

WORLD MARKET SURVEY

U.S. Stocks Improve, Slightly

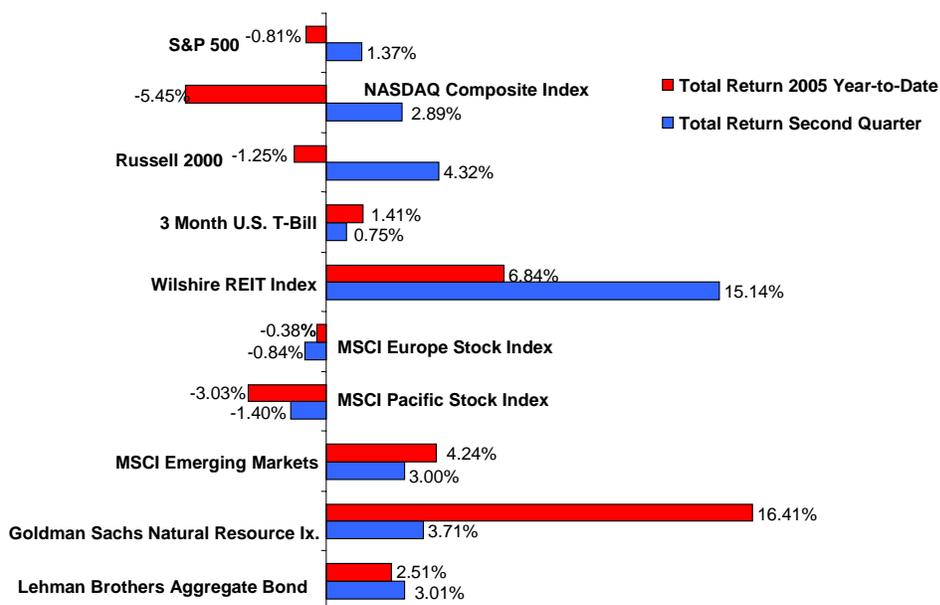
Continuing concerns about oil prices, higher interest rates, and a potentially weakening economy combined to restrain the returns from U.S. stocks during the second quarter. Although most market indices edged higher during the past three months, it was not enough to offset losses incurred during the first quarter. Thus, the total returns for most domestic stock indices remain negative over the year-to-date period.

Foreign Stock Returns Vary

Stock markets in Europe posted solid gains for the quarter, with the Dow Jones Stoxx Index of leading European companies gaining 9.9%. However, an unexpected strengthening of the dollar relative to the euro diminished returns

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Returns from Market Indices: Year-to-Date 2005 & Second Quarter



PLANNING FOR RETIREMENT INCOME

Two Critical Questions

The ability to accurately estimate the future consequences of investment decisions is critical to the design and implementation of reasonable financial strategies. When planning for retirement income distributions, there are two critical questions:

- 1) How much money can be taken from an investment portfolio each month, without incurring too great a risk of completely depleting the portfolio?
- 2) How should the money be invested?

Each question is multidimensional. Figuring an acceptable monthly withdrawal amount requires numerous ancillary decisions, such as identifying the preferred retirement date, determining a minimum size for a "rainy day fund" (more technically, precautionary savings objectives), identifying gift and bequest preferences, and so forth. Investment strategy requires sound decision-making in the areas of asset allocation, active vs. passive asset management strategies, and individual investment selection.

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TIPS: PROMISES & PITFALLS

A Tip By Any Other Name

In January of 1997, the US Treasury first issued bonds with interest payments linked to the urban Consumer Price Index (CPI). Although the technical designation for these special bonds is officially "Treasury Inflation-Indexed Securities," they are more commonly referred to as Treasury Inflation-Protected Securities, or TIPS. While the difference between "Inflation-Indexed" and "Inflation-Protected" may appear to be a matter of semantics, the official name more accurately reflects how the securities operate in practice.

Mechanics of the TIPS Inflation Adjustment

Each year, the Treasury adjusts the bond's principal amount to reflect changes in inflation.¹ Since the bond's coupon payments are a fixed percentage of the accreted principal, they, too, are inflation adjusted. At maturity, a TIPS bond is redeemed for the greater of the inflation-adjusted principal or the original issue 'par' value. During the life of the bond, however, the principal may be adjusted to a value lower than par (in the event of deflation); and, therefore, future coupons may have a dollar value less than the coupon at the time of issue.

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PLANNING FOR RETIREMENT INCOME

The best solution to the retirement income quandary is to follow a process that maximizes the probability of a successful financial outcome.

Few investors fully understand that high percentage returns, earned inconsistently, are generally incompatible with consumption objectives funded through a fixed pattern of portfolio withdrawals.

Not only are the two questions complex, but they cannot be solved either in isolation or sequentially. Rather, the problem is akin to a simultaneous equation: the amount of money that can be spent depends on the amount of money accumulated, which in turn depends on the amount of risk taken, which then depends on personal risk tolerance as well as intended spending targets. The problem is 'circular' in that it begins and ends with retirement income (consumption) targets.

Furthermore, the planning process is dynamic, because several key variables are outside one's control. Inflation, future investment returns, and longevity are just some of the elements that cannot be confidently forecasted. Thus, retirement income planning becomes a multidimensional problem that lacks a fixed, closed form, or analytical solution. The nature of the problem gives rise to a retirement income quandary—what financial decisions should be made today to increase the likelihood of securing a desirable economic future throughout retirement?

Possible Solutions

Two apparently reasonable solutions may be to:

- 1) Manage the portfolio for maximum return; or
- 2) Manage the portfolio for maximum safety.

A 'maximize return solution' seems reasonable (more money is always better than less). However, if investment risk manifests at an inopportune time, this approach may lead to catastrophic downside results (at the limit, portfolio bankruptcy prior to the end of the planning horizon).

A 'maximize safety solution' also seems reasonable (indeed, given a sufficient amount of capital and sufficiently modest consumption and bequest preferences, it is irrational to assume unnecessary risk). However, maximizing safety often entails unacceptable opportunity costs. Decision making based on low-probability, worst-case scenarios may mean that a lifetime of savings is used inefficiently during retirement—you die with a lot of wealth but never have a chance to enjoy it!

Solving the Retirement Income Quandary

The retirement income quandary is the tradeoff between the risk of running out of money prematurely, and, through excessive frugality, the risk of enduring a reduced standard of living despite having worked for many years to save money. The best possible solution to the retirement income quandary is to

follow a process that maximizes the probability of a successful financial outcome. In general, this is neither a process that ignores risk (i.e., seeks to maximize return on capital), nor a process that avoids risk (i.e., seeks to maximize safety of principal).

What does such a process look like? To answer this question, we should first consider some popular nostrums that give rise to spurious solutions. We know that the solution cannot be based solely on specific investment recommendations (buy this/sell that) because such recommendations yield uncertain future results. Nevertheless, many investors charge ahead enthused by the promises of "performance driven portfolios," "superlative track records," "proprietary systems to identify securities with above average growth and earnings potential," "disciplined investing with high quality managers," and other marketing claims that focus primarily on high returns. Nor, unless you are blessed with great wealth, can the best solution assume the form of unproductive conservatism. Absent risk, return expectations must equal the risk-free rate. Unfortunately, the risk-free rate is usually inadequate to meet the legitimate needs and standard of living expectations of most retirees. The task is not to avoid risk any more than it is to ignore it. Rather, the task is to understand and measure risk so that it can be prudently managed to the best advantage.

The Perils of Maximizing Return

Portfolios sometimes fail to achieve investor objectives not because investors neglect to seek maximum return (or maximum safety), but because seeking maximum return (or safety) may be incompatible with maximizing the probability of a good financial outcome. The perils of maximizing return are easy to see from today's perspective on Enron, the NASDAQ meltdown, and other disasters befalling high-flying investment strategies. Nonetheless, investments, such as hedge funds, that offer the promise of high returns, but expose investors to less obvious risk factors, continue to be popular. Beyond the risk of bankruptcy, however, lies a more important observation. Investors spend dollar wealth, not rates of return. Few investors fully understand that high percentage returns, earned inconsistently, are generally incompatible with consumption objectives funded through a fixed pattern of portfolio withdrawals.

The Perils of Maximizing Safety

The perils of maximizing safety are not as easy to see, but are, nevertheless, real. For example, lacking the ability to make intelligent

PLANNING FOR RETIREMENT INCOME

assessments regarding investment risks, investors often default to suboptimal 'rules of thumb' (e.g., the percentage allocation to equity securities should be 100 minus age). Retirees may eviscerate the future purchasing power of their nest eggs because they overweight portfolios toward fixed-income investments that provide little opportunity for inflation-adjusted growth ("spend income only and do not touch principal"). Paradoxically, over time, the safe portfolio may become risky or wealth saved for retirement may go unused. The fear of uncertainty may dominate the desire to maintain a reasonable standard of living.

Risk Assessment and Asset Management

Thus, the optimal solution to the retirement income quandary calls for intelligent risk assessment and prudent asset management. That is to say, the solution is at least two dimensional. It involves an appreciation of the risk/reward tradeoffs of each investment management decision as well as of the interactive results of a sequence of such decisions. Portfolios sometimes fail, not because the retiree has too little money to support consumption objectives, but because imprudent decisions (such as incurring high commissions and expenses) undermine the portfolio's ability to generate adequate long-term income. The investment advisor's job is to help visualize the risks and rewards of decisions. There is no fixed, closed form, or analytical solution to the retirement income problem. As the American social critic H. L. Mencken stated: "for every complex problem there is always a simple solution, and it is always wrong."

What process can be used to make good current decisions in the face of future uncertainty? The question, in many respects, contains the seeds of an answer. It is important to upgrade both the investment selection process and the investment decision-making process. It requires the "care, skill and caution" that characterize prudent investment management.

Care can be defined as extensive consideration of economic objectives (including consumption targets and bequest preferences) before committing to a particular course of action. Skill can be defined as expertise in financial economics and the statistical and quantitative methods underlying modern principles of wealth management. Caution can be defined as an unbiased and critical examination of the likely monetary effects of asset management decisions prior to their actual implementation.

Ideally, investors should assure themselves that current resources are adequate to support future consumption objectives. Current resources are defined as the value of the retirement income portfolio plus the aggregate value of future portfolio additions. These two elements are assets. Consumption and, by extension, gift and bequest objectives, are liabilities that must be funded from these assets. At retirement, most individuals have little or no labor income flexibility ("retirement" means the end of work, and as work ends, so does labor income.) Retirement spending is typically financed through financial assets only. If these assets plummet in value, the economic consequences can be catastrophic. As retirement approaches, investors become acutely aware that their labor income will stop. Consequently, investment decisions become fraught with risk. Investors struggle to avoid paralysis in their decision-making process.

Identifying a Feasible Retirement Date

A feasible retirement date is when the present value of assets equals or exceeds the present value of liabilities. Investors with substantial surplus assets tend to be more risk tolerant than investors with asset values close to liabilities. But asset values go up and down, and liability values change merely because of the passage of time (all else equal, the value of liabilities faced by a 90-year old differ from those faced by a 60-year old). Likewise, although the average life expectancy of a 75-year-old male may be the same as for an 80-year-old female, the 'force of mortality' (i.e., the actual distribution of expected deaths) differs markedly. Planning around averages tends to lead to financial tragedies, because people must live with actual results not average results. Additionally, liability values are as volatile as asset values, and can suddenly increase or decrease based on changes of health, marital status, rates of inflation, and so forth. Values that change randomly are said to be random or stochastic variables.

Reformulating the Problem

Thus, we reformulate the retirement income problem (How much income will be available without depleting the portfolio?/How should money be invested?) as follows:

A successful retirement is possible when the stochastic present value of assets equals or exceeds the stochastic present value of liabilities.

The good news is that we now have a better formulation of the problem. The bad news is that we are faced with randomness everywhere. Retirement seems risky. Unless the investor has vast wealth, perhaps it is better to work until death. In some respects, this is a rational solu-

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tion to the retirement income problem—indeed, such a solution would maximize safety because there would always be labor income. However, for most people, it is not an acceptable solution.

After considering the retirement income issue carefully, investors acknowledge that they do not seek maximum dollar wealth, but, rather, maximum welfare. From one perspective, this is merely the observation that having a pile of money is no fun unless it can be spent on something enjoyable. Economists like to express this concept in jargon phrases like “maximizing the utility of wealth.” The distinction between ‘wealth’ and ‘utility of wealth’ is subtle but important. A single, childless retiree might derive no utility from a bequest; however, a retiree with a spouse and children might be very pleased to pass wealth to the surviving spouse and, ultimately, to the next generation. For the first retiree, an optimal retirement plan would spend the last nickel at the last breath; for the second retiree, large amounts of unspent terminal wealth might generate substantial utility. So money is not just money. We have already determined that optimal retirement income planning is not based on rate of return calculations (rates of return calibrate poorly to stochastic objectives), and now it seems that we have concluded that optimal retirement income planning is not based solely on dollar wealth.¹

Therefore, we offer the following definition of successful retirement income planning:

Successful retirement income planning is the process of portfolio design, implementation, monitoring and revision that enables the investor to maximize the utility of wealth over an uncertain planning horizon.

Successful retirement income planning helps address questions, such as:

- 1) What patterns of consumption and bequest are most important?
- 2) What patterns of consumption and bequest are most likely to be supported by personal wealth?
- 3) How can wealth be invested to ensure asset management decisions align well with spending objectives?

Monte Carlo Simulations Can Help Address the Problem

So, how does one plan for a successful retirement? Fortunately, computers easily answer multi-dimensional stochastic asset/

liability matching problems. The computer application of choice is a Monte Carlo simulation engine used in an asset management framework.² Such an application produces thousands of potential future asset/liability paths including early deaths, late deaths, low inflation, high inflation, good returns, bad returns, and so forth. Just as important, however, is the asset management framework that allows the examination of the consequences of a variety of asset management decisions (intelligent agent behaviors, in the words of economists) over a wide range of possible future economies. The distribution of outcomes helps answer strategic questions, such as:

- ◆ What would retirement look like if a *buy-and-hold* (“benign neglect”) asset management strategy were adopted?
- ◆ What would retirement look like if the portfolio holds 60% bonds, or 20% bonds, or 0% bonds?
- ◆ What would retirement look like under a low cost passively managed or indexed investment strategy?

What does it mean to ask the question: “what does retirement look like?” The answer is that good decision making relies on good information. Good information allows one to project the spectrum of possible future results in order to visualize clearly the risks and rewards of current decisions. Simulating asset management decisions can help investors see their retirement unfolding in terms of success and failure rates. This can help answer practical questions, such as:

- ◆ How many times does the simulated portfolio go bankrupt while a retiree or spouse is still living?
- ◆ How often does a particular asset allocation penetrate a minimum dollar “floor value?”
- ◆ What are the chances of ending up with 20% less wealth in 10 years? What affects might that have?
- ◆ What are the chances of experiencing a 20% drop in asset values over a single 12-month period?
- ◆ Which set of asset management elections gives the highest expected terminal values?
- ◆ What are the tradeoffs between high expected values and portfolio failure rates?

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PLANNING FOR RETIREMENT INCOME

Planning for retirement income is an extraordinarily difficult exercise. The number of interrelated variables makes the problem intractable to most traditional analytical approaches. However, Monte Carlo simulation represents a different path to addressing the problem. Rather than generating a single answer, simulation engines generate thousands of plausible scenarios. By reviewing the distribution of outcomes arising from various inputs, one can rationally consider the future implications of today's decisions. When planning for retirement, perfect foresight is impossible. Consequently, prudent decision making processes are essential—always exercise care, skill and caution. Monte Carlo simulation can be an effective tool for careful, skillful and cautious retirement planning.

¹ Nobel Prize winner Robert Merton provides a good example of this point: “Which would you rather have—\$5 million or \$10 million? Merton reframes the question: Which would you rather have—\$5 million with the opportunity to earn a real (i.e., after-inflation) return of 10% into the future; or \$10 million with the opportunity to earn a real 1%. The \$5 million provides a perpetual yearly income stream of \$500,000, while the \$10 million generates only \$100,000. Only if the planning horizon is ten years or less does the larger amount dominate. Merton concludes: “...end-of-period wealth, or wealth in general, is not a sufficient statistic for financial welfare. Wealth, or income, should be translated into an implied stream of sustainable consumption—unless, of course, we are in a one-period world in which the two match up.” [*Financial Analysts Journal*] (January/February, 2003), p. 18].

² There are many asset management / portfolio optimization software packages available to both individual investors and financial planning / investment management professionals. There are also several simulation programs / advice engines that can be accessed on the Internet or through other venues. Linking the two types of applications can be extraordinarily helpful. The challenge, however, is not so much in producing vast quantities of data; but, in integrating data (i.e., design of ‘bookkeeping algorithms’) and in presenting it in a customized format that reflects the investor's specific preferences regarding wealth accumulation, consumption and bequests.

TIPS: PROMISES AND PITFALLS

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Although TIPS bonds are protected against inflation, investors should remember that inflation is only one component of interest rates. The formula for figuring interest rates is as follows:

Nominal interest rate = expected inflation + transitory impact of monetary policy + compensation for consumption deferral given the investment opportunity set within the general economy.

Stated more simply, nominal interest rates include three elements: expected inflation, the time value of money, and how the Fed is managing the money supply.

The required return on a bond rises as interest rates rise. All else equal, as required returns for bonds rise, the market price of existing bonds falls. Thus, it is quite possible (indeed, very probable) that, when the coupon yield for TIPS is low, TIPS will not protect the investor against the adverse consequences of rising interest rates caused by factors other than increases in expected inflation. Indeed, TIPS investors have encountered periods in which the magnitude of the rise in the economy's underlying interest rate has exceeded the rise in expected inflation. Paradoxically, during such periods, inflation-protected securities lose more value than higher yielding fixed coupon instruments despite the fact that the rate of inflation increases. TIPS, however, are very good instruments to protect a portfolio against shocks arising from unexpected inflation increases; and, over the long-term, TIPS are excellent vehicles for delivering inflation-adjusted “units of consumption” to the investor.

TIPS Value Depends on Investment Objectives

As we review the characteristics of TIPS to determine whether TIPS are appropriate for a given investor, we must necessarily review the fundamental purpose of the investor's portfolio. Consider, for example, a portfolio designated as a “retirement income” portfolio. If the investor has a high preference for gifts and/or bequests, (i.e., leaving money to a surviving spouse, children, or a charity), the investor may be concerned with optimizing the portfolio's terminal wealth. However, if the investor lacks such preferences, any funds remaining at death can be viewed as merely a lost consumption opportunity. The latter type of investor may be more focused on optimizing period-by-period consumption.

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TIPS: PROMISES AND PITFALLS

Elasticity of Intertemporal Substitution in Consumption—Huh?

However, as our main article notes, planning for consumption, in the retirement income portfolio context, is a tricky concept. Some retirement investors may prefer to “back-load” their consumption budget, increasing withdrawals later in life to account for the probability and magnitude of end-of-life costs. These investors are willing to defer consumption in favor of precautionary savings. Conversely, other retirement investors may prefer to “front-load” consumption to fund higher travel and entertainment budgets early in retirement. A third group of retirement investors might prefer a flat-consumption path (adjusted to maintain purchasing power). The willingness to tilt the retirement consumption path is known as the investor’s “elasticity of intertemporal substitution in consumption,” and is an important factor in the design, implementation and monitoring of investment policy for retirement income portfolios.²

If an investor asks the question: “Which investment will produce the highest rate of return?” the vocabulary used implies that the investor seeks to maximize ending-period-wealth. If an investor asks the question: “How much can I spend during retirement to assure a reasonable and secure standard of living?” the vocabulary implies that the investor seeks to maximize period-by-period consumption.³ These are important distinctions because certain financial instruments such as annuities and TIPS can have great value in one context, but little or no value in another.

TIPS May Help Resolve Financial Planning Debate

Furthermore, the presence of TIPS in the marketplace provides investors with a vehicle that may “solve” a long-standing controversy for retirees—namely, should the retiree tilt the portfolio towards stocks with a higher expected return, or towards bonds with increased safety of principal. Much financial planning advice suggests that retirees, because they no longer have the financial flexibility provided by labor income, should not own volatile assets such as stocks. Therefore, the conventional advice is to buy lower volatility fixed income instruments (e.g., bonds). However, low volatility assets do not produce attractive total returns; and, retirees faced with longevity risk may find that their portfolios produce a return inadequate to discharge important long-term economic objectives. Although fixed income instruments may seem risk-free from the point of view of a short-term investor, they become very risky from the

point of view of a longer-term investor because they must be reinvested at uncertain future interest rates. However, an inflation-protected bond, although potentially risky for a short-term investor, can be seen as a “safe” asset for a long-term investor because it supports a stable long-term standard of living. In a controlled-inflation environment, TIPS may perform much like fixed nominal coupon bonds,⁴ however, in a more volatile inflation environment long-term fixed-coupon bonds, despite having high coupon yields, are not a safe asset compared to TIPS.⁵ Thus, if the purpose of wealth is to generate income for consumption, TIPS may be a particularly desirable investment.

¹ Both coupon payments and principal adjustments are currently taxable events. However, principal adjustments are not paid to the investor until the bond matures. Consequently, TIPS are usually not considered suitable investments for taxable accounts for high bracket investors.

² Elasticity of intertemporal consumption not only refers to the subjective discount rate preferences that equate the enjoyment of future spending to current spending but, also, to the willingness to spend the same fraction of wealth during times of depression/recession as well as during times of prosperity.

³ More precisely, maximizing the utility of intertemporal consumption. Such an investor is very concerned with bankruptcy risk because running out of money has been known to produce a great amount of “disutility” for people who like to eat.

⁴ Indeed, TIPS may underperform because nominal fixed-coupon bonds offer investors a premium to compensate for unexpected inflation risk.

⁵ Technically inclined readers may be interested to learn that under the traditional Capital Asset Pricing Model, a maximize-end-of-period-wealth investor would tilt away from long term bonds because of their inferior Sharpe (reward-to-risk) ratios. Under the Intertemporal Capital Asset Pricing Model developed primarily by Nobel Prize winner Robert Merton, long term bonds may be a valuable hedging instrument because the interest rate decreases resulting in lower coupon reinvestment income for future consumption, are offset by bond price appreciation. At the extreme, investors for whom wealth produces no utility whatsoever (i.e., wealth is important only because it finances consumption; and, only consumption produces utility), the most valuable financial instrument is an inflation-adjusted annuity.

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SURVEY OF INDICES & FUND AVERAGES
PERIOD AND ANNUALIZED COMPOUND RETURNS IN PERCENT

	Second Quarter 2005	Year to Date 6/30/05	3 Years Ending 6/30/05	5 Years Ending 6/30/05	10 Years Ending 6/30/05
Inflation Index & Risk Free Rate					
Consumer Price Index	0.57	2.15	2.62	2.43	2.46
U.S. 3-Month Treasury Bills	0.75	1.41	1.56	2.49	3.87
U.S. Stock Market (Large Companies)					
Standard & Poor's (S & P) 500 Index	1.37	-0.81	8.28	-2.37	9.93
S & P/Barra Large Cap Growth Index	0.14	-1.73	6.43	-7.87	9.13
S & P/Barra Large Cap Value Index	2.59	0.10	10.09	3.35	10.30
Average Large Cap Blend Fund ‡	1.41	-0.60	7.44	-1.79	8.61
U.S. Stock Market (Small Companies)					
Russell 2000 Index	4.32	-1.25	12.81	5.71	9.90
Dimensional US Micro Cap Fund	3.93	-2.75	16.00	11.40	13.92
Russell 2000 Growth Index	3.48	-3.58	11.37	-4.51	5.16
Russell 2000 Value Index	5.08	0.90	14.15	16.12	13.89
Average Small Cap Blend Fund ‡	3.31	0.21	12.75	9.96	11.99
Real Estate					
Wilshire REIT Index	15.14	6.84	21.13	20.97	15.63
Fixed Income (Bond) Markets					
Lehman Government Bond Index	3.36	2.93	5.41	7.06	6.63
Average Intermediate Gov't Bond Fund ‡	2.37	2.00	4.09	5.99	5.64
Lehman Municipal Bond Index	2.93	2.89	5.85	6.88	6.38
Avg. California Intermed/Short Muni Bond ‡	2.13	1.55	3.71	4.87	4.84
CSFB High Yield Bond Index	1.90	0.77	14.11	8.51	7.60
Average High Yield Bond Fund ‡	1.90	0.33	12.08	5.47	5.82
Citigroup World Gov't Bond Index	-1.43	-3.97	9.82	7.91	5.51
Average World Bond Fund ‡	-0.09	-2.00	9.08	7.50	6.66
International Stocks					
MSCI EAFE Foreign Stock Index	-1.01	-1.17	12.06	-0.58	5.22
Average Foreign Large Blend Stock Fund ‡	-0.75	-1.20	9.51	-2.51	5.73
MSCI Europe Stock Index	-0.84	-0.38	12.60	0.56	9.17
MSCI Pacific Stock Index	-1.40	-3.03	10.81	-3.11	-0.39
MSCI Emerg Mkt Index (excl. dividends)	3.00	4.24	20.91	4.90	1.84
Average Emerging Markets Fund ‡	3.88	5.19	22.48	7.42	5.29

‡ Source: Morningstar Principia 6/30/05

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markedly for U.S. investors. The dollar, which had been rising gradually this year along with short-term interest rates, shot up in value after voters in France and Holland rejected the constitution for the new European Union. The "no" vote is testing efforts to unify the euro-zone economy. Nonetheless, the MSCI Europe Index, when measured in local currency, finished the quarter with a gain of 4.5% bringing the year-to-date return to more than 8%. When measured in dollars, the index has declined slightly, losing 0.8% for the quarter and 0.3% year-to-date.

In the Pacific, Japan's market was flat for the quarter, although smaller Asian markets posted decent gains. Once again, the resurgent dollar subtracted value for U.S. investors. The aggregate MSCI Pacific Index is down 3.0% for the quarter and 1.4% for the year-to-date, when measured in dollars. The emerging markets posted positive returns during the quarter, in local currency and dollar terms. The dollar adjusted MSCI Emerging Markets index gained 3.0% for the quarter and 4.2% for the year.

Bond Market Proves Resilient as Short-Term Rates Go Up

Bond prices remained steady during the quarter despite the Federal Reserve's policy of raising short-term interest in six-week intervals. The Fed's target rate increased from 2.75% to 3.25% during the quarter. The boost in short-term rates had little effect on the widely followed 10-year Treasury Note, which saw its yield decline slightly during the quarter to 3.92%. Fed Chief Alan Greenspan referred to the flattening yield curve as a "conundrum".

The slight decline in intermediate and longer term Treasury rates was helpful to existing bond holders. The Lehman Aggregate Bond Index gained 2.5% for the quarter for a total return of 3.0% for the year-to-date.

Real Estate and Commodities

Low mortgage rates and a heated market in several regions around the country fueled talk of a real estate bubble. Prices for Real Estate Investment Trusts (REITS) jumped in sympathy during the second quarter, as investors chased both the asset class and the seemingly attractive yields. The Wilshire REIT Index advanced 15.1% in the second quarter, erasing a 7.2% loss in the first, for a year-to-date gain of 6.8%

With oil prices topping \$60 per barrel, the Goldman Sachs Natural Resources Index advanced 3.7% for the quarter. The year-to-date return on the energy dominated index is 16.4%.

Individual Country Returns Second Quarter 2005

	U.S. Dollar	Local Currency
North America		
United States	1.71%	1.71%
Canada	1.85	3.11
Latin America		
Brazil	5.66	-6.15
Chile	3.15	1.99
Mexico	9.81	5.87
Venezuela	-8.37	-17.14
Africa		
South Africa	-0.51	6.68
Europe		
Austria	3.71	11.34
Belgium	-7.73	-0.94
Denmark	1.28	8.76
Finland	4.18	11.84
France	-2.60	4.56
Germany	-3.26	3.85
Ireland	1.82	9.30
Great Britain	-1.06	4.30
Italy	-6.79	0.06
Netherlands	-1.59	5.65
Norway	4.25	7.94
Portugal	-11.08	-4.54
Spain	-1.34	5.91
Sweden	-3.26	7.26
Switzerland	-1.95	5.39
Asia		
Australia	2.33	3.85
Hong Kong	5.74	5.39
Indonesia	-0.33	2.72
Japan	-3.46	0.01
New Zealand	2.27	4.79
Philippines	1.84	3.69
Singapore	1.66	4.00
South Korea	0.33	2.11
Taiwan	4.14	4.51
Thailand	-4.76	0.61

Source: Dow Jones Global Indexes

INVESTMENT QUARTERLY

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