



Q3 Market Review ~ Dow Jones Hits New High: Big Deal!?

October 2006 - Buoyed by a retreat in energy prices and the Federal Reserve's hiatus from increasing interest rates, stock and bond markets rebounded from their second-quarter swoon. Real Estate Stocks sustained their year-to-date leadership position with an advance of 24.9% after a third-quarter gain of 9.1%. Notably, long-struggling Domestic Large Cap sectors outperformed Domestic Small Cap sectors during the quarter, adding 3.9% to 6.2%. Also recovering were International Emerging Markets, jumping 5.0%, and International Developed Markets, rising 4.0%. The only losing sector was Domestic Small Cap Growth, falling 1.8%.

After raising the Fed Funds rate to 5.25% in 17 consecutive quarter-point increments, The Federal

Reserve paused at both meetings in the third quarter. Signaling that rate increases may be over for this economic cycle, bonds rallied across the board. At quarter end, the yield on the 10-year Treasury Note was 4.63%, down 22 basis points for the quarter, but up 24 basis points from the start of the year (the yield as of October 24th was 4.82%). Lower interest rates propelled gains in the riskiest segments of the bond market, with International Emerging Markets swelling 6.3% and U.S. Corporate High Yield picking up 4.2%.

Below are rates of return for selected market indices for the third quarter of 2006, year-to-date 2006, and the three-, five-, and 10-year averages as of December 31, 2005.

	<u>3Q:2006</u>	<u>YTD-2006</u>	<u>3-Yr. Avg.</u>	<u>5-Yr. Avg.</u>	<u>10-Yr. Avg.</u>
<u>Equity (Stock) Indices</u>					
Domestic Large Cap					
Russell 1000 - Growth	3.94%	2.97%	13.23%	-3.58%	6.73%
Russell 1000 - Value	6.22%	13.19%	17.49%	5.28%	10.94%
Russell 1000 - Blend	5.06%	7.95%	15.42%	1.07%	9.29%
Domestic Small Cap					
Russell 2000 - Growth	-1.76%	4.21%	20.93%	2.28%	4.69%
Russell 2000 - Value	2.55%	13.26%	23.18%	13.55%	13.08%
Russell 2000 - Blend	0.44%	8.69%	22.13%	8.22%	9.26%
Real Estate (Dow Jones Wilshire REIT)	9.11%	24.92%	27.32%	19.16%	15.36%
International Developed Mkts (MSCI EAFE)	3.99%	14.91%	24.18%	4.94%	6.18%
International Emerging Mkts (MSCI EM)	5.01%	12.71%	38.52%	19.44%	6.98%
<u>Fixed-Income (Bond) Indices</u>					
Lehman Brothers					
Global Aggregate	2.20%	4.49%	5.76%	6.81%	5.35%
U.S. Aggregate	3.78%	3.06%	3.62%	5.87%	6.17%
U.S. Corporate High Yield	4.20%	7.34%	14.28%	9.34%	6.92%
Municipal	3.41%	3.69%	4.44%	5.58%	5.71%
International Emerging Markets	6.33%	5.82%	17.03%	12.96%	13.15%

Dow Jones Hits New High: Big Deal!?

On October 3rd, 2006, the Dow Jones Industrial Average hit an all-time closing high of 11,727.34, surpassing its record of 11,722.98 set on January 14, 2000, and has since moved ahead to top the 12,000 mark. Although the blue-chip indicator is the oldest and probably best-known market bellwether, is it really the most relevant? Despite the widely-publicized peaks, the Dow does not represent how most investors allocate or evaluate their portfolios. Moreover, the Dow's computation is fundamentally flawed. Knowing how the Dow works provides insight beyond the headline number so investors can appropriately assess portfolio performance.

First, here are some facts. The Dow Jones Industrial Average was created in 1896 by Charles Dow, co-founder of Dow Jones & Company, publishers of *The Wall Street Journal*. For the original average, Dow chose the stocks of 12 major companies representing different industries from that era. The share prices of each company were simply added together and divided by 12 to calculate the average. As a "price-weighted average," the fundamental method of computing the Dow hasn't changed since its inception. However, the number of stocks represented in the average increased to 20 in 1916 and 30 in 1928.

Am I Diversified?

The 30 companies in the Dow are comprised of large-capitalization domestic equities (capitalization is measured by multiplying a company's stock price times the number of common shares outstanding). Prudent investors allocate their portfolios among many investment styles or asset classes, such as domestic large and small caps, international equities, and fixed-income securities. On a global basis, thousands of company stock- and bond-investments are available to diversify a portfolio. Thus, the



Dow does not reflect how most investors allocate their portfolios.

Portfolio Evaluation?

When evaluating the performance of a portfolio, professional investors use a benchmark which is relevant to their investment strategy. As a result, an investor with a well-diversified portfolio would find the performance of the Dow meaningless.

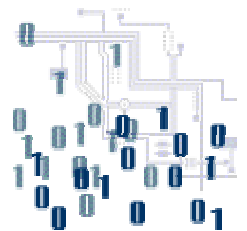


Further, most investors have a total return focus, reflecting returns from both capital appreciation and income (dividends and interest). When a dividend-paying stock is purchased, total return is comprised of stock-price appreciation and the dividend. Even though the well-known Dow primarily consists of dividend-paying stocks, the average only reflects the movement of its component stock prices, not the return from the receipt of dividends.

Historically, dividends have represented more than 40% of the total return of the Standard & Poor's 500 Stock-Index. Combined with recent legislation which maintains lower tax rates on qualifying dividends through 2010, dividends should continue to provide a meaningful portion of an equity investor's total return.

Barometer Computation?

Since the Dow's creation, numerous market barometers, such as those maintained by Standard & Poor's, Wilshire, Russell, and Morgan Stanley, have been developed to measure the performance of baskets of stocks representing various asset classes and/or investment styles. The main difference between the Dow and these other measures is that the Dow is a "price-weighted average," while the other indicators are "market-value weighted indexes."



The calculation of the Dow is based upon the movement of its component stock prices. Each company's weight in the "average" is based upon its stock price. Thus, higher-priced stocks have a larger affect on the average's movement.

The calculation of a "market-value weighted index" is based upon the movement of the market value of the component companies, as measured by market capitalization (again, market capitalization is measured by multiplying a company's stock price times the number of common shares outstanding). Each company's weight in the index is based upon its market capitalization, not an arbitrary stock price. Thus, each company's affect on the index represents the change in underlying-company market value and its relative weight in the index. In addition, some indexes are computed to reflect the payment of dividends.

How Now The Dow?

It has taken the Dow more than six-and-a-half years to eclipse its all-time record. At the same time, broader-market measures such as the S&P 500-Stock Index and the NASDAQ Composite Index have not recovered from their bear-market losses of 2000 through 2002. The S&P 500 is still nearly 10% off its high (1,527.46 on March 24, 2000), while the NASDAQ Composite Index is a sizeable 54% below its peak (5,048.62 on March 10, 2000), requiring that it double to meet its zenith.

The main point is that none of these market indicators represents an appropriately diversified portfolio. The S&P consists of 500 stocks which are among the largest domestic companies, while the market capitalization of the NASDAQ is dominated by technology stocks.

Investors with diversified portfolios recovered from the bear market much sooner and exceeded their highs well before 2006. If your portfolio is just now recovering or has not rebounded from the market sell-off of 2000 through 2002, it is probably not well diversified.

Despite its flaws, it is certainly bullish that the Dow is reaching new milestones, but it should not be confused with portfolio or market performance. Do you know what return your portfolio has generated so far in 2006 or in prior years? You will need to know how your portfolio has performed to determine whether you are on track to reach your goals. Comparing portfolio performance with an appropriate benchmark will also provide insight into how your portfolio and its investments stack up against other similar or alternative investments.

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