

Morningstar[®] Market Commentary

1st Quarter 2007

Morningstar Market Barometer™



The good cheer markets had retained at the start of 2007 seems in jeopardy at the end of the first quarter. The momentum from last year's strong finish lasted well into February, but since then, markets have shown violent fluctuations. Consider this: the worst and the best weekly returns since almost the start of the bull market in 2003 both occurred in the final stage of the recently concluded quarter. The Morningstar US Market Index registered a 4.5% slump in the week ending March 2nd. And then two weeks later—through the week ending March 23—the benchmark index jumped 3.6%. Overall, the Morningstar US Market Index was up 1.4% through the end of the quarter, well off the highs scaled earlier in the year.

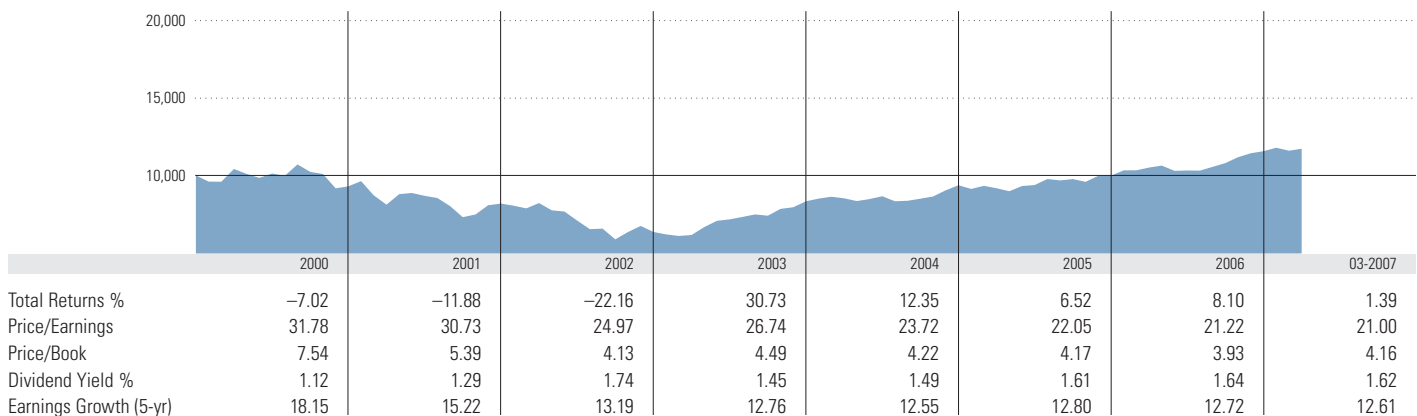
The current bout of indecisiveness is understandable, however, as markets are grappling with some tricky macroeconomic questions. Chief among them is the fate of the U.S. housing market. What began last autumn as rumblings in the form of an increase in cases of late payments in the subprime mortgage segment, has now graduated to a full-blown meltdown with mounting defaults and bankrupt lenders. The malaise could spread further into the housing market and the broader economy. The fear is that a loss of liquidity in the housing market, would depress home prices, which would then have a trickle-down effect on consumer spending and hurt employment. And due to signs of

sticky inflation in the economy, many fear that the Federal Reserve has limited flexibility to rescue the situation by cutting interest rates.

Still, market bulls have some ammunition to counter these gloomy scenarios. Globally, economic growth looks to be solidly on pace, and liquidity plentiful. The developed markets of Europe and Japan have retained strength despite the increasingly serious signs of slowdown in the U.S. Moreover, emerging markets, unlike almost any time in their past, are proving to be a source of stability to the global economy due to their continued robust growth and sound finances. To what extent these stabilizing influences from abroad can remain in place amidst a deeper slump in the U.S. is debatable, but many believe they will. Indeed, risky assets such as high-yield and emerging market bonds have held up remarkably well amidst the recent turbulence. Finally, merger and acquisition activity does not show signs of abating anytime soon, which suggests there is still abundant cash out there to keep markets lubricated.

Amidst these macroeconomic debates and market turbulence, it might be a particularly good idea at this time to look at markets more microscopically. Looking at how the various Morningstar Style and Sector Indexes have fared may help settle nerves and suggest fundamentally sound investing ideas.

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



Surveying the Sectors

Utilities easily took the top spot among sectors. These stocks have led just about all other areas of the market in recent years, and fresh takeover activity gave them yet another triumphant quarter. Power generator TXU Corp. received the largest leveraged buyout bid in history from two prominent private equity firms, making the stock the biggest contributor to the Morningstar Utilities Index. Although the threat of regulatory backlash against such deals remains, many peers such as Public Service Enterprise Group Inc. and Constellation Energy Group Inc. posted lavish gains amid merger speculation.

to generate plenty of cash, possess strong competitive advantages, and are trading at bargain prices to boot. Lackluster business spending has also depressed hardware stocks.

With two champion sectors, utilities and industrial materials, under its belt, the Morningstar Manufacturing Super Sector Index (which also includes consumer goods and energy sectors) led by miles in the first quarter. The Morningstar Service Super Sector Index finished a distant second, as decent performances in business and consumer services areas were marred by the troubles in financial services stocks. With both technology hardware and software stocks badly out of favor, the Morningstar Information Super Sector Index finished last.

Morningstar Sectors: 1st Quarter 2007 Return %

	Quarter	1 Year	3 Year
Information	0.40	10.14	6.81
Software	-1.64	10.27	9.53
Hardware	-0.83	1.05	2.67
Media	-0.67	21.05	5.83
Telecommunication	6.93	26.46	17.38
Service	-0.09	10.25	9.82
Healthcare	1.54	7.59	6.87
Consumer Services	1.93	8.01	8.12
Business Services	2.87	7.98	16.04
Financial Services	-2.47	13.41	10.92
Manufacturing	4.09	17.83	17.51
Consumer Goods	1.97	17.86	9.39
Industrial Materials	4.59	13.49	14.69
Energy	3.26	16.87	29.21
Utilities	9.35	36.55	22.47

Takeover speculation also sustained the telecommunications rally of last year. Stocks such as NII Holdings Inc., which provides wireless services in lucrative, high-growth Latin American markets, surged after global telecom behemoths continued to show willingness to buy out smaller companies.

Understandably, the financial sector finished dead last in the first quarter. The subprime lending meltdown has sent several smaller lenders en route to bankruptcy. Even larger players like Washington Mutual Inc. and Countrywide Financial Corp. have had their stock price wither in the meltdown.

Software has struggled to keep up with the rest of the market throughout the current bull run, and the first quarter was no exception. Businesses have been rather cautious spenders on their technology infrastructure, a trend that shows no sign of abating with latest reports suggesting further dips in capital investment. Still, companies like security software vendor Symantec Corp. and accounting software developer Intuit Inc. continue

Industry Performance

At the industry level, raw materials such as rubber products, metal products and steel/iron finished the quarter among the winners, surprisingly so considering a generally softening economy. However, those industries enjoyed a steady or improving pricing environment due to strong global demand for capital goods. Overall, economic growth and spending on infrastructure projects remain especially strong in emerging markets, keeping prices of industrial goods high.

Homebuilder stocks finished deep in the red as home prices fell for the first time in years, and backlogs of unsold homes rose to alarming levels. Surprisingly, REITs held up well as institutional demand for real estate exposure continues to support stocks in that industry. Biotechnology was another troubled industry in the first quarter, led by Amgen Inc.'s sharp, double-digit loss. Investors fled Amgen after the firm suffered setbacks in the development of its key cancer drug and safety concerns regarding its existing anemia treatments.

Top and Bottom Five Industries:

1st Quarter 2007 Return %

Steel/Iron	23.57
Mining (Nonferrous & Nonmetals)	22.93
Oil/Gas Products	22.81
Metal Products	17.72
Education	15.68
Gold & Silver	-7.17
Finance	-7.68
Contract Manufacturers	-8.14
Savings & Loans	-9.09
Home Building	-18.98

Style and Market Cap Indexes

It's no secret that growth stocks, especially large growth stocks, have had a mighty rough struggle keeping pace with rivals in other corners of the style box since soon after the turn of the century. This sustained underperformance has led many observers to pound the table for large growth, and many believe 2007 could finally be the year. Signs look at least partly encouraging through the end of the first quarter. The Morningstar Large Growth Index has opened up a sizable lead over its Large Core and Large Value peers, and the Morningstar US Growth Index has also dominated. Across the market cap spectrum, however, large-cap stocks continue to lag. As they have for the past several years, mid-cap stocks remained the market's sweet spot in the first quarter.

Morningstar US Value Index +1.5%

Value stocks had their pockets of strength in the first quarter, though housing-related woes alone proved a formidable hurdle. Utility stocks thrived as merger and takeover speculation drew swarms of investors. Industrial materials stocks had the best of both heightened

takeover activity and sustained demand for raw industrial goods across the globe. For example, Alcoa Inc., the world's largest aluminum producer, surged after reported takeover plans considered by Australian mining giants BHP Billiton and Rio Tinto. Financials stocks detracted heavily, however. A string of smaller home lenders such as NovaStar Financial Inc. and Accredited Home Lenders Holding Co. slumped to the brink of bankruptcy, but even stalwarts like Citigroup Inc. and Bank of America Corp. did not escape the negative sentiment. As a result, value stocks surrendered a long-held lead to their growth counterparts.

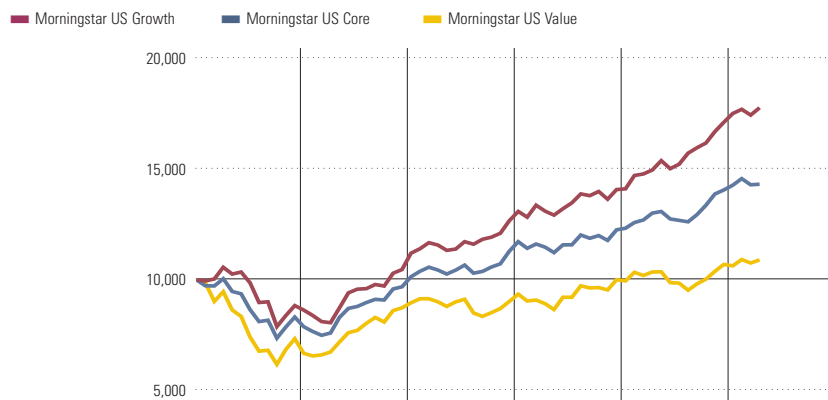
Morningstar US Core Index +0.3%

Markets gave negative verdicts on key blue chip core stocks, resulting in the Morningstar US Core Index's poor showing. Despite strong operating performance at Microsoft Corp., investors remain fearful that "Software as a Service" upstarts (companies that deliver software and a host of services to their customers over the Internet) would chip away at the software giant's empire by delivering cheaper applications. Advanced Micro Devices Inc. suffered big losses in the first quarter due to a downturn in semiconductor demand and a bruising price war with arch-rival Intel Corp. (which also fell in the quarter but not as much). Motorola Inc. has been dogged by admission that its key mobile handset business isn't faring well enough against the competition.

Morningstar US Growth Index +2.5%

Despite a struggling technology sector and a subdued healthcare arena, growth stocks produced enough winners to finish ahead of value and core rivals. Yahoo! Inc. made up for a big chunk of last year's painful loss by launching its enhanced search engine across several platforms and ahead of schedule. Somewhat similarly, Corning Inc. is getting ample recognition from investors for its commanding market position in Liquid Crystal Display components after markets mostly ignored the stock last year. Gilead Sciences proved a bright spot in an otherwise bleak quarter for biotechnology stocks, as the company blew past earnings expectations. On the other hand, Oracle Corporation brought relief to a besieged software sector by beating expectations and doing a solid job of absorbing its acquisitions.

Morningstar Style Indexes: Growth of \$10,000



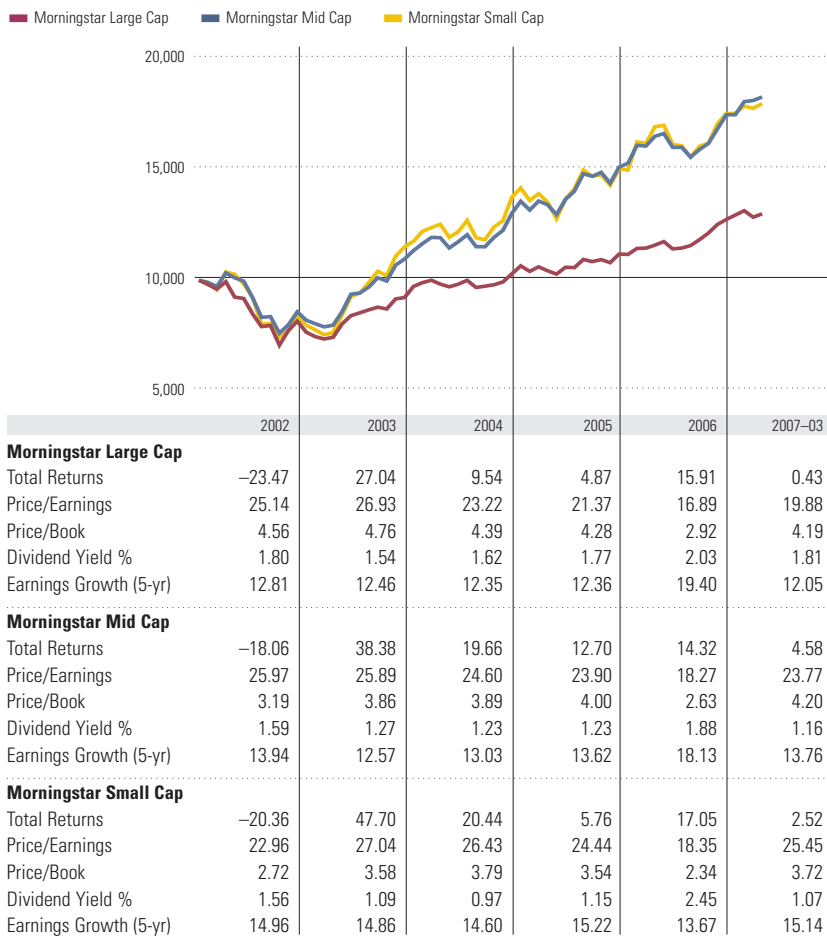
	2002	2003	2004	2005	2006	2007-03
Morningstar US Value						
Total Returns	-13.68	29.75	16.85	7.82	24.10	1.50
Price/Earnings	20.53	18.58	16.79	14.98	13.26	15.56
Price/Book	2.17	2.83	2.57	2.53	2.13	2.62
Dividend Yield %	3.40	2.69	2.68	2.89	2.81	2.73
Earnings Growth (5-yr)	9.08	8.48	8.77	8.00	14.101	8.63
Morningstar US Core						
Total Returns	-21.18	28.63	15.62	5.19	15.76	0.30
Price/Earnings	21.46	23.75	21.90	20.92	18.09	20.47
Price/Book	4.24	4.64	4.33	3.95	2.98	4.10
Dividend Yield %	1.59	1.27	1.30	1.43	1.68	1.52
Earnings Growth (5-yr)	12.46	12.11	11.89	12.13	20.40	11.64
Morningstar US Growth						
Total Returns	-33.20	34.12	4.37	6.41	6.83	2.53
Price/Earnings	32.89	38.45	33.50	30.62	24.20	27.75
Price/Book	5.61	5.93	5.96	6.04	4.04	5.90
Dividend Yield %	0.50	0.43	0.40	0.53	1.04	0.53
Earnings Growth (5-yr)	17.52	17.26	17.74	18.17	28.84	17.94

Morningstar Large Cap Index +0.4%

A combination of stock-specific factors and pervasive negative sentiment surrounding certain industries caused large-cap stocks to trail mid- and small-cap rivals yet again. Graphics chip designer NVIDIA Corp. sank due to a depressed market for its products and renewed competitive threat from market leader Intel Corp. Large financial companies, including giant insurer American International Group, Inc. suffered as worries regarding subprime home loans spread far and wide. Johnson & Johnson took a slide as fresh regulatory woes involving possible kickbacks in some of its overseas units compounded an already uncertain picture of the firm's pharmaceutical business.

Morningstar Mid Cap Index +4.9%

Mid-cap stocks strongly outperformed both small- and large-cap peers, as they have for the past several years. MEMC Electronic Materials Inc. has already had a huge year, as analysts perceive the tight supply conditions in the company's silicon-wafer market to persist. Indeed, MEMC found itself in a sweet spot in what has proven a tough year for semiconductor-related stocks. Mid-sized utility stocks such as Constellation Energy Group Inc. have thrived on merger speculation since the announcement of a massive buyout offer for TXU provoked hopes of vigorous consolidation in the industry. Oil refiners have also had it rather good, as the likes of Tesoro Corp. have maintained their bumper profits of recent years as refining capacity remains tight.

Morningstar Cap Indexes: Growth of \$10,000**Morningstar Small Cap Index +2.5%**

Small-cap stocks posted middling results. Acquisition activity continued to play a big role, boosting the fortunes of WebEx Communications Inc., for example. That developer of Web-conferencing software thrived upon the announcement of an agreement to be acquired by networking giant Cisco Systems Inc. Some small companies such as CF Industries Holdings Inc., which benefited in the first quarter from strong demand and low raw material costs in the chemical industry, found themselves in favorable niches. The Morningstar Small Cap Index's performance was marred, however, by a host of small home lenders who suffered cruelly due to the subprime meltdown. The biggest debacle of the quarter was New Century Financial, one of the nation's largest subprime lenders, which recently declared bankruptcy. Homebuilder Beazer Homes USA Inc. also paid a steep price for being in the wrong business at the wrong time.

Active vs. Passive, 1st Qtr 2007

	Value	Core	Growth
Large Cap	61.19	91.70	39.16
	0.82	-0.90	1.58
Mid Cap	47.50	36.77	22.11
	4.19	4.35	5.22
Small Cap	81.06	66.84	36.40
	1.31	2.40	3.85

○ Percent of actively managed mutual funds outperforming their respective benchmark. Includes the oldest share class for all U.S. diversified mutual funds with at least a one-year history. As of March 30, 2007 there were 2,558 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 (%), 1st Quarter, 2007

Fund Categories vs. the Benchmarks

Active managers beat their relevant style-based Morningstar indexes in four out of the nine style benchmarks, which is a decent showing as these things go (the pickings were much slimmer toward the end of 2006, for example). Once again, the fund categories whose respective indexes performed solidly proved the hardest for active managers to earn their keep.

The widest margin of underperformance was in mid-growth funds, which averaged 1.3% below the Morningstar style benchmark. The Morningstar Mid Cap Indexes' strong showing, and their "style-purity" (for example, only mid-cap stocks that display strong growth characteristics fall in the Morningstar Mid Cap Growth Index, which means the index reaps much of the performance characteristics of that style) made it difficult for active managers to add value.

The symmetry was almost perfect in categories that did not do so well, as in large core, for example. The Morningstar Large-Core Index's subdued performance in the quarter went in hand with an impressive display by active managers, the average large-blend fund outpacing the index by 2%. Small-value, large value and small core were the other three categories where active managers beat their respective indexes, with generally bigger margins of victory for active managers in categories whose corresponding indexes had poorer performance.

Conclusion

The recent rise in market volatility and slowing macro-economic trends in the U.S. may well signal that the bull market, now in its fifth year, is starting to tire. Many observers are also pointing to signs of excess in debt markets, which is often a potent indicator of a turn in the market cycle.

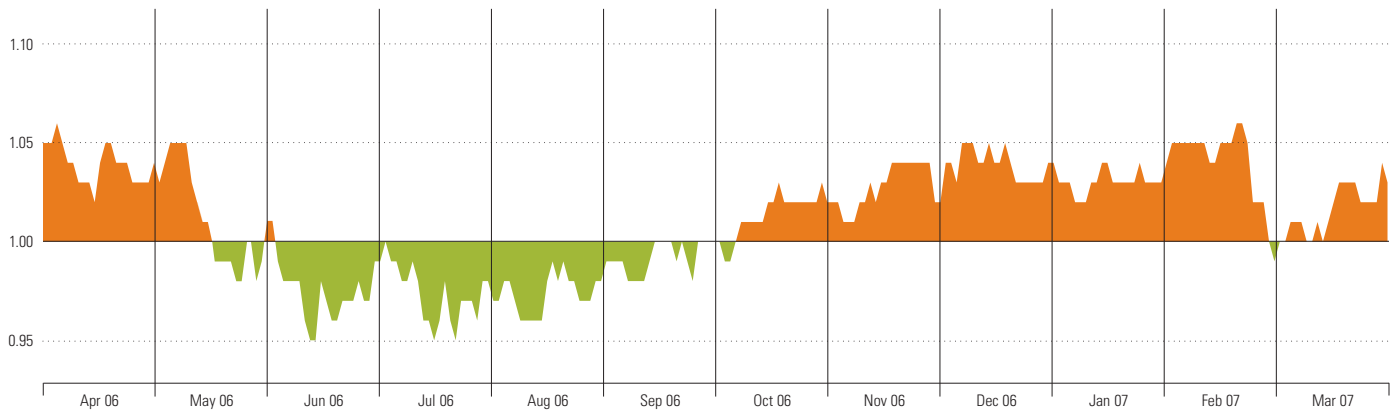
Morningstar analysts acknowledge, however, that it is extremely difficult to tell when markets are past their peak, and that there could be several small rallies before a bear market truly sets in. Instead, Morningstar analysts' conclusions about the broad market are based on detailed fair value calculations on more than 1,900 domestic and international stocks. On that basis, the overall stock market does look slightly expensive, but prices are not alarmingly high relative to historical valuation levels. Thus, this market will probably not disappoint those who keep their expectations modest.

The one area where Morningstar analysts continue to see good value on a relative basis is in large-cap stocks. Overall, markets aren't exactly cheap right now, but larger companies are farther away from historical peak valuations than small- and mid-cap companies. If the multiyear trend of record-high profit margins falters a bit, investors are likely to put a premium on blue chip companies that generate stable cash flows.

Arijit Dutta
Analyst

Market Valuation

■ Overvalued ■ Undervalued



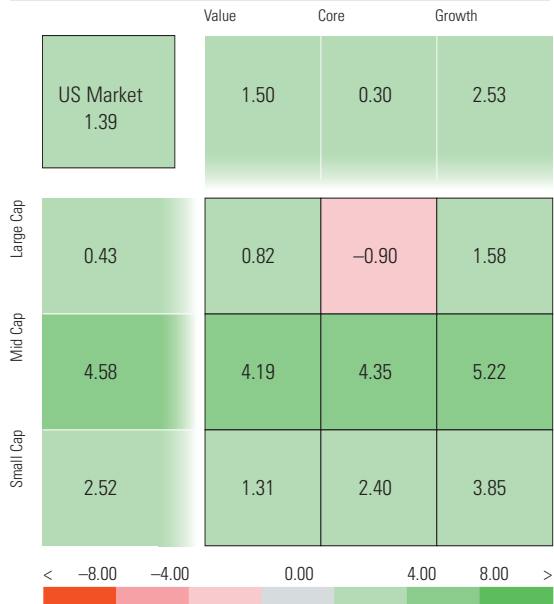
52-Week High 1.06 (04-05-06)	52-Week Low 0.95 (07-21-06)	All-Time High 1.14 (12-01-04)	All-Time Low 0.78 (10-09-02)	1st Quarter Close 1.02 (03-30-06)
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Market Valuation Chart

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 US Market	1.39	8.51	11.48	11.14	7.29	8.51
Large Cap	0.43	7.12	12.20	9.79	5.52	7.34
Mid Cap	4.58	12.98	10.77	15.33	12.08	11.25
Small Cap	2.52	11.01	6.20	12.80	11.60	11.24
US Value	1.50	9.85	18.80	15.39	10.94	NA
US Core	0.30	7.09	10.02	11.10	7.33	NA
US Growth	2.53	8.65	5.28	6.57	2.87	NA
Large Value	0.82	8.90	20.21	14.87	9.71	NA
Large Core	-0.90	5.29	10.05	9.99	5.46	NA
Large Growth	1.58	7.24	5.78	3.92	0.55	NA
Mid Value	4.19	13.46	16.31	17.36	14.07	NA
Mid Core	4.35	12.99	11.08	14.11	12.40	NA
Mid Growth	5.22	12.47	5.33	14.36	8.98	NA
Small Value	1.31	10.38	9.68	14.30	13.92	NA
Small Core	2.40	11.27	8.62	15.02	13.42	NA
Small Growth	3.85	11.31	0.43	8.91	7.08	NA

Morningstar Market Barometer 1st Quarter Return %**Morningstar Market Barometer Trailing 4 Quarters Return %****2nd Quarter 2006**

5.50	4.06	1.49
6.43	7.77	9.52
10.86	14.22	13.78

3rd Quarter 2006

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

4th Quarter 2006

7.47	6.55	3.34
2.65	2.34	-1.78
3.08	1.17	-1.94

1st Quarter 2007

0.82	-0.90	1.58
4.19	4.35	5.22
1.31	2.40	3.85

Biggest Positive Influence on Morningstar US Market Index

	Style	Contribution %	QTR	1-Year	3-Year
AT&T Inc.	■	0.10	11.45	52.57	23.10
Abbott Laboratories	■	0.08	15.23	34.84	13.55
Qualcomm Inc.	■	0.06	13.22	-14.69	9.79
Valero Energy Corp.	■	0.05	26.33	8.56	63.74
Yahoo! Inc.	■	0.05	22.51	-3.01	8.90
Schlumberger Ltd.	■	0.05	9.71	10.13	30.70
Apple Computer Inc.	■	0.05	9.51	48.13	90.23
Corning Inc.	■	0.04	21.54	-15.53	26.73
Dow Chemical Co.	■	0.04	15.87	17.19	7.91
Altria Group Inc.	■	0.04	3.37	29.24	22.78

Biggest Negative Influence on Morningstar US Market Index

	Style	Contribution %	QTR	1-Year	3-Year
Citigroup Inc.	■	-0.13	-6.92	13.12	3.66
Microsoft Corp.	■	-0.11	-6.34	3.91	8.74
General Electric Co.	■	-0.11	-4.22	4.76	7.93
Johnson & Johnson	■	-0.10	-8.19	4.17	8.20
Amgen Inc.	■	-0.10	-18.20	-23.19	-1.32
Cisco Systems Inc.	■	-0.07	-6.59	17.81	2.70
Merrill Lynch & Co. Inc.	■	-0.07	-11.95	5.10	12.55
American Int'l Group Inc.	■	-0.06	-5.97	2.72	-1.18
Bank of America Corp.	■	-0.05	-3.39	16.88	12.59
Time Warner Inc.	■	-0.05	-9.22	18.81	6.07

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 to Launch Family of Fixed-Income Indexes

Morningstar announced plans to launch a family of investor-friendly fixed income indexes with a focus on transparency and "investability." In addition to serving as tools for portfolio benchmarking and performance measurement, the Morningstar Indexes can be licensed to institutions for the creation of investment vehicles. Morningstar expects to launch these indexes in stages beginning in May 2007. The initial indexes will cover the core fixed income categories of Government, Corporate, and Mortgage bonds.