Morningstar Market Commentary

2nd Quarter 2006

Morningstar Market Barometer℠

2nd Quarter, 2006 Return %

	Value	Core	Growth
Large Cap	2.71	−1.91	−4.56
Mid Cap	−0.14	−3.93	−4.65
Small Cap	−3.60	−3.51	−7.99

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1 Year Return %

	Value	Core	Growth
Large Cap	13.38	8.16	3.09
Mid Cap	11.70	12.46	18.24
Small Cap	11.53	16.57	13.27

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Fears of inflation and uncertainty regarding the sustainability of corporate profits led to a market sell-off late in the second quarter. Volatility rudely imposed itself on investors accustomed to calm after the end of the bear market in 2002. All Morningstar equity indexes except the Morningstar Large Value Index posted losses for the quarter, and the Morningstar US Market Index shed 1.8% over the same period, but still managed to post a gain of about 3.3% for the year to date. Smaller-cap and more value-oriented indexes are outperforming for the year, but fell harder in the second quarter.

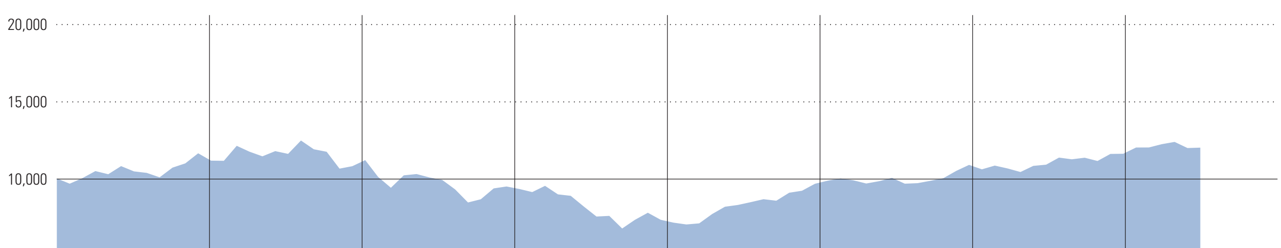
Macroeconomic questions gripped the markets, as new Federal Reserve Chairman Ben Bernanke appears poised to raise rates at least one more time as of this writing, precisely as the economy appears to be slowing. Investors fear the Fed tightening too hard, sending the economy into a recession. They also fear a return of "stagflation" from the 1970s, when rising prices (partly due to higher energy costs) and a slowdown visited the economy simultaneously.

There seemed to be no place to hide, with foreign markets also declining and the Lehman Brothers Aggregate Bond Index falling over 1%. However, large, slow-growing companies weathered the swoon rather well. The Morningstar large-cap indexes held up the best during the bloodletting of the past month, with the small-cap indexes bringing up the rear.

This didn't catch Morningstar analysts completely by surprise. First, Morningstar's director of stock analysis Pat Dorsey reported on April 21 that a variety of factors pointed toward investor complacency and the inexpensiveness of high-quality stocks. Second, mutual fund analysts have been hearing from their favorite managers that high-quality large-cap stocks haven't looked this cheap in a long time, and fund analyst Gregg Wolper reported that world stock fund managers had noticed topnotch U.S. companies selling at more compelling prices than their foreign counterparts.

The domestic-foreign debate continues, however, with Warren Buffett telling shareholders of his company, Berkshire Hathaway, not to be surprised if he follows up his recent acquisition of Israeli metal-cutter Iscar with other foreign purchases. Buffett also picked up shares of integrated oil company ConocoPhillips, industrial conglomerate General Electric, and package carrier United Parcel Service, all of which share the theme of global operations, according to Morningstar stock analyst Justin Fuller.

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



	1999	2000	2001	2002	2003	2004	2005	2006-06
Total Returns %	19.79	−7.02	−11.88	−22.16	30.73	12.35	6.52	3.32
Price/Earnings	37.99	31.78	30.73	24.97	26.74	23.72	22.05	21.39
Price/Book	10.45	7.54	5.39	4.13	4.49	4.22	4.17	3.96
Dividend Yield %	1.09	1.12	1.29	1.74	1.45	1.49	1.61	1.65
Earnings Growth (5 Yr)	18.80	18.15	15.22	13.19	12.76	12.55	12.80	12.93

Surveying the Sectors

Media dragged itself up off the mat, posting a 5.4% return for the second quarter. The worst five-year performing sector, media bounced back to the satisfaction of Morningstar analysts, who have viewed newspapers and other media enterprises as cheap for some time. Tribune, owner of newspapers, radio and television stations, and the Chicago Cubs baseball team, surged 19% for the trailing three months through June 30 on pressure from the Chandler Trusts, which are 12% owners, to spin off the television-broadcasting assets.

Morningstar Sectors: 2nd Quarter 2006 Return %

	Quarter	1 Year	3 Year
Information	–5.70	4.99	7.11
Software	–8.57	0.62	5.47
Hardware	–10.13	4.17	8.05
Media	5.43	3.12	3.28
Telecommunication	–0.54	14.75	11.11
Service	–1.01	10.23	11.86
Health Care	–4.06	1.33	4.94
Consumer Services	–3.12	2.77	11.72
Business Services	0.26	30.33	18.89
Financial Services	1.30	14.44	14.79
Manufacturing	2.64	16.22	19.65
Consumer Goods	0.45	5.48	10.21
Industrial Materials	0.11	17.26	18.18
Energy	5.79	28.17	33.51
Utilities	8.06	8.43	18.40

Media conglomerate Liberty Global rose 5% for the trailing three months through June 30, while cable companies Comcast and Cablevision added 25% and 21%, respectively. Additionally, the cable companies' main rivals, the regional bell operating companies, had solid returns. Qwest Communications International tacked on 19%, while BellSouth added 5%.

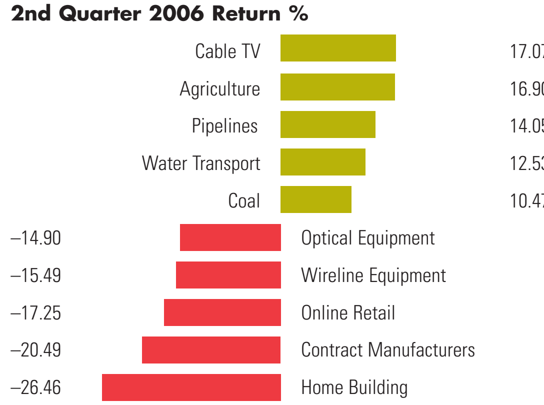
Hardware and software brought up the rear, dropping 10% and 9%, respectively, through June 30. In hardware, navigation-device maker Garmin surged 33%, while networking and telecommunications infrastructure firms faltered. JDS Uniphase, for example, dropped 40%. Software outfits Salesforce.com and Microsoft dropped 27% and 14%, respectively.

Industry Performance

Cable TV, Agriculture, Pipelines, Water Transportation, and Coal led the industry charge. The big news in the pipeline business was the announcement that an investor group, including three private-equity firms and CEO Richard Kinder, would buy out Kinder Morgan for $100/share and take it private. This announcement in late April sent the stock price up to just under the announced price from $85, and produced a 10% return in the stock for the quarter. If the deal goes through, it will be the largest leveraged buyout (LBO) in history. Kinder Morgan has a complicated structure, including two other units Kinder Morgan Energy Partners and Kinder Morgan Management, which are not included in the deal. Besides Kinder Morgan, deal announcements and rumors fueled higher prices throughout the oil and gas pipeline industry, with El Paso surging 25% for the quarter.

While pipelines enjoyed surging stocks, homebuilders suffered the hardest share price declines, with the category shedding 26% for the quarter. Centex dropped about 25% over that period and about 30% for the year to date. Hovnanian, Pulte, and DR Horton all experienced similar swoons as investors anticipate lower housing activity given higher interest rates.

Top and Bottom Five Industries: 2nd Quarter 2006 Return %



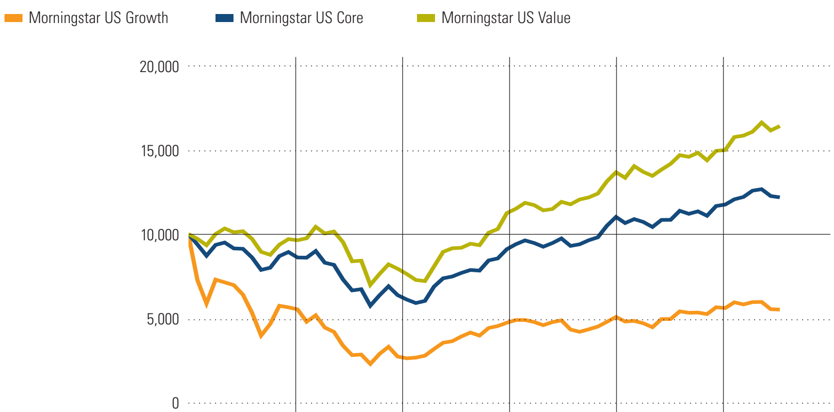
Style and Market Cap Indexes

Morningstar US Value Index: +1.8%

Continuing a multiyear trend, value outperformed growth for the quarter. The Morningstar US Value Index added 1.8% for the trailing 13 weeks through June 30, and maintained an 8% gain for the year to date. The energy-heavy index got a boost from integrated oil company Chevron, which jumped nearly 8% during the quarter. Other energy components ConocoPhillips and ExxonMobil were up around 5% and 1%, respectively, for the quarter. Analysts continue to differ about where the price of oil is headed, and, therefore, what these businesses are worth.

The Morningstar US Value Index, with its heavy weighting in financials services stocks, rose modestly for the quarter. Citigroup and Bank of America posted gains of 3% and 8%, respectively, for the trailing three months through June 30, despite the uncertainty of interest rates and inflation.

Morningstar Style Indexes: Growth of $10,000



	2001	2002	2003	2004	2005	2006-06
Morningstar US Value						
Total Returns %	–0.68	–13.68	29.75	16.85	7.82	7.88
Price/Earnings	21.85	20.53	18.58	16.79	14.98	15.73
Price/Book	3.00	2.17	2.83	2.57	2.53	2.42
Dividend Yield %	2.74	3.40	2.69	2.68	2.89	2.79
Earnings Growth (5yr)	10.21	9.08	8.48	8.77	8.00	8.38
Morningstar US Core						
Total Returns %	–9.31	–21.18	28.63	15.62	5.19	2.87
Price/Earnings	28.24	21.46	23.75	21.90	20.92	21.02
Price/Book	6.03	4.24	4.64	4.33	3.95	3.97
Dividend Yield %	1.04	1.59	1.27	1.30	1.43	1.46
Earnings Growth (5yr)	14.35	12.46	12.11	11.89	12.13	11.85
Morningstar US Growth						
Total Returns %	–26.32	–33.20	34.12	4.37	6.41	–1.01
Price/Earnings	47.43	32.89	38.45	33.50	30.62	29.98
Price/Book	6.92	5.61	5.93	5.96	6.04	5.91
Dividend Yield %	0.17	0.50	0.43	0.40	0.53	0.55
Earnings Growth (5yr)	21.75	17.52	17.26	17.74	18.17	17.53

Morningstar US Core Index: –2.5%

The Morningstar US Core Index dropped 2.5% for the quarter, though it maintained a 2.9% gain for the year. Industrial material component General Electric continued to flounder, shedding nearly 5% for the trailing three months. The index's second-largest component, Wal-Mart, finished the quarter with a 2% gain through June 30. Investors continue to debate whether the stock's stagnant price accurately accounts for the business's likely slower future growth or whether the stock is too cheap, given its earnings gains in recent years.

Morningstar US Growth Index: –4.9%

Once again, growth lagged its core and value counterparts, shedding 4.9% for the quarter. Besides Microsoft's extended underperformance, the index's second-largest component, Johnson & Johnson, has continued to trade at historically low valuation multiples. The stock gained a modest 2% for the trailing three months through June 30. Concerns over how much it paid recently for Pfizer's consumer-products unit held the stock back as well.

Interestingly, at the time of June reconstitution of Morningstar Indexes, both Microsoft and Johnson & Johnson, moved from being a component of Large Growth to Large Core. In case of Microsoft, the change in classification was largely driven by a 16% drop in the stock price year-to-date, which has lowered its price ratios. Also, maturing core markets in operating systems and productivity software, coupled with delayed new product launches have diminished the firm's growth prospects.

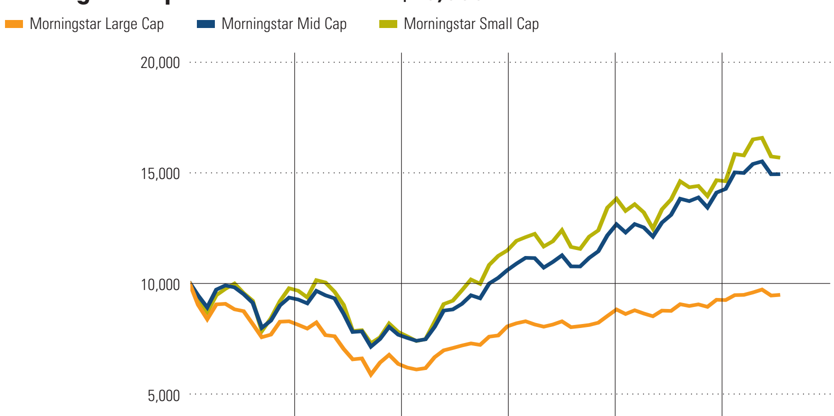
Among other major index contributors were biotech bellwethers Genentech and Amgen, which suffered losses of 3% and 10% respectively, for the trailing three months through June 30. They lost 12% and 17% for the year to date, respectively.

The US Growth Index remains the second-worst for the trailing three- and five-year periods (behind the Morningstar Large Growth Index). Investors will have to wait longer for growth stocks to rebound after their dismal performance during the bear market (2000-02) and subsequent losses.

Morningstar Large Cap Index: –1.1%
Although there was no reversal of past trends among style indexes, large caps squeezed out a victory over their smaller brethren. The Morningstar Large Cap Index dropped 1.1%, versus 3% and 5% declines for its mid-cap and small-cap counterparts, respectively. Although industrial conglomerate GE and software behemoth Microsoft struggled for the quarter, financial components Citigroup and Bank of America provided strength. Additionally, integrated oil giant ExxonMobil and retailer Wal-Mart had steady quarters.

The index has underperformed its mid- and small-cap brethren over the past five years, averaging a 1.5% gain annually over that time. In addition to its extended underperformance, its higher dividend yield and lower price/earnings ratio compared with its counterparts give investors hope that it might be poised for a rebound.

Morningstar Cap Indexes: Growth of $10,000



	2001	2002	2003	2004	2005	2006-06
Morningstar Large Cap						
Total Returns	–15.10	–23.47	27.04	9.54	4.87	2.58
Price/Earnings	32.03	25.14	26.93	23.22	21.37	20.35
Price/Book	5.98	4.56	4.76	4.39	4.28	3.98
Dividend Yield %	1.29	1.80	1.54	1.62	1.77	1.82
Earnings Growth (5yr)	14.78	12.81	12.46	12.35	12.36	12.39
Morningstar Mid Cap						
Total Returns	–4.63	–18.06	38.38	19.66	12.70	4.70
Price/Earnings	26.96	25.97	25.89	24.60	23.90	24.15
Price/Book	3.96	3.19	3.86	3.89	4.00	4.04
Dividend Yield %	1.33	1.59	1.27	1.23	1.23	1.23
Earnings Growth (5yr)	16.14	13.94	12.57	13.03	13.62	13.92
Morningstar Small Cap						
Total Returns	5.26	–20.36	47.70	20.44	5.76	7.31
Price/Earnings	25.22	22.96	27.04	26.43	24.44	25.63
Price/Book	3.11	2.72	3.58	3.79	3.54	3.57
Dividend Yield %	1.18	1.56	1.09	0.97	1.15	1.13
Earnings Growth (5yr)	17.57	14.96	14.86	14.60	15.22	15.98

Morningstar Mid Cap Index: –3%
The Morningstar Mid Cap Index lost 3% for the quarter. The losses tended to be spread out among various sectors and components. Top components Garmin, Hilton, and Host Hotels & Resorts rose 33%, 11%, and 4%, respectively. Americans continue to travel more, and hotel rooms remain in short supply. However, pharmaceutical distributor AmerisourceBergen and software/business-services outfit Autodesk lost 14% and 11% for the quarter, respectively. Additionally semiconductor company Altera lost 15% for the quarter. Online brokerage E*Trade Financial also shed 15%, while industrial conglomerate ITT Industries lost 12%.

Morningstar Small Cap Index –5%
The Morningstar Small Cap Index declined 5% during the quarter. Transportation company Arkansas Best gained 29% for the quarter, despite higher energy costs, new EPA emission requirements in 2007, and more freight being shipped by rail. AirTran Holdings, by contrast, shed 18%. FormFactor, manufacturer of semiconductor wafer probe test cards, added 13.5% for the quarter, but building–materials outfit Granite Construction dropped 7%. Additionally, biotech firm Nektar Therapeutics, steelmaker Oregon Steel Mills, and retailer Rent-A-Center dropped 10%, 1%, and 3%, respectively.

Active vs. Passive, 2nd Qtr 2006

	Value	Core	Growth
Large Cap	2.05 / 2.71	40.08 / –1.91	52.83 / –4.56
Mid Cap	23.08 / –0.14	75.50 / –3.93	33.33 / –4.65
Small Cap	58.72 / –3.60	34.15 / –3.51	68.55 / –7.99

○ 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 June 30, 2006 there were 2,313 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 (%), 2nd Quarter, 2006

Fund Categories vs. the Benchmarks

Active management overcame the indexes in four diversified categories—large growth, mid-blend, small growth, and small value. In large growth, the difference was slight, with the fund category average dropping 4.75% versus 4.56% for the index through June 30. Mid-blend funds fared better than the index, with the average fund dropping 2.8% versus 3.9% for the index. Having some larger-cap names, which held up better, helped the actively managed funds. Although mid-caps have performed better for the year, they faltered for the quarter, causing analysts to wonder if their multiyear dominance is coming to an end. Additionally, large value continued to do well. Similarly, small-value and small-growth funds were able to beat their benchmarks by owning some mid-cap names.

Morningstar indexes are "style pure," meaning they exhibit clearly the characteristics associated with a specific style box. This makes them difficult to beat when they are the darlings and relatively easy to beat when they are the dogs. Two victories in the small-cap area for actively managed funds may bode well for those anticipating a large-cap comeback.

Conclusion

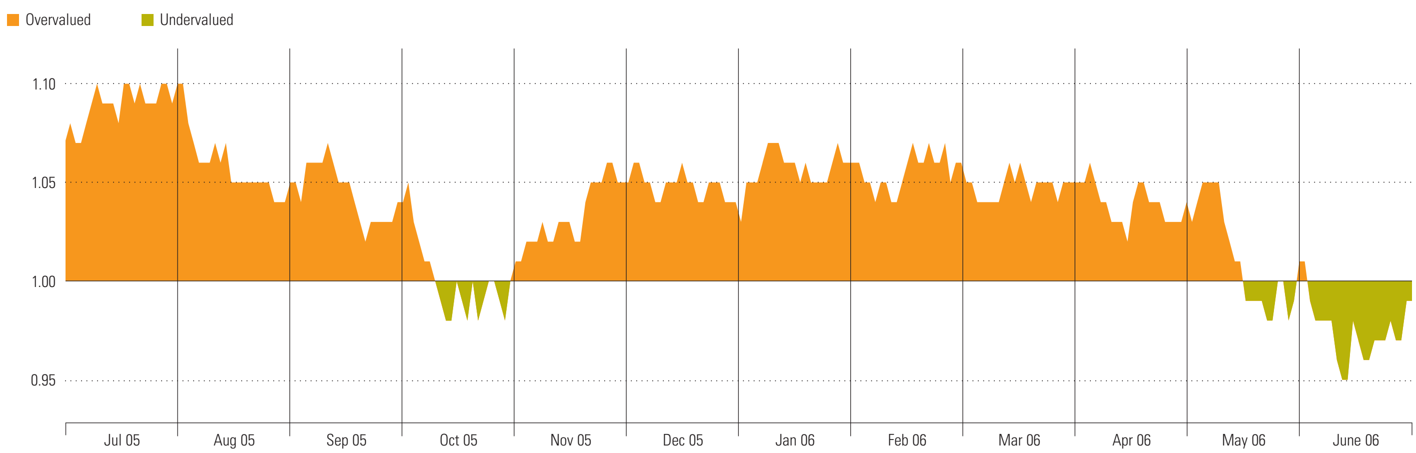
For the first time since mid-2004, the aggregate of stocks covered by Morningstar analysts appeared undervalued, according to the Morningstar Market Valuation Graph. There are currently more than 150 5-star stocks (stocks trading below Morningstar's estimates of their fair value). "Wide moat" stocks—those deemed by Morningstar analysts to have superior, sustainable competitive advantages and returns on invested capital—have appeared undervalued for almost the entire period beginning in 2004 to the present. Among the wide-moat businesses on Morningstar's 5-star list are health-care companies Abbott Laboratories, Novartis, Biomet, Medtronic, and Zimmer; consumer-products companies Anheuser-Busch, Cadbury Schweppes PLC, Coca-Cola, Wrigley, and PepsiCo; technology-related firms Dell and Microsoft; financial-services outfits Fifth-Third Bancorp, J.P. Morgan Chase, and MasterCard; retailers Home Depot and Wal-Mart; and Warren Buffett's Berkshire Hathaway.

The markets could always send these stocks down further, but Morningstar analysts believe these highly profitable businesses are currently priced with large enough margins of safety below the present value of their future free cash flows to make them fine long-term holdings.

The return of volatility may be unnerving, but Morningstar analysts think that it presents opportunities for those who take the longer view.

John Coumarianos
Mutual Fund Analyst

Market Valuation



52-Week High	52-Week Low	All-Time High	All-Time Low	2nd Quarter Close
1.10 (07-12-05)	0.95 (06-13-06)	1.14 (12-01-04)	0.78 (10-09-02)	0.99 (06-30-06)

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 US Market	–1.81	3.32	9.88	12.78	3.48	8.37
Large Cap	–1.13	2.58	8.36	10.32	1.45	7.50
Mid Cap	–3.00	4.70	14.13	19.30	8.80	10.31
Small Cap	–5.03	7.31	13.77	19.49	9.48	9.86
US Value	1.75	7.88	12.96	16.69	8.09	NA
US Core	–2.53	2.87	9.54	12.97	4.50	NA
US Growth	–4.86	–1.01	6.94	8.48	–3.04	NA
Large Value	2.71	8.36	13.38	15.04	6.35	NA
Large Core	–1.91	2.07	8.16	10.73	2.22	NA
Large Growth	–4.56	–3.14	3.09	4.86	–5.25	NA
Mid Value	–0.14	6.28	11.70	20.96	12.28	NA
Mid Core	–3.93	3.53	12.46	18.51	10.88	NA
Mid Growth	–4.65	4.42	18.24	18.00	2.64	NA
Small Value	–3.60	6.87	11.53	20.49	14.90	NA
Small Core	–3.51	10.22	16.57	21.69	12.37	NA
Small Growth	–7.99	4.69	13.27	16.11	1.56	NA

Morningstar Market Barometer 2nd Quarter Return %

		Value	Core	Growth
	US Market –1.81	1.75	–2.53	–4.86
Large Cap	–1.13	2.71	–1.91	–4.56
Mid Cap	–3.00	–0.14	–3.93	–4.65
Small Cap	–5.03	–3.60	–3.51	–7.99

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Morningstar Market Barometer Trailing 4 Quarters Return %

3rd Quarter 2005

3.85	2.91	3.46
3.62	6.13	8.34
3.78	3.83	5.99

4th Quarter 2005

0.75	2.97	2.87
1.43	2.35	4.52
0.56	1.87	2.08

1st Quarter 2006

5.50	4.06	1.49
6.43	7.77	9.52
10.86	14.22	13.78

2nd Quarter 2006

2.71	–1.91	–4.56
–0.14	3.93	–4.65
–3.60	–3.51	–7.99

Biggest Positive Influence on Morningstar US Market Index

	Style	Contribution %	QTR	1-Year	3-Year
Bank of America Corp.		0.10	6.72	9.84	10.62
Chevron Corp.		0.07	7.95	14.32	22.89
Comcast Corp. Cl A		0.06	25.15	6.75	2.75
Citigroup Inc.		0.05	3.20	8.39	7.57
TXU Corp.		0.05	34.50	47.57	77.12
Altria Group Inc.		0.05	4.76	18.51	21.86
Wells Fargo & Co.		0.04	5.84	12.31	13.07
Google Inc. Cl A		0.04	7.52	42.56	NA
United Technologies Corp.		0.04	9.86	25.31	22.91
Exxon Mobil Corp.		0.04	1.33	8.87	21.65

Biggest Negative Influence on Morningstar US Market Index

	Style	Contribution %	QTR	1-Year	3-Year
Microsoft Corp.		–0.25	–14.04	–4.83	1.89
Qualcomm Inc.		–0.12	–20.59	22.61	31.41
General Electric Co.		–0.12	–4.51	–2.08	7.44
Sprint Nextel Corp.		–0.11	–22.45	–19.83	16.41
American Interntl. Group Inc.		–0.11	–10.43	2.67	3.00
UnitedHealth Group Inc.		–0.11	–19.84	–14.06	21.28
Home Depot Inc.		–0.10	–15.04	–6.71	3.72
Cisco Systems Inc.		–0.09	–9.88	2.36	5.16
Dell Inc.		–0.08	–17.81	–38.01	–8.41
eBay Inc.		–0.07	–24.90	–11.27	4.05

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

News Briefs: Morningstar Announces Semi-Annual Reconstitution of Style Indexes

At the time of reconstitution, stocks are: added and deleted, reclassified by style and capitalization, and assigned new index weights. One notable change is Microsoft's shift from large-growth to large-core, a change largely driven by a 16% drop in the stock price year-to-date, which lowered its price ratios. To read the full announcement and get summary statistics, including a data fact sheet and a list of stocks added and deleted from the index, go to http://indexes.morningstar.com/Index/NewsList.asp