

Morningstar Market Commentary

3rd Quarter 2005

Morningstar Market Barometer™



Equity markets were notably stable for the third quarter of 2005. The Federal Reserve's rate-raising campaign, catastrophic hurricanes Katrina and Rita, surging commodity prices, and the bankruptcy filings of Northwest and Delta airlines had little negative effect on equities.

Alan Greenspan is entering the homestretch of his long tenure as Federal Reserve chairman, and it appears that he will go out as an "inflation hawk" when he finally hangs up his spreadsheets in early 2006.

In the quarter, large-cap stocks mostly stalled as mid-caps and small caps posted gains, causing observers to wonder how much longer that now-familiar pattern can continue. Real estate and energy-related issues powered higher, also continuing familiar trends. The Morningstar US Market Index posted a 4.02% gain, and is up 4.18% for the year to date.

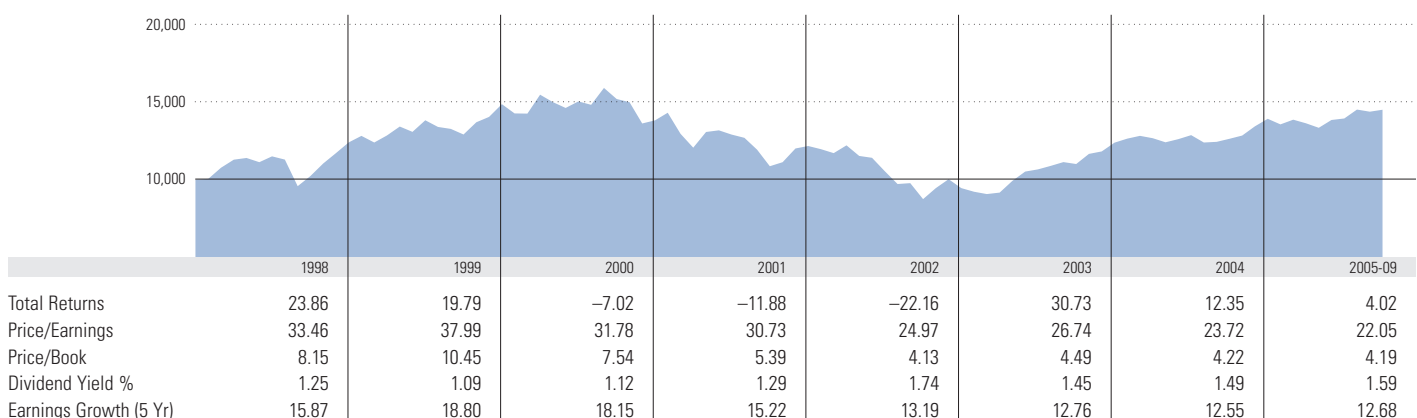
The yield curve remained rather flat in defiance of Greenspan. The Fed chairman issued repeated warnings regarding the dangers of cheap credit, but investors distrustful of the recovery seemed in no hurry to sell longer-term debt. Shorter-term rates continued to rise, while the 10-year Treasury note stubbornly remains at around 4.4% after beginning the quarter at roughly 4%. Perhaps contributing

to the slight rise in yield was the announcement from the Chinese government—which had been heavily purchasing U.S. debt with the flood of dollars pouring in from exports—that it would now buy a basket of foreign currencies instead of more exclusively dollar-denominated securities. Although the dollar will dominate that basket for now, nagging questions have arisen about whether China's reduced debt purchases will remove support for the torrid U.S. real estate market over the longer run.

Quieter corporate debt markets didn't keep raiders idle. While the second quarter saw the credit downgrade of embattled automaker General Motors attract the interest of Kirk Kerkorian to the company's equity, the third quarter saw Carl Icahn pick up shares of stumbling media giant TimeWarner and lead a group of hedge funds in a fight to split the company's media and cable operations.

As TimeWarner found itself in Icahn's crosshairs, media upstart Google found its way into many of Morningstar's favorite growth funds, according to fund analyst Paul Herbert. Additionally, director of fund analysis Kunal Kapoor noted that faltering retailer Wal-Mart caught the fancy of some of our favorite value managers. To us, Google appears overvalued, while Wal-Mart appears undervalued.

Morningstar US Market Index (Growth of \$10,000)



Surveying the Sectors

After playing second fiddle to utilities in the second quarter, energy surged again, leading all sectors with a whopping 20% gain for the quarter. Mid-cap names in the sector led the way. Oil and natural-gas exploration and production company Chesapeake Energy and coal producer Fording Canadian Coal Trust continued their multiyear runs with 58% and 41% increases, respectively. Fording Coal is up nearly ninefold for the trailing three-year period.

Industry Performance

The coal and oil/gas products were the top-performing industries, with coal adding 45% and oil/gas products putting on 35%. Oil refiner Valero gained 39%. Nevertheless, analyst Justin Perucki describes the refining business as “brutally competitive and frighteningly cyclical,” and thinks Valero is significantly overvalued at its current price of around \$113. It wasn’t all roses for energy stocks, however, as Suburban Propane SPH shed 18% for the quarter. Analyst Elizabeth Collins favors Suburban’s propane business, but is leery of its fuel oil distribution business because of its inability to impose switching costs on customers. Consumer-related industries were the laggards for the quarter. Clothing stores and rental-and-repair services dropped 12% each. Among the clothing stores, TJX Companies, parent of Marshalls and T.J. Maxx stores, shed 16% for the quarter. Analyst Kimberly Picciola has awarded the popular retailer a narrow moat, but notes that her fair value estimate is dependent upon margins ceasing to erode.

Steel & mining industries also had a banner quarter, with steel gaining 26% and mining adding 28%. Hospitals and rental & repair services were the two worst performers, with each dropping 13%.

Growing numbers of uninsured patients continue to hurt the hospital industry, including HCA and Lifepoint, according to analyst Curt Morrison.

Morningstar Sectors: 3rd Quarter 2005 Return %

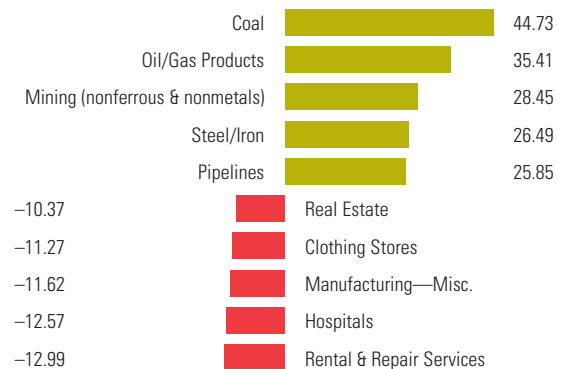
	QTD	1 Year	3 Year
Information	4.15	11.38	19.85
Software	4.04	11.23	16.83
Hardware	7.01	16.11	25.40
Media	0.19	4.49	10.94
Telecommunication	0.17	5.49	19.39
Service	1.40	11.16	15.28
Health Care	2.19	13.02	11.07
Consumer Services	-3.21	9.79	15.76
Business Services	10.54	20.51	19.48
Financial Services	0.81	8.56	17.03
Manufacturing	7.92	22.43	22.00
Consumer Goods	3.49	12.74	12.67
Industrial Materials	2.68	7.39	18.76
Energy	19.61	51.67	37.23
Utilities	6.60	36.50	25.30

The utilities sector had another great quarter posting a gain of 6.6%. Texas-based utility holding company TXU led the sector with a gain of 34%.

Media and consumer services were the laggards in the quarter. Media rose only 0.19%, with major newspapers such as the *New York Times* and the *Washington Post* turning in losses of 3.8% and 5.3%, respectively. The *Times* recently began to charge online readers for some of its editorial content. Tribune also fell 3.2%, while Dow Jones surged 5%. Cable companies Cablevision Systems and Comcast both posted losses.

Consumer services was the worst performing sector, posting a loss of 3.2% for the quarter. Retailers Abercrombie & Fitch and Petsmart both suffered losses of 28%. Online retailers didn’t fare much better, with IAC/InterActiveCorp sinking over 4% after its spin-off of online travel booking service firm Expedia.

Top and Bottom Five Industries: 3rd Quarter 2005 Return %



Style and Market Cap Indexes

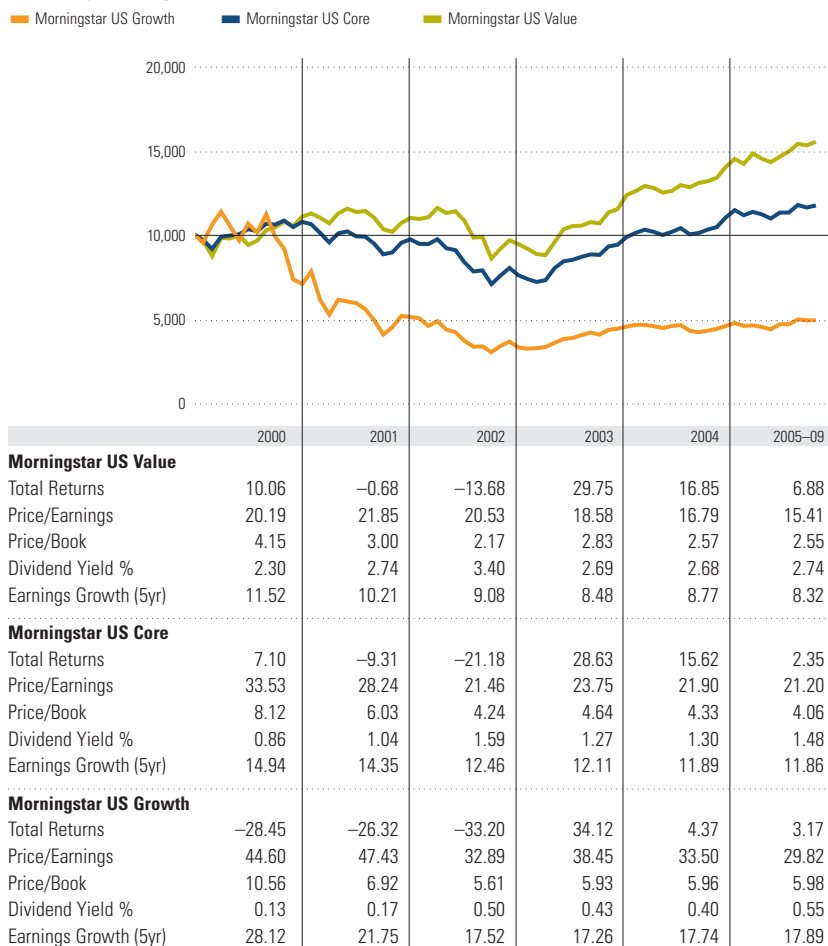
Morningstar US Value Index: +3.80%

Although the US Value Index posted a respectable gain for the quarter, it was a mixed story. Oil stocks ExxonMobil, ConocoPhillips, and Chevron led the way, and tobacco company Altria also finished strong. Embattled computer maker Hewlett Packard rose 20% as some investors anticipated a restructuring that would split its profitable printer business from its “box-making” unit. Financials Citigroup, Bank of America, and J.P. Morgan Chase lagged, however. Additionally, regional bell operating company Verizon posted a 4% loss, while fellow regional operator SBC Communications was flat.

Morningstar US Core Index: +3.60%

The US Core Index posted solid returns as well, with computer-equipment maker IBM (+7%), embattled insurer American International Group (+6%), and especially consumer-products leader Procter & Gamble (+13%) overcoming weakness in industrials such as General Electric (-2%). Media conglomerate TimeWarner also helped, surging nearly 10% as Carl Icahn led a group of hedge funds in pressuring the company to restructure. Pfizer continued to struggle with a 6% loss for the quarter as investors remained concerned about the removal of painkiller Celebrex, the depth of the company’s pipeline of new drugs, and older, established drugs such as Lipitor and Viagra, which are beginning to face competition from rivals.

Morningstar Style Indexes: Growth of \$10,000



Morningstar US Growth Index: +4.74%

Growth squeezed out impressive victories against value and blend (especially considering the energy exposure of the value index) largely on the backs of telecommunications-equipment maker Qualcomm and biotech firm Amgen. Investors anticipate Qualcomm will benefit from the next generation of cell phones and wireless devices, which provide greater communications, photo, and computing capabilities. Qualcomm has technological patents and derives royalty revenue from each device sold containing its CDMA technology. Retailer Wal-Mart and chipmaker Intel were laggards in the category. Microsoft was flat as cash continued to build on its balance sheet.

Morningstar Large Cap Index: +3.40%

Despite nice absolute performance, large caps continued to underperform mid-caps and small caps for the quarter. Although growth is looking stronger than it has in past years, the rotation into large caps that we've been waiting for hasn't materialized yet. The Large Cap Index continues to have a negative five-year trailing return of 3.51%. It also lags its small and mid-cap brethren for the year to date through the third quarter. The index's price/earnings ratio of 21 is slightly lower than that of the Mid Cap Index (23) and the Small Cap Index (24), though it appears pricier on a price/book basis (4.21 versus 3.85 for the Mid Cap Index and 3.52 for the Small Cap Index). Its dividend yield is higher (1.77% versus 1.26% for the Mid Cap Index and 1.05% for the Small Cap Index), though its earnings growth for the trailing five years is slightly lower (12.05%

versus 13.37% for the Mid Cap Index and 14.80% for the Small Cap Index). Oil firms led the charge in the quarter, but the larger-cap companies in the energy sector tended not to do as well as their mid- and smaller-cap brethren. Financials Citigroup and Bank of America lagged. Wal-Mart held the group back as well.

Morningstar Mid Cap Index: +6.05%

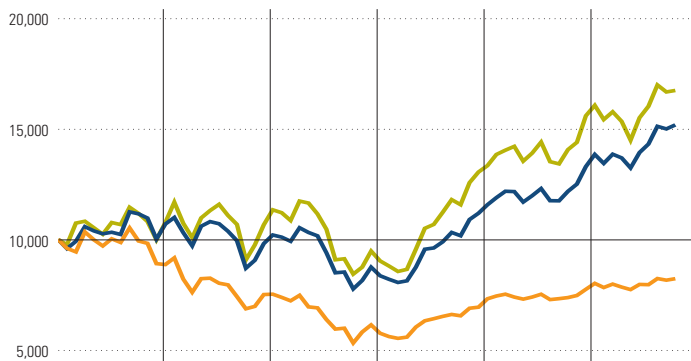
The Morningstar Mid Cap Index continued its upward trend, tacking on over 6%. It has nearly a 7% average annual return for the trailing five years and a whopping 25% average annual return for the trailing three years, only barely lagging the Morningstar Small Cap Index for the latter period. The Mid Cap Index also leads the Small Cap Index for the trailing year (23% versus 17%), surging ahead in the manner that some analysts thought large caps might. Homebuilders such as Centex, Lennar, and DR Horton cooled off after torrid runs. Retailers such as Federated Department Stores also hurt the index, but energy-related companies such as exploration and production concern Williams Companies, oil and natural-gas pipeline Kinder Morgan, and producer Amerada Hess all powered the index higher. Analyst Michael Cumming has awarded Kinder Morgan a wide moat and a Stewardship Grade of A, though the stock currently trades above his fair value estimate of \$80 per share.

Morningstar Small Cap Index: + 4.47%

It's possible that the darling of the equity markets may finally be showing signs of slowing down, as the Morningstar Mid Cap Index outpaced the Morningstar Small Cap Index for the quarter and the trailing year. Nevertheless, a 4.47% quarterly gain and a 17% trailing one-year gain for the Small Cap Index are as gaudy as ever. Carrying the energy theme for the Small Cap Index, oil and natural-gas producer Cimarex Energy added 13%. Also, cell tower company Global Signal racked up a 19% gain. Intuitive Surgical, maker of surgical robots and surgeons' consoles, rocketed up over 50%, while Lifepoint Hospitals suffered due to increased uninsured patients. Chemical producer Chemtura lagged badly, dropping 16% as investors feared that the economic recovery is now long in the tooth.

Morningstar Cap Indexes: Growth of \$10,000

— Morningstar Large Cap — Morningstar Mid Cap — Morningstar Small Cap



	2000	2001	2002	2003	2004	2005-09
Morningstar Large Cap						
Total Returns	-11.38	-15.10	-23.47	27.04	9.54	2.65
Price/Earnings	33.75	32.03	25.14	26.93	23.22	21.18
Price/Book	8.49	5.98	4.56	4.76	4.39	4.30
Dividend Yield %	1.02	1.29	1.80	1.54	1.62	1.76
Earnings Growth (5yr)	18.16	14.78	12.81	12.46	12.35	12.20
Morningstar Mid Cap						
Total Returns	6.94	-4.63	-18.06	38.38	19.66	9.63
Price/Earnings	27.01	26.96	25.97	25.89	24.60	24.21
Price/Book	5.35	3.96	3.19	3.86	3.89	4.00
Dividend Yield %	1.40	1.33	1.59	1.27	1.23	1.25
Earnings Growth (5yr)	17.74	16.14	13.94	12.57	13.03	13.52
Morningstar Small Cap						
Total Returns	7.66	5.26	-20.36	47.70	20.44	4.20
Price/Earnings	21.28	25.22	22.96	27.04	26.43	24.90
Price/Book	3.68	3.11	2.72	3.58	3.79	3.67
Dividend Yield %	1.35	1.18	1.56	1.09	0.97	1.07
Earnings Growth (5yr)	19.65	17.57	14.96	14.86	14.60	14.95

Active vs. Passive, 3rd Qtr 2005

	Value	Core	Growth
Large Cap	44.31 3.85	78.84 2.91	71.40 3.46
Mid Cap	62.75 3.62	27.33 6.13	24.90 8.34
Small Cap	68.52 3.78	83.7 3.83	45.25 5.99

○ Percent of actively managed mutual funds outperforming their respective benchmark. Includes the oldest share class for all US diversified mutual funds with at least a one-year history. As of Sept. 30, 2005, there were 2,433 eligible funds. Morningstar classifies funds into style categories based on the average style score (using the same 10-factor methodology as underlying benchmarks) of all available portfolio holdings over a three-year period.

● Index Returns (%) for 3rd Quarter, 2005

Fund Categories vs. the Benchmarks

Active management scored some points this quarter against the argument for indexing, as five Morningstar diversified fund categories beat their indexes.

The returns of the average mutual fund surpassed the returns of the relevant style-based benchmark in the mid-value, small-value, small-blend, large-blend, and large-growth categories. The large-cap victories are particularly impressive, as active managers typically have a more difficult time in beating the larger-cap indexes, which include stocks that are more closely followed. Overloading on energy helped funds in all market-cap ranges.

Conclusion

None of the 80 or so stocks currently in 5-star territory are energy stocks, and our energy analysts are modeling lower prices into their discounted cash-flow models for the future. There is also only one 5-star steel company, Mittal Steel.

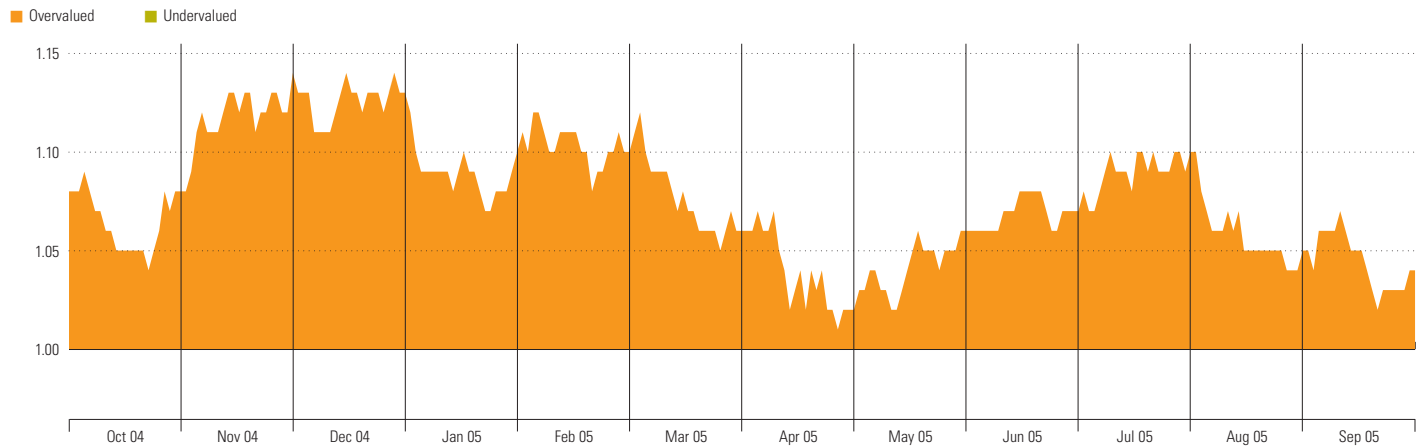
We think investors should not chase sectors that are roaring, especially when they are cyclical and the economics of their businesses give companies little pricing power. The current P/E of the Morningstar US Market Index is 22, and our market valuation graph,

which takes the aggregate of all the stocks we have under coverage, shows that the market is slightly overvalued, according to our fair value estimates for individual stocks.

Encouragingly, however, some wide-moat companies, such as 3M, Abbott Laboratories, Anheuser-Busch, Johnson & Johnson, Microsoft, the Washington Post, and Expedia, are trading at attractive prices, according to our analysts. Investors can still find some reasonably priced stocks if they are willing to do some work and be patient.

John Coumarios
Mutual Fund Analyst

Market Valuation



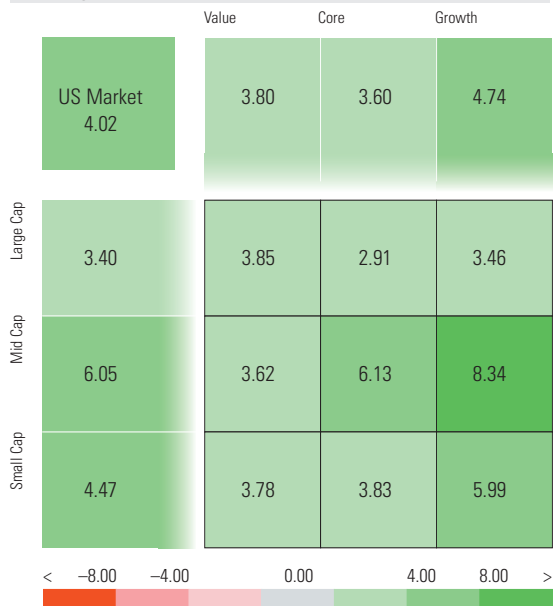
52-Week High 1.14 (12-01-04)	52-Week Low 1.01 (04-28-04)	All-Time High 1.14 (12-01-04)	All-Time Low 0.78 (10-09-02)	3rd Quarter Close 1.04 (09-30-05)
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Market Valuation Chart

The graph shows the ratio of price to fair value for the median stock in the universe of stocks covered by Morningstar over time. A ratio above 1.00 indicates that the stock's price is higher than Morningstar's estimate of its fair value; a ratio below 1.00 indicates that the stock's price is lower than our estimate of its fair value. The further the price/fair value ratio rises above 1.00, the more the median stock is overvalued. The further it moves below 1.00, the more the median stock is undervalued.

Trailing Returns %

Index	Quarter	6-Month	1-Year	3-Year	5-Year	10-Year
Morningstar U.S. Market	4.02	6.37	14.75	18.23	-0.92	9.37
Large Cap	3.40	4.83	11.59	15.62	-3.69	8.68
Mid Cap	6.05	10.89	24.63	24.99	6.34	10.83
Small Cap	4.47	9.11	19.03	25.64	8.40	10.23
US Value	3.80	6.76	17.30	21.04	8.00	NA
U.S. Core	3.60	4.55	13.43	17.65	2.00	NA
U.S. Growth	4.74	8.12	13.29	15.98	-12.38	NA
Large Value	3.85	5.79	15.59	19.22	5.32	NA
Large Core	2.91	2.81	10.64	15.32	-1.46	NA
Large Growth	3.46	6.33	7.94	12.23	-14.94	NA
Mid Value	3.62	9.49	22.88	25.50	14.85	NA
Mid Core	6.13	10.15	22.46	23.89	12.60	NA
Mid Growth	8.34	12.95	28.54	25.22	-6.43	NA
Small Value	3.78	9.09	18.45	25.56	18.53	NA
Small Core	3.83	7.72	18.77	25.03	13.42	NA
Small Growth	5.99	10.74	19.91	26.09	-5.01	NA

Morningstar Market Barometer 3rd Quarter Return %**Morningstar Market Barometer Trailing 4 Quarters Return %****4th Quarter 2004**

8.79	9.74	7.36
11.74	13.89	15.54
13.32	13.82	15.73

1st Quarter 2005

0.43	-1.93	-5.44
0.44	-2.38	-1.51
-4.18	-3.13	-6.44

2nd Quarter 2005

1.87	-0.10	2.77
5.66	3.79	4.25
5.12	3.75	4.48

3rd Quarter 2005

3.85	2.91	3.46
3.62	6.13	8.34
3.78	3.83	5.99

Biggest Positive Influence on Morningstar US Market Index

	Style	Contribution %	3 Month	1 Year	3 Year
Exxon Mobil Corp.	■	0.33	11.07	33.79	27.82
Amgen Inc.	■	0.24	31.77	40.24	24.06
Qualcomm Inc.	■	0.19	35.88	15.45	48.58
Chevron Corp.	■	0.18	16.56	23.84	26.02
Altria Group Inc.	■	0.17	15.23	63.05	28.34
Hewlett-Packard Co.	■	0.15	24.54	57.44	37.19
Apple Computer Inc.	■	0.15	45.64	176.70	94.70
Procter & Gamble Co.	■	0.15	13.25	11.83	11.71
ConocoPhillips	■	0.14	22.14	71.47	46.45
Halliburton Co.	■	0.11	43.55	104.87	75.61

Biggest Negative Influence on Morningstar US Market Index

	Style	Contribution %	3 Month	1 Year	3 Year
Pfizer Inc.	■	-0.12	-8.77	-15.98	-2.43
Bank of America Corp.	■	-0.08	-6.60	1.43	13.74
Dell Inc.	■	-0.07	-13.33	-3.93	13.29
Wal-Mart Stores Inc.	■	-0.07	-8.78	-16.54	-2.79
Fannie Mae	■	-0.07	-22.81	-27.26	-5.84
Abbott Laboratories	■	-0.06	-12.93	2.62	3.99
General Electric Co.	■	-0.06	-2.19	2.89	13.56
Intel Corp.	■	-0.06	-4.96	24.28	21.86
Cisco Systems Inc.	■	-0.05	-6.08	-0.99	19.56
Merck & Co. Inc.	■	-0.05	-10.42	-12.94	-11.50

Biggest Influence on 1 year performance is calculated by multiplying stock returns for the quarter with their respective weight in the Index as of the start of the quarter.