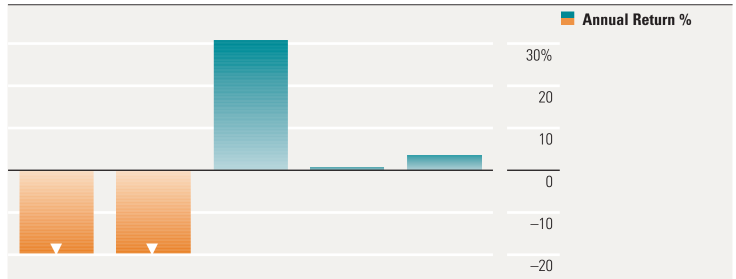


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Large Growth Index

Ticker	Index Inception Date	Number of Holdings
$MLGRT	06-30-1997	104



2001	2002	2003	2004	2005	History
1,117	747	976	978	1,011	Index Value
–29.07	–33.15	30.65	0.19	3.43	Annual Return %
50.85	32.83	39.24	33.73	30.07	Price/Earnings
7.38	6.05	6.06	6.09	6.25	Price/Book
0.21	0.64	0.53	0.47	0.62	Dividend Yield %
6.88	10.08	31.21	29.12	31.28	Earnings Growth %
22.46	8.44	11.62	23.41	23.32	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	6.43	10,643
1-Year	3.43	10,343
3-Year Avg	10.63	13,539
5-Year Avg	–8.48	6,420
Since Inception	0.13	10,113

Risk Measures	%
Standard Deviation	23.47
Mean (5-year monthly return)	–1.73
Best 3 Mo Ret (Nov 98 to Jan 98)	33.60
Worst 3 Mo Re t(Sep 00 to Nov 00)"	–34.21

Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
Microsoft	8.02	–0.95
Johnson & Johnson	5.14	–3.36
Intel	4.38	8.12
Cisco Systems	3.24	–11.39
PepsiCo	2.82	15.24
Amgen	2.80	22.93
Genentech	2.79	69.91
UnitedHealth Group	2.44	41.22
Google	2.38	115.19
Dell	2.14	–28.93

% Weight Top 10 Holdings	36.17
Turnover Ratio %	27.30
Median Market Cap	18,921
Maximum Market Cap	278,358
Minimum Market Cap	9.908

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	39.20	2.00
Software	12.29	3.18
Hardware	20.98	2.29
Media	5.93	1.56
Telecomm	0.00	0.00
Service	43.83	0.90
Healthcare	25.68	1.97
Consumer Svcs	10.87	1.17
Business Svcs	4.64	0.86
Financial Svcs	2.64	0.13
Manufacturing	16.97	0.54
Consumer Goods	5.42	0.67
Ind Materials	3.45	0.30
Energy	7.11	0.80
Utilities	0.99	0.31

Ownership Zone

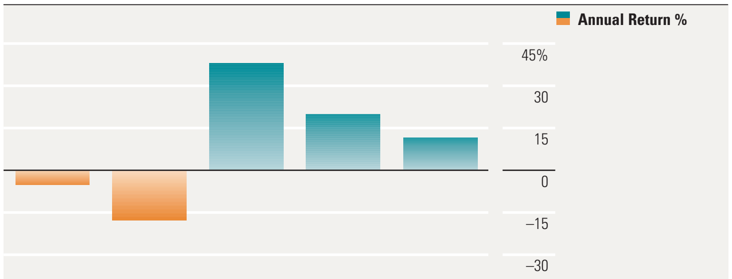
The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Index Reports | Mid Cap

Morningstar Mid Cap Index

Ticker	Index Inception Date	Number of Holdings
$MMCPT	12-31-1991	728



2001	2002	2003	2004	2005	History
3,141	2,574	3,561	4,261	4,802	Index Value
–4.63	–18.06	38.38	19.66	12.70	Annual Return %
26.95	25	25.89	24.60	23.88	Price/Earnings
3.96	3.19	3.86	3.89	4.00	Price/Book
1.33	1.59	1.27	1.23	1.21	Dividend Yield %
10.78	4.64	18.62	21.49	23.68	Earnings Growth %
23.49	9.01	7.24	14.52	16.89	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	9.01	10,901
1-Year	12.70	11,270
3-Year Avg	23.11	18,661
5-Year Avg	7.83	14,583
Since Inception	11.85	48,024

Risk Measures	%
Standard Deviation	16.26
Mean (5-year monthly return)	2.57
Best 3 Mo Ret (May 97 to Jul 97)	20.26
Worst 3 Mo Ret (Jun 98 to Aug 98)	–20.76

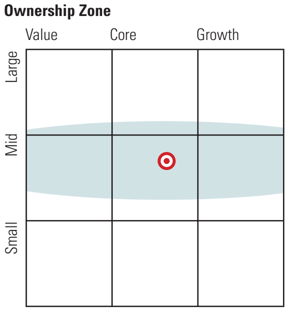
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
Weatherford International	0.41	41.13
Advanced Micro Devices	0.40	38.96
XL Capital	0.38	–10.73
ProLogis Trust	0.37	11.73
General Growth Properties	0.36	35.15
American Tower A	0.36	47.28
DR Horton	0.36	19.41
Celgene	0.36	144.34
CIT Group	0.35	14.58
CSX	0.35	27.91

% Weight Top 10 Holdings	3.71
Turnover Ratio %	22.65
Median Market Cap	3,564
Maximum Market Cap	12,584
Minimum Market Cap	1,440

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	16.76	0.86
Software	3.20	0.83
Hardware	7.95	0.87
Media	3.07	0.81
Telecomm	2.54	0.91
Service	52.48	1.08
Healthcare	10.19	0.78
Consumer Svcs	11.92	1.28
Business Svcs	8.69	1.61
Financial Svcs	21.68	1.03
Manufacturing	30.76	0.97
Consumer Goods	8.00	0.99
Ind Materials	10.89	0.95
Energy	7.26	0.82
Utilities	4.61	1.44

Ownership Zone

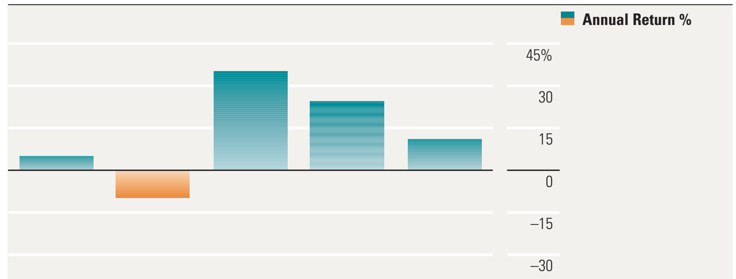


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Mid Value Index

Ticker	Index Inception Date	Number of Holdings
$MMVLT	06-30-1997	231



2001	2002	2003	2004	2005	History
1,525	1,372	1,866	2,319	2,586	Index Value
5.06	–10.00	35.94	24.30	11.54	Annual Return %
17.95	18.21	18.25	18.77	16.26	Price/Earnings
1.99	1.67	2.19	2.32	2.39	Price/Book
3.29	3.71	2.61	2.32	2.26	Dividend Yield %
5.36	–8.39	14.64	14.99	17.95	Earnings Growth %
15.82	4.76	1.10	9.79	12.34	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	5.10	10,510
1-Year	11.54	11,154
3-Year Avg	23.52	18,845
5-Year Avg	12.23	17,820
Since Inception	11.82	25,863

Risk Measures	%
Standard Deviation	13.32
Mean (5-year monthly return)	3.61
Best 3 Mo Ret (Mar 00 to May 00)	20.67
Worst 3 Mo Ret (Jul 02 to Sep 02)	–17.81

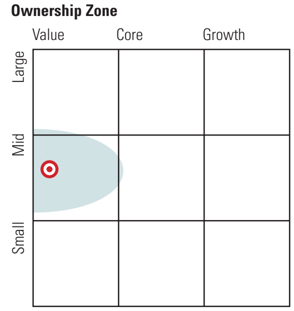
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
XL Capital	1.22	–10.73
CIT Group	1.13	14.58
Sunoco	1.10	94.37
Qwest Comm Int'l	1.09	27.25
Nucor	1.07	31.61
Constellation Energy Group	1.06	35.05
Ameriprise Financial	1.06	NA
Eaton	1.03	–5.44
UnionBanCal	1.03	9.20
Seagate Technology	0.99	17.81

% Weight Top 10 Holdings	10.79
Turnover Ratio %	44.94
Median Market Cap	3,576
Maximum Market Cap	10,670
Minimum Market Cap	1,528

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	8.40	0.43
Software	0.19	0.05
Hardware	3.18	0.35
Media	1.21	0.32
Telecomm	3.82	1.37
Service	49.80	1.02
Healthcare	1.11	0.09
Consumer Svcs	6.77	0.73
Business Svcs	2.99	0.55
Financial Svcs	38.93	1.85
Manufacturing	41.80	1.32
Consumer Goods	11.87	1.46
Ind Materials	10.94	0.96
Energy	5.02	0.57
Utilities	13.97	4.37

Ownership Zone

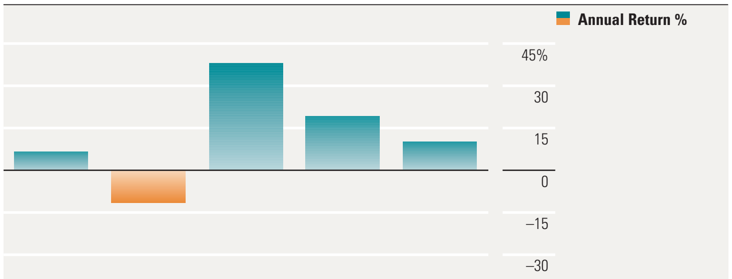


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Mid Core Index

Ticker	Index Inception Date	Number of Holdings
$MMCRT	06-30-1997	256



2001	2002	2003	2004	2005	History
1,427	1,250	1,734	2,064	2,271	Index Value
6.05	–12.42	38.68	19.05	10.05	Annual Return %
24.40	22.37	24.68	22.78	23.15	Price/Earnings
3.38	3.02	3.69	3.56	3.90	Price/Book
0.98	1.43	1.02	1.10	1.10	Dividend Yield %
11.41	3.65	17.30	19.16	21.36	Earnings Growth %
19.82	4.77	5.76	13.01	14.91	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	8.62	10,862
1-Year	10.05	11,005
3-Year Avg	22.03	18,170
5-Year Avg	11.02	16,877
Since Inception	10.12	22,714

Risk Measures	%
Standard Deviation	14.64
Mean (5-year monthly return)	3.35
Best 3 Mo Ret (Sep 98 to Nov 98)	20.83
Worst 3 Mo Ret (Jun 98 to Aug 98)	–23.39

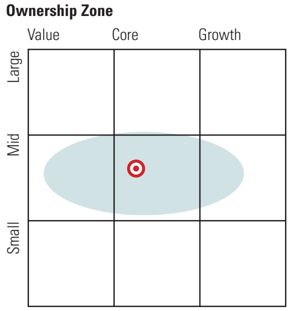
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
ProLogis Trust	1.05	11.73
DR Horton	1.03	19.41
CSX	1.01	27.91
Rockwell Automation	0.98	21.29
Nordstrom	0.95	61.70
Pulte Homes	0.94	23.78
Murphy Oil	0.92	35.48
Office Depot	0.90	80.88
Frport-McMoRan Cop&Gld B	0.90	49.20
Ameritrade Holding	0.90	68.78

% Weight Top 10 Holdings	9.59
Turnover Ratio %	57.15
Median Market Cap	3,513
Maximum Market Cap	11,376
Minimum Market Cap	1,440

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	12.83	0.65
Software	2.08	0.54
Hardware	7.18	0.78
Media	2.73	0.72
Telecomm	0.84	0.30
Service	54.25	1.11
Healthcare	7.48	0.57
Consumer Svcs	16.86	1.81
Business Svcs	10.60	1.96
Financial Svcs	19.31	0.92
Manufacturing	32.92	1.04
Consumer Goods	10.78	1.33
Ind Materials	16.31	1.43
Energy	5.15	0.58
Utilities	0.68	0.21

Ownership Zone

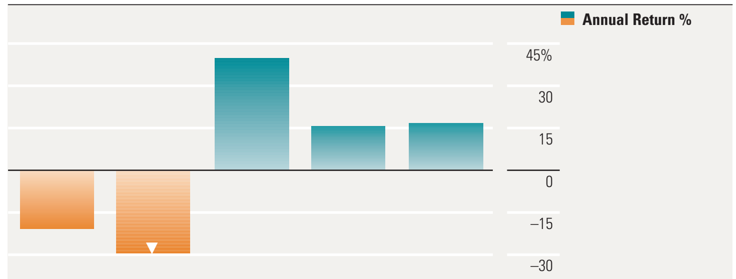


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Mid Growth Index

Ticker	Index Inception Date	Number of Holdings
$MMGRT	06-30-1997	241



2001	2002	2003	2004	2005	History
1,242	838	1,173	1,355	1,575	Index Value
–21.59	–32.54	40.02	15.45	16.27	Annual Return %
39.92	33.78	35.47	32.39	31.84	Price/Earnings
6.42	4.64	5.63	5.73	5.61	Price/Book
0.09	0.18	0.25	0.28	0.36	Dividend Yield %
15.81	17.40	24.04	30.12	31.83	Earnings Growth %
34.71	18.26	14.60	20.63	23.13	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	13.24	11,324
1-Year	16.27	11,627
3-Year Avg	23.41	18,796
5-Year Avg	–0.12	9,943
Since Inception	5.49	15,751

Risk Measures	%
Standard Deviation	24.28
Mean (5-year monthly return)	0.83
Best 3 Mo Ret (Dec 99 to Feb 99)	41.08
Worst 3 Mo Ret (Jul 01 to Sep 01)	–32.47

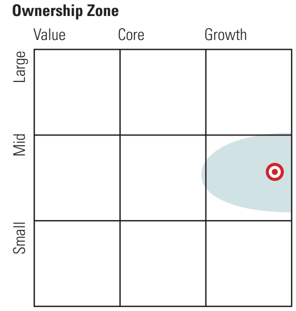
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
Weatherford International	1.21	41.13
Advanced Micro Devices	1.19	38.96
General Growth Properties	1.07	35.15
American Tower A	1.07	47.28
Celgene	1.05	144.34
International Game Tech	1.01	–8.92
Whole Foods Market	0.95	63.73
KLA-Tencor	0.93	6.74
Intuit	0.93	21.11
Ecolab	0.90	4.37

% Weight Top 10 Holdings	10.31
Turnover Ratio %	44.62
Median Market Cap	3,614
Maximum Market Cap	12,584
Minimum Market Cap	1,662

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	28.60	1.46
Software	7.16	1.85
Hardware	13.17	1.44
Media	5.15	1.36
Telecomm	3.12	1.12
Service	53.11	1.09
Healthcare	21.41	1.64
Consumer Svcs	11.57	1.25
Business Svcs	11.99	2.22
Financial Svcs	8.14	0.39
Manufacturing	18.29	0.58
Consumer Goods	1.55	0.19
Ind Materials	5.23	0.46
Energy	11.51	1.30
Utilities	0.00	0.00

Ownership Zone



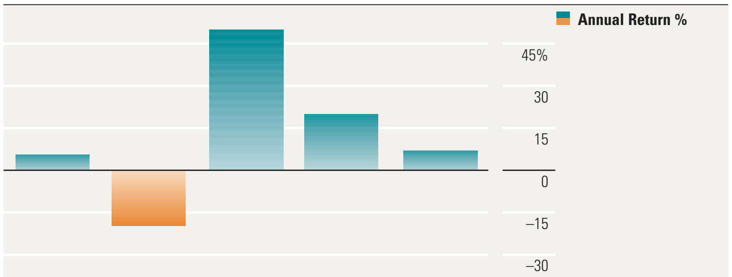
The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Index Reports | Small Cap

Morningstar Small Cap Index

Ticker	Index Inception Date	Number of Holdings
$MSCPT	12-31-1991	1087



2001	2002	2003	2004	2005	History
3,218	2,563	3,785	4,558	4,821	Index Value
5.26	–20.36	47.70	20.44	5.76	Annual Return %
25.14	22.96	27.04	26.43	24.40	Price/Earnings
3.11	2.72	3.58	3.79	3.53	Price/Book
1.18	1.56	1.09	0.97	1.13	Dividend Yield %
11.30	0.11	14.52	18.68	21.64	Earnings Growth %
23.00	9.23	7.13	16.61	21.49	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	6.03	10,603
1-Year	5.76	10,576
3-Year Avg	23.45	18,814
5-Year Avg	9.53	15,772
Since Inception	11.88	48,212

Risk Measures	%
Standard Deviation	19.56
Mean (5-year monthly return)	3.20
Best 3 Mo Ret (May 97 to Jul 97)	25.04
Worst 3 Mo Ret (Jun 98 to Aug 98)	–28.09

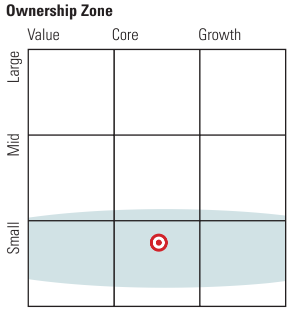
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
Integrated Device Tech	0.24	14.01
US Airways Group	0.23	NA
Avid Technology	0.21	–11.32
La Quinta	0.20	22.55
Trinity Industries	0.20	30.35
Covanta Holding	0.19	78.22
Pediatrix Medical Group	0.19	38.28
Lifepoint Hospitals	0.19	7.70
Titanium Metals	0.18	424.11
Anteon International	0.18	29.84

% Weight Top 10 Holdings	2.02
Turnover Ratio %	33.60
Median Market Cap	986
Maximum Market Cap	2,770
Minimum Market Cap	201

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	17.27	0.88
Software	4.51	1.17
Hardware	8.93	0.97
Media	1.89	0.50
Telecomm	1.95	0.70
Service	54.90	1.12
Healthcare	10.39	0.80
Consumer Svcs	11.30	1.22
Business Svcs	11.64	2.15
Financial Svcs	21.57	1.02
Manufacturing	27.83	0.88
Consumer Goods	5.79	0.71
Ind Materials	14.29	1.25
Energy	5.15	0.58
Utilities	2.60	0.81

Ownership Zone

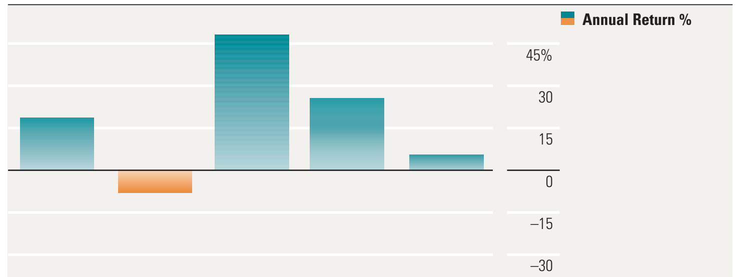


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Small Value Index

Ticker	Index Inception Date	Number of Holdings
$MSVLT	06-30-1997	337



2001	2002	2003	2004	2005	History
1,486	1,363	2,030	2,517	2,646	Index Value
18.58	–8.24	48.87	24.03	5.12	Annual Return %
20.30	18.23	21.71	21.68	18.70	Price/Earnings
2.25	1.52	2.27	2.76	2.18	Price/Book
3.22	3.72	2.32	2.15	2.61	Dividend Yield %
2.09	–3.54	6.28	11.71	10.97	Earnings Growth %
9.22	7.05	0.16	10.45	11.73	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	4.36	10,436
1-Year	5.12	10,512
3-Year Avg	24.74	19,409
5-Year Avg	16.11	21,118
Since Inception	12.12	26,464

Risk Measures	%
Standard Deviation	15.44
Mean (5-year monthly return)	4.69
Best 3 Mo Ret (Apr 03 to Jun 03)	25.86
Worst 3 Mo Ret (Jun 98 to Aug 98)	–20.25

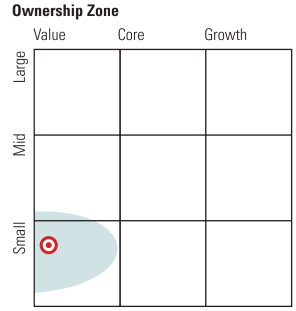
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
US Airways Group	0.74	NA
Trinity Industries	0.62	30.35
New Century Financial	0.58	–31.98
Briggs & Stratton	0.57	–4.67
Assured Guaranty	0.55	29.81
Colonial Properties Trust	0.54	14.28
Prentiss Properties Trust	0.53	13.13
United Rentals	0.52	23.76
Alexandria RealEstate Eq	0.52	12.16
Ohio Casualty	0.52	22.87

% Weight Top 10 Holdings	5.68
Turnover Ratio %	51.07
Median Market Cap	999
Maximum Market Cap	2,770
Minimum Market Cap	415

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	9.12	0.47
Software	0.47	0.12
Hardware	3.57	0.39
Media	2.47	0.65
Telecomm	2.61	0.94
Service	58.85	1.21
Healthcare	2.37	0.18
Consumer Svcs	11.08	1.19
Business Svcs	6.68	1.23
Financial Svcs	38.72	1.84
Manufacturing	32.03	1.01
Consumer Goods	6.32	0.78
Ind Materials	16.41	1.43
Energy	2.76	0.31
Utilities	6.54	2.04

Ownership Zone

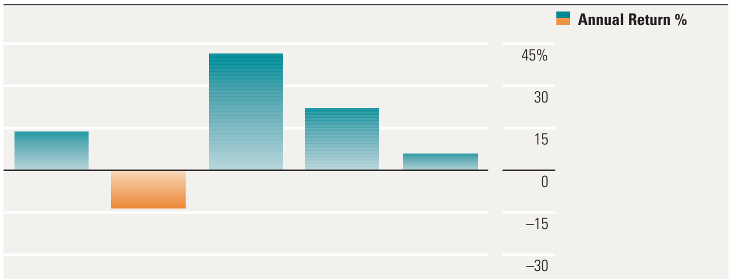


The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holdings.

Morningstar Small Core Index

Ticker	Index Inception Date	Number of Holdings
$MSCRT	06-30-1997	382



2001	2002	2003	2004	2005	History
1,660	1,425	2,032	2,512	2,670	Index Value
14.60	–14.16	42.59	23.61	6.30	Annual Return %
22.01	20.90	24.56	23.93	22.16	Price/Earnings
2.65	2.52	3.08	3.25	3.07	Price/Book
0.73	1.26	0.80	0.62	0.74	Dividend Yield %
14.20	–3.29	19.05	15.96	22.41	Earnings Growth %
18.15	6.52	7.46	15.76	20.46	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	5.77	10,577
1-Year	6.30	10,630
3-Year Avg	23.28	18,737
5-Year Avg	13.00	18,433
Since Inception	12.24	26,698

Risk Measures	%
Standard Deviation	17.43
Mean (5-year monthly return)	3.99
Best 3 Mo Ret (Oct 01 to Dec 01)	21.97
Worst 3 Mo Ret (Jun 98 to Aug 98)	–30.36

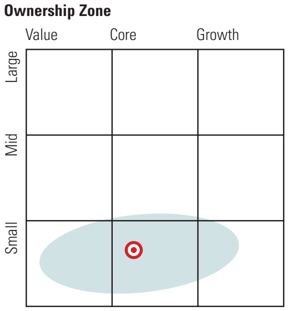
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
Integrated Device Tech	0.69	14.01
Pediatrix Medical Group	0.55	38.28
Titanium Metals	0.53	424.11
Arch Capital Group	0.51	41.47
Walter Industries	0.50	47.98
Cleveland-Cliffs	0.50	71.93
Toro	0.50	8.30
Holly	0.49	112.87
Columbia Sportswear	0.47	–19.93
Fremont General	0.47	–6.38

% Weight Top 10 Holdings	5.23
Turnover Ratio %	67.63
Median Market Cap	974
Maximum Market Cap	2,631
Minimum Market Cap	201

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	12.44	0.64
Software	1.84	0.48
Hardware	7.67	0.84
Media	1.91	0.50
Telecomm	1.02	0.37
Service	53.86	1.10
Healthcare	8.15	0.63
Consumer Svcs	11.18	1.20
Business Svcs	13.46	2.49
Financial Svcs	21.07	1.00
Manufacturing	33.70	1.07
Consumer Goods	8.41	1.04
Ind Materials	17.81	1.56
Energy	6.39	0.72
Utilities	1.09	0.34

Ownership Zone



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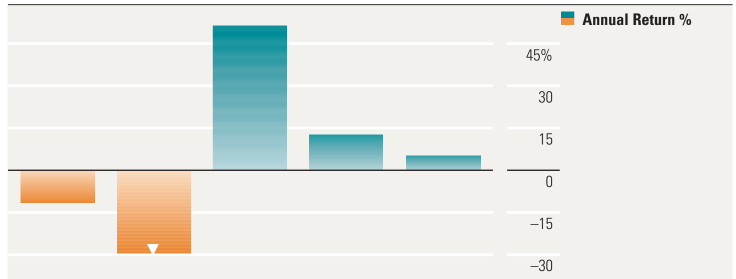
Morningstar Small Growth Index

Ticker	Index Inception Date	Number of Holdings
$MSGRT	06-30-1997	368



2001	2002	2003	2004	2005	History
1,092	690	1,053	1,195	1,263	Index Value
–12.92	–36.87	52.65	13.48	5.77	Annual Return %
35.25	30.55	37.70	34.67	33.49	Price/Earnings
4.26	3.94	5.42	5.47	5.27	Price/Book
0.06	0.11	0.13	0.10	0.15	Dividend Yield %
18.60	9.43	21.25	30.49	33.58	Earnings Growth %
38.93	14.17	13.96	24.11	31.86	Revenue Growth %

Trailing Total Returns	%	Grth of $10K
6-Month	8.20	10,820
1-Year	5.77	10,577
3-Year Avg	22.37	18,322
5-Year Avg	0.14	10,072
Since Inception	2.79	12,634

Risk Measures	%
Standard Deviation	28.34
Mean (5-year monthly return)	1.23
Best 3 Mo Ret (Dec 99 to Feb 99)	55.22
Worst 3 Mo Ret (Jul 01 to Sep 01)	–35.30

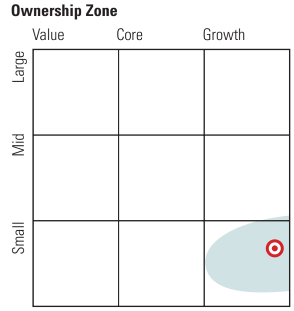
Portfolio Analysis

Top 10 Holdings	% Assets	1-Yr Ret %
Avid Technology	0.61	–11.32
La Quinta	0.60	22.55
Covanta Holding	0.57	78.22
Lifepoint Hospitals	0.55	7.70
Anteon International	0.54	29.84
FactSet Research Systems	0.53	6.27
Panera Bread	0.52	62.90
Foundry Networks	0.52	4.94
Silicon Laboratories	0.52	3.82
National Financial Partners	0.51	37.00

% Weight Top 10 Holdings	5.46
Turnover Ratio %	56.80
Median Market Cap	987
Maximum Market Cap	2,282
Minimum Market Cap	295

Morningstar Sectors	% of Stocks	Rel to US Mkt
Information	29.78	1.52
Software	10.99	2.85
Hardware	15.19	1.66
Media	1.31	0.35
Telecomm	2.29	0.82
Service	52.26	1.07
Healthcare	20.13	1.55
Consumer Svcs	11.61	1.25
Business Svcs	14.40	2.66
Financial Svcs	6.12	0.29
Manufacturing	17.96	0.57
Consumer Goods	2.62	0.32
Ind Materials	8.74	0.76
Energy	6.12	0.69
Utilities	0.47	0.15

Ownership Zone



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Morningstar Market Barometer: Six-Year Recap, 2000–2005

The Morningstar Market Barometer provides an at-a-glance view of the market, allowing instant analysis of performance trends. By illustrating market movements in varying shades of green and red, it intuitively presents where the headwinds and tailwinds are in the market. Investors use the Market Barometer to identify investment opportunities and to understand the long-term benefits of diversification.

2000

	Value	Core	Growth
Large Cap	5.7	4.2	–33.5
Mid Cap	24.6	14.8	–11.1
Small Cap	18.7	23.2	–12.1

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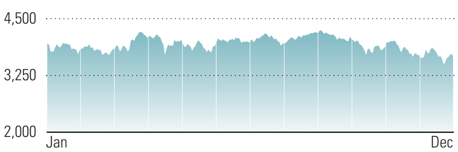
% Return

Morningstar US Market Index



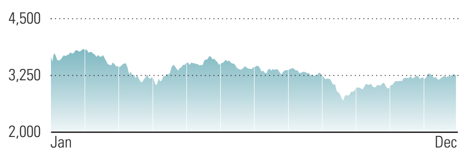
Total Annual Return –7.0%

2000 will be remembered as the year the tech bubble burst. The broad market was down for the year—the US Market Index lost 7.02%. The glamour growth stocks—which rallied strongly in the bull market of late ‘90s—incurred big losses. Disciplined investors who maintained a diversified portfolio through the tech bubble benefited from dichotomy in performance of growth and value stocks. Diversification was key, as the US Value Index posted an impressive 10% gain in contrast to the US Growth Index falling 28.5%.

2001

	Value	Core	Growth
Large Cap	–3.4	–14.4	–29.1
Mid Cap	5.1	6.1	–21.6
Small Cap	18.6	14.6	–12.9

Morningstar US Market Index



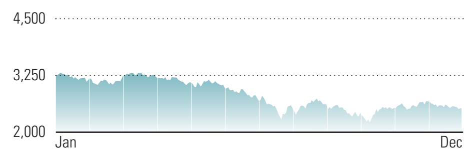
Total Annual Return –11.9%

Though the US Market Index bounced back from its post-September 11 lows, it still closed the year down 11.9%. Growth stocks took a beating as the US Growth Index tumbled 26.3%, versus a 9.3% loss incurred by the US Core Index and the 0.7% drop in the US Value Index. Opportunities surfaced as the Small Value Index posted a respectable 18.6% gain. Large tech stocks took the hardest hit, causing the Large Growth Index to drop 29.1%.

2002

	Value	Core	Growth
Large Cap	–15.1	–23.8	–33.2
Mid Cap	–10.0	–12.4	–32.5
Small Cap	–8.2	–14.2	–36.9

Morningstar US Market Index



Total Annual Return –22.2%

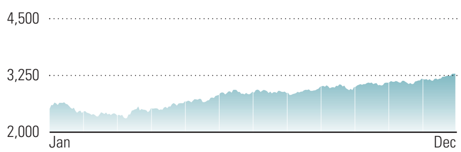
Neither style nor size sheltered investors from a stormy 2002 as the US Market Index dropped 22.2%. Value stocks fared better than their pricier growth counterparts, and investors favored small and midsize stocks—neglected during the bull market. The Small Value Index emerged as the year’s best performer with a modest 8.2% loss. The US Growth Index trailed the rest of the market with a dramatic 33.2% drop.

The following six-year series portrays the start of the bear market, followed by a rebound during the past three years led by small- and mid-cap stocks. Value stocks outperformed growth stocks for most of the decline and rebound periods, except for a growth comeback in 2003. Showing signs of life, and perhaps setting the stage for the long anticipated rally, growth and large caps ended the fourth quarter of 2005 on a strong note.

2003

	Value	Core	Growth
Large Cap	26.3	24.7	30.7
Mid Cap	35.9	38.7	40.0
Small Cap	48.9	42.6	52.7

Morningstar US Market Index



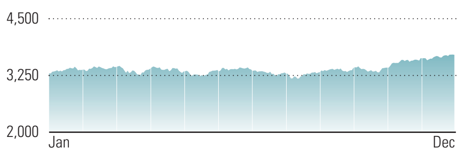
Total Annual Return +30.7%

The US Market Index rallied from the previous year's losses by gaining 30.7%. All of Morningstar's style indexes finished the year with sizable gains. The year's winner was the Small Growth Index, which gained 52.7%. Small stocks fared far better than large-cap stocks, and growth outperformed value. The worst performer, the Large Core Index, gained a comparably modest 24.7%.

2004

	Value	Core	Growth
Large Cap	14.1	14.0	0.2
Mid Cap	24.3	19.1	15.5
Small Cap	24.0	23.6	13.5

Morningstar US Market Index



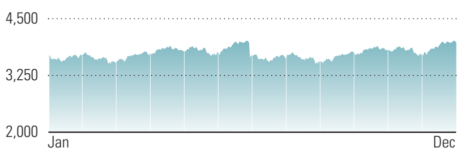
Total Annual Return +12.4%

Despite lingering uncertainty over the prospects for the U.S. economy, the stock market closed 2004 on an optimistic note. The US Market Index gained 12.4%—thanks in part to a 10.1% spike in the fourth quarter. Growth stocks continued to lag behind value stocks—the US Growth Index gained only 4.4% while the US Value Index picked up 16.9%. Similarly, large-cap stocks trailed small-cap stocks.

2005

	Value	Core	Growth
Large Cap	7.1	3.8	3.4
Mid Cap	11.5	10.1	16.3
Small Cap	5.1	6.3	5.8

Morningstar US Market Index



Total Annual Return +6.5%

The US Market Index posted a modest gain of 6.5% against the difficult backdrop of interest rate increases and surging commodity prices. The index achieved nearly half its gain in the fourth quarter, as rate increases appeared to be coming to an end. Mid-cap stocks ruled the roost, with the Mid Growth Index leading the way, posting a gain of 16.3%. Large-cap stocks lagged for the year again, but outperformed during the fourth-quarter rally.

Glossary

Available Dividends
Dividends per share multiplied by the number of free float shares.

Best/Worst Three-Month Return
The return for the three-month period since index inception in which the index had its highest percentage gain or loss.

Book Value Growth
Book value growth represents the weighted average of one-year growth in book value or shareholders' equity for each stock in the index's portfolio.

Centroid
Plotted in the middle of the Ownership Zone, this represents the weighted average of all the fund's holdings.

Dividend Coverage Ratio
Estimated earnings per share (provided by IBES) divided by indicated dividends.

Dividend Yield
Regular dividend per share for the current year divided by the current stock price.

Earnings Growth History
Historical earnings growth represents the weighted average of one-year growth in earnings from operations for each stock in the index's portfolio.

Float-Adjusted Market Cap
The number of free-floating shares multiplied by current share price.

Free-Float Shares
A company's outstanding shares adjusted for non-trading blocks of 5% or more total share capitalization, to better reflect shares available for investment.

Indicated Dividends
Current dividend amount multiplied by the annual frequency of dividend payout.

Mean
The average monthly return of the index over a five-year period.

Median Market Capitalization
The midpoint of market capitalization (price multiplied by the number of shares outstanding) of the stocks in the index's portfolio.

Morningstar Market Barometer
The Morningstar Market Barometer provides an at-a-glance view of the markets, allowing instant analysis of performance trends. The performance of each Morningstar Index is depicted in varying shades of red and green that clearly reveal the magnitude of market movements while placing them in context of the overall market. The indexes are based on the same methodology as the Morningstar Style Box.

Morningstar Sectors
Morningstar has an industry sector structure to help investors and investment professionals more easily compare and understand the sector exposures of portfolios. The sector classifications are also designed to create a more useful way to evaluate common stocks and to address the limitations of conventional sector analysis. Morningstar divides the economy into three "Super Sectors"—the **Information Economy**, the **Service Economy**, and the **Manufacturing Economy**—each of which contains four sectors.

Information Economy

Software Sector
Companies engaged in the design and marketing of computer operating systems and applications.

Hardware Sector
Manufacturers of computer equipment, communication equipment, semiconductors, and components.

Media Sector
Companies that own and operate broadcast networks and those that create content or provide it to other media companies.

Telecommunications Sector
Companies that provide communication services using fixed-line networks or those that provide wireless access and services.

Service Economy

Healthcare Sector
Includes biotechnology, pharmaceuticals, research services, HMOs, home health, hospitals, assisted living, and medical equipment and supplies.

Consumer Services Sector
Includes retail stores, personal services, home-builders, home supply, travel and entertainment companies, and educational providers.

Business Services Sector
Includes advertising, printing, publishing, business support, consultants, employment, engineering and construction, security services, waste management, distributors, and transportation.

Financial Services Sector
Includes banks, finance companies, money management firms, savings and loans, securities brokers, and insurance companies.

Manufacturing Economy

Consumer Goods Sector
Companies that manufacture or provide food, beverages, household and personal products, apparel, shoes, textiles, autos and auto parts, consumer electronics, luxury goods, packaging, and tobacco.

Industrial Materials Sector
Includes aerospace and defense firms, and companies that provide or manufacture chemicals, machinery, building materials, and commodities.

Energy Sector
Companies that produce or refine oil and gas, oilfield services and equipment companies, and pipeline operators.

Utilities Sector
Electric, gas, and water utilities.

Ownership Zone
Derived by plotting each stock in the index's portfolio within the proprietary Morningstar Style Box. The shaded area represents 75% of the index's assets.

Price/Book Ratio
The current stock price divided by its book value per share for the most recent year-end.

Price/Cash Flow Ratio
The current stock price divided by its cash flow per share for the most recent year-end.

Price/Sales Ratio
The current stock price divided by sales per share for the most recent year-end.

Price/Projected Earnings Ratio
The current stock price divided by the median EPS estimate for the current year. EPS estimates are provided by IBES.

Revenue Growth
Revenue growth shows the weighted average of the sales-growth rates for each stock in the index's portfolio.

Standard Deviation
A statistical measurement of dispersion about an average, which depicts how widely the monthly returns varied over the trailing five-year period. A high standard deviation indicates that the predicted range of performance is wide, implying greater volatility.

Total Return
Expressed in percentage terms, return is determined each period by taking the change in price, reinvesting all income and capital gains distributions during that period, and dividing by the starting price.

Turnover Ratio %
This is a measure of the index's trading activity, which is computed by taking the lesser of purchases or sales and dividing by the average monthly market cap for all securities in the index portfolio.

Learn More About Morningstar Indexes

There are a variety of avenues for licensing the Morningstar Indexes

Investment Products Creation

A consistent and stable methodology, objective rules, and a name that evokes trust and confidence among investors worldwide make the Morningstar Indexes perfect vehicles for creating index-linked investment products, such as funds, ETFs and derivatives.

Data Services and Distribution

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Morningstar offers real-time values for all Morningstar Indexes. Index values are distributed through leading data vendors and can also be found at **http://indexes. morningstar.com**.

Back History

The back histories for Morningstar US Market Index and the Cap Indexes are available from December 1991 to the present. The back histories for all other indexes are available from June 1997 to the present.

Constituent Data Feeds

Constituent names, weights, prices, market caps as well as free-float values are available daily or monthly. A separate file with details on all corporate actions impacting the index constituents is also available each business day.

Index Data Feeds

More than 50 unique data elements including index closing values, total returns, risk statistics, sector breakdowns, and index level fundamental data are available electronically via FTP downloads or e-mail.

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The Morningstar Market Barometer can be incorporated into your Web site, giving users an intuitive way to understand shifting patterns across the market in real time.

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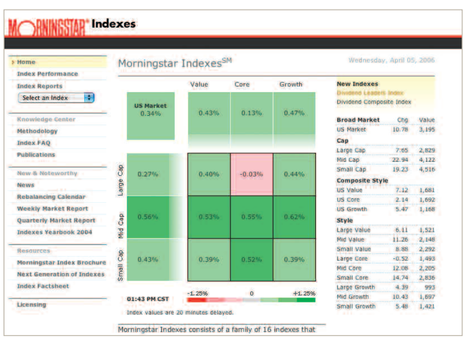

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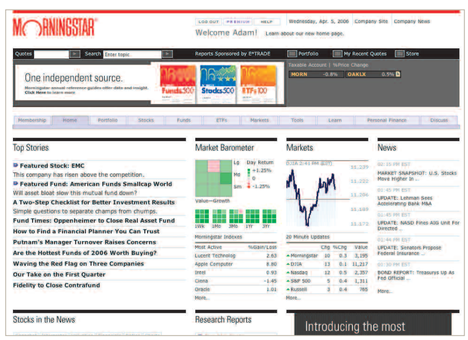

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