

Strategic Insight

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This latest issue of SI's *Windows* observes the reassuring patterns of mutual fund flows lately. Mutual fund fees and costs, including some highlights of Fiscal 2005 fees and management company profitability trends, are summarized. Innovative investment strategies in the US and in Europe are also discussed.

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Perspectives: NAV Corrections, Investor Acceptance



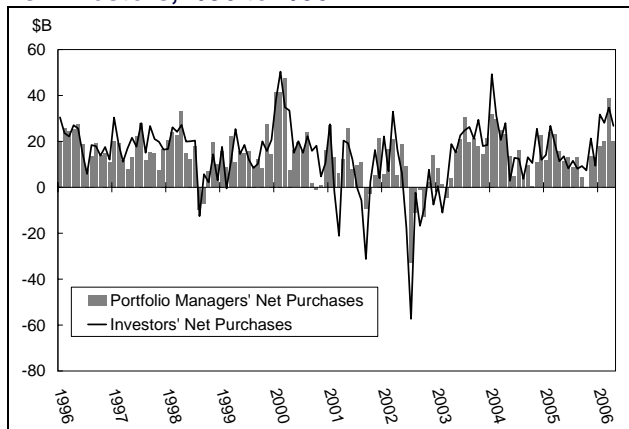
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Equity funds have given up about 5% of their value, on average, during the second quarter, following a market peak in early May and subsequent retraction on a worldwide basis. NAV declines were sharper in selected areas, most notably, emerging markets.

Portfolio Managers Always Buffer Redemption Actions

Falling stock and bond prices, rising inflation and interest rates, energy prices and availability, and other sources of economic uncertainty may result in further reduction of flows into stock funds and periodically elevated withdrawal activity. In that context, we share our perspective on net purchases of equities within mutual funds, by investors and by portfolio managers.

Equity Fund Net Purchases: Portfolio Managers vs. Investors, 1/96 to 4/06



Source: Strategic Insight Simfund, ICI

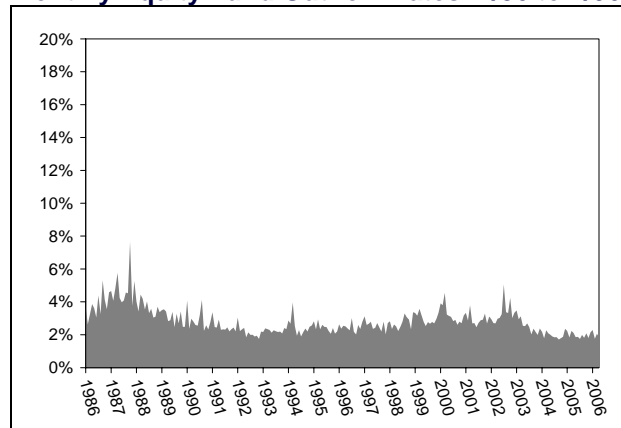
Historical data going back 20 years shows that aggregate net redemptions by investors happened infrequently and were limited in scope and duration. **During such redemption periods, portfolio managers of stock funds, in aggregate, served as a**

buffer against the effects of stock market volatility, and sold fewer stocks than did fund shareholders.

More History Lessons

Today, fund shareholders' aggregate redemption activity runs at its lowest level in the modern history of the mutual fund industry.

Monthly Equity Fund Outflow Rates: 1/86 to 4/06



Source: Strategic Insight Simfund, ICI

It is at times speculated that investors in equity funds would accelerate their redemption activity and trigger a self-reinforcing security price decline in a bear market. This belief, while intuitively appealing, contradicts the empirical evidence collected during the past four decades of mutual fund experience, both in the US and in selected foreign markets.

Repeatedly, **in times of financial uncertainty, investors have been found to reduce (not increase!) the turnover of their financial assets. The emerging principles of behavioral economics** (e.g., loss aversion) partly explain such inaction. **Redemption activity tends to fall in a bear market, with the exception of brief and modest spikes during sharp down-market months.** No historical evidence (including data from the 1970s in the U.S., 1987 worldwide, Japan's 1990s bear market, or the periodic stock market dips in the 1990s and early in this decade) confirms the alarmist viewpoint of aggregate equity fund redemptions. Of course, while overall industry redemption patterns are comforting, individual funds and fund managers constantly face the risk of rapid asset withdrawals.

The major change for equity funds in the next bear market, as in the past, will not be overwhelming redemptions, but lower new purchases. However, persistent retirement investing, dollar-cost-averaging, lifecycle and other asset allocation programs, and some opportunistic buying should persist even in a bear phase. As a result, we do not project sustained equity fund net redemptions early in a bear market period.

Fund FlowWatch: May Results, Looking Ahead



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Recent Flow Trends Reassuring

During May, NAVs fell, on average, roughly 3% for US equity funds and about 5% for international equity funds. Losses from the stock markets' May peak were even greater. So far in June, prices retreated a further 4-5%, on average, erasing 2006 gains.

Mutual Fund Flow Trends; Excludes ETFs and VAs				
	Est. YTD Returns	Net Flows \$B		
		3/06	4/06	5/06
US. Equity / Hybrid	0%	11	8	-7
Int'l / Global Equity	3%	19	18	8
Tax-Free Bond	0%	1	0	0
Taxable Bond	0%	5	2	0
Money Market	2%	-13	-28	48

Source: Strategic Insight Simfund

With the expected slowdown in sales and somewhat higher defensive redemption activity, stock fund flows moderated. Yet, in our view, these modest reactions to the worldwide stock market declines reflect underlying investor acceptance of such volatility as well as on-going confidence. (Note the table above excludes ETF flows, which, due to traders' and institutional activity, including shorting, at times distort analysis of the demand pattern of "core" mutual fund customers).

We would also argue that the structural changes the fund industry has been going through in recent years, with more mutual fund investments occurring within some form of "asset allocation," are also slowly reducing both the opportunities and the temptations to "time the market ups-and-downs." For example, inflows into lifecycle and other fund-of-fund programs totaled \$6 billion in May, just a little under the monthly averages earlier in 2006.

While US Equity/Hybrid funds suffered modest redemptions last month, such withdrawals equaled only 0.2% of assets. International funds continued to benefit from inflows.

The worst NAV declines came in developing/emerging markets. Yet redemption activity in diversified emerging market equity funds was limited on a net basis to about \$200 million in May, or less than 0.5% of their beginning assets. Higher redemptions were experienced among Latin America funds (about 5% of their \$9 billion was net redeemed last month).

Among bond funds, the anticipation of further increases in interest rates helped floating (Prime Rate) funds attract new assets (\$0.9 billion). Inflation-indexed bond fund flows rose to nearly \$700 million (year-to-May TIPS funds have brought in \$2.1 billion).

Global bond funds garnered more than \$1 billion during May (redemptions among emerging market bond funds were minimal at about \$250 million, slightly above 1% of the category's assets). Multi-sector Strategic Income fund inflows remained strong, nearing \$0.8 billion.

Corporate high yield funds suffered net redemptions of \$1.2 billion during May.

Money market fund inflows in May, nearing \$50 billion, reflected both institutional MMF activity and retail-investor defensive shifts (out of both funds and stocks and into a money market fund).

Two-thirds of fund management firms experienced positive cash flows during May. Among the other one-third: eight suffered redemptions of 2-3% of their assets, while the balance experienced more moderate redemptions.

Among individual funds, excessive redemptions (over 3% of assets) occurred within funds controlling just 3% of all industry assets.

Flow volumes in June are, not surprisingly, weaker than May's very reassuring results. But we believe that barring on-going and significant NAV price declines in the second half of 2006, many of the investment trends evidenced just before the May correction should continue.

New Fund Filings



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Recently, several fund complexes have filed new **open-end funds with non-traditional strategies** such as: i) a market-neutral or long/short approach, ii) global hybrid strategies with either an explicit “absolute return” objective or the words “absolute return” in the name. We highlight below just a few of these proposed funds.

Credit Suisse filed two such funds; both will be offered in Classes A, C and “Common” shares (Common shares are no-load and sold through intermediaries or directly from the fund):

- The quantitatively managed **Credit Suisse Long Short Market Neutral** will seek a total return greater than that of the 1-month LIBOR over a 3-5 year market cycle. The fund will carry a base management fee of 1.00% and a **performance fee** based on performance relative to the 1-month LIBOR (maximum performance fee adjustment in any month would be 1/12 of +/- 0.50% of average net assets).
- The **Credit Suisse Total Return Global** fund will, over a 3-5 year economic cycle, seek an **aggregate absolute return of 3-month LIBOR + 350 basis points, gross of fees**. It will invest in a diversified portfolio of equity securities, debt securities, money market instruments and commodity-linked derivatives. The fund’s portfolio managers will actively allocate among and within various asset classes. They will also diversify assets over a range of global securities.

Legg Mason filed the **Western Asset Absolute Return Portfolio**, which will be co-advised by fixed-income specialist subsidiary Western Asset. The Portfolio will invest in a variety of securities, instruments and techniques to try to maximize long-term total return. Normally, the Portfolio plans to devote at least half its net assets to debt / fixed-income securities rated Baa3 or BBB- or equivalent at the time

of purchase. It may enter into various derivative transactions for both hedging and other purposes, including enhancing returns. It is expected to normally have a dollar-weighted average duration (including any futures positions) of between 5 and 10 years. The fund will be offered in **“Institutional” and “Financial Intermediary” classes**. Fund investors will be required to have a minimum of **\$1 million in aggregate invested in Western Asset funds**.

Old Mutual filed the **Analytic Global Defensive Equity** fund sub-advised by its affiliate **Analytic Investors**. The fund will invest in domestic and foreign stocks, debt securities, and derivative investments. Normally, **80% of net assets will be invested in equity**. The fund will use long-short and call option writing strategies. Its long equity exposure will usually range from 110% to 125% of the fund’s net assets and short equity exposure from 10% to 33%. The fund will be offered in retail classes (A and C; with \$2,500 minimum initial investment) as well as “Z” and Institutional shares.

Funds Started in 2006 Raising Most Cash Flows Lately* Actively Managed Stock and Bond Open-end Funds \$MM

Portfolio Name	Assets 5/06	Net Flows	
		May'06	3 Mth-5/06
Domestic Equity			
Vanguard Structured Lg Cap Eq	202	202	202
Vanguard Strategic Sm Cap Eqty	152	75	156
SEI SIIT Large Cap Dvrsfd Alpha	139	0	142
W&R Advisors Energy	110	16	109
JPMorgan Hibrdg Stat Mkt Neut	134	54	81
JPMorgan US Lg Cp Core Plus	60	0	60
JPMorgan Intrepid Long/Short	56	0	54
International Equity			
Northern Emerging Markets Eqty	129	43	140
UBS Pace Alternative Strtgies Inv	52	2	53
Bond			
GMO Strategic Fixed Income	407	407	407
GMO Inflation Indexed Plus Bd	294	294	294
RiverSource Floating Rate	182	62	126
TIAA-CREF Instl Short Term II	56	6	56
TIAA-CREF Instl Bond Plus II	53	2	53
TIAA-CREF Instl Hi Yld Bond II	52	2	52
TIAA-CREF Instl Tx Ex Bond II	51	1	51

* Funds with trailing 3- month net flows > \$50 MM.
Source: Strategic Insight Simfund.

International Funds: Correcting, Pausing



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The worldwide stock market correction since mid-May, following years of extraordinary appreciation (with extreme gains among emerging markets), was, to many, not unexpected. By June 23rd, emerging equity funds gave back virtually all of their 2006 gains (losing on average nearly 10% during the second quarter). International developed market equity funds lost on average just about 4% in the second quarter yet still show over 20% appreciation in the trailing 12-months (to 5/23/06). Thus, **even after the correction, the trailing one-year returns of international funds outpace their similar-style US-centered funds by 15-20%.**

It is in that light that investors in international equity funds were largely unfazed during May, as reflected in that month's cash inflows. Inflows into such funds naturally slowed in May and likely have further declined in June. Yet, in our view, demand for such funds should persist in the second half of 2006, barring a continuation of additional large corrections of stock prices.

International / Global Funds * \$B				
	Assets		Net Flows	
	5/06	3/06	4/06	5/06
Int'l/Global Equity				
Actively Managed	1,060	18	17	7
Indexed (x ETFs)	51	1	1	1
ETFs	84	3	3	1
Emerging Mkts Equity** (included above)				
Active	110	2.4	2.9	-0.6
Indexed (x ETFs)	8	0.3	0.2	0.2
ETFs	28	0.5	0.8	0.2
Active Int'l/Global Bond				
	69	2	1	1

Source: Strategic Insight Simfund; * excluding VA underlying funds; ** Included diversified; China; Latin America; single emerging country funds.

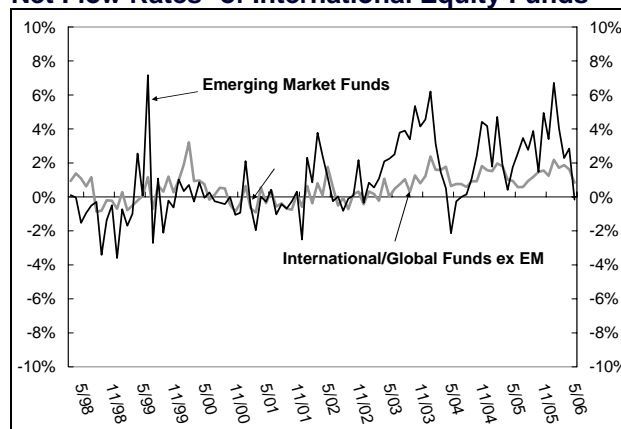
When reviewing the details of fund flows to emerging market funds, we note that although the small \$8-9 billion fund segment of Latin America funds redeemed about 5% of their assets in May, within broadly

diversified emerging market funds, redemptions did not exceed 0.5% of assets, on average, a remarkable show of acceptance in light of the sector's losses. Once again, while some institutional investors, including hedge funds, were rushing for the exits, fund investors provided a buffer and a cushion.

We continue to assume that demand for broad international investing, and to a lesser extent, emerging market investing, is now more structural in nature and not just opportunistic return-chasing behavior.

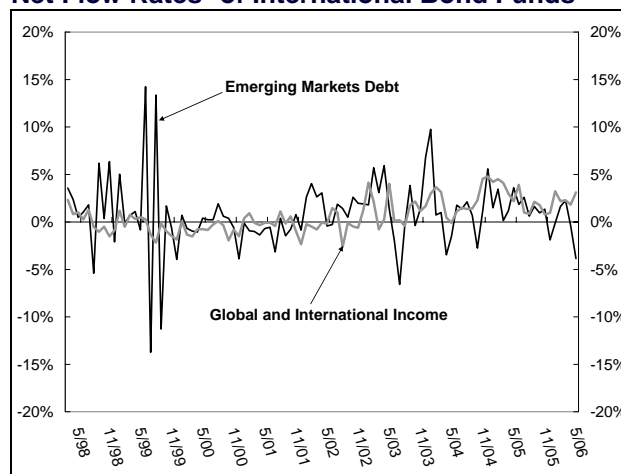
The charts below show past patterns of net flow rates in both developed and emerging international funds. Importantly, **growing assets offer a more diversified shareholder base, which should help mitigate the periodic, often temporary, redemptions during periods of sharp market corrections.**

Net Flow Rates* of International Equity Funds



* Net flows as a % of beginning assets.
Source: Strategic Insight Simfund, Lipper Inc. (classifications).

Net Flow Rates* of International Bond Funds



* Net flows as a % of beginning assets.
Source: Strategic Insight Simfund, Lipper Inc. (classifications).

International Funds-of-Funds



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The January 2006 issue of Windows discussed growth in specialized funds-of-funds (FoFs), including single asset-class offerings, which were not part of lifecycle programs. We had mentioned in that context the successful entry of the 2004-incepted **MFS International Diversification** fund into the international FoF niche. Year-to-date through May, the International Diversification fund was MFS's highest cash flow offering. Over the last few months, a number of other managers have joined the field, including **OppenheimerFunds, AIM, ING, Phoenix, Columbia Management Advisors** and **TA IDEX**.

International Funds-of-Funds

Portfolio Name	Assets		Net Flows \$MM	
	\$B	2004	2005	1-5/06
Vanguard Total Intl Stk Idx	15.7	1,873	2,565	1,735
Vanguard Dvlpd Mkts Idx	4.6	683	848	578
MFS Intl Diversification	1.2	117	440	474
Oppenheimer Intl Dvrsfd	0.4		46	326
ING Diversified Int'l	0.2		4	166
AIM International Allocation	0.1		9	73
TA IDEX Multi Manager Intl	0.1			72
Price Spectrum Int'l	0.2	18	27	53
Columbia Masters Intl Eqty	0.0			27
Weston New Century Intl*	0.1	7	39	10
Phoenix Intl PHOLIO	0.0		0	0
STAAR International*	0.0	0	0	0
GMO Intl Equity Allocation	0.7	212	48	-7
GMO CurrencyHedgd Intl Eq	0.2	367	13	-566
Total above	23.4	3,278	4,040	2,940

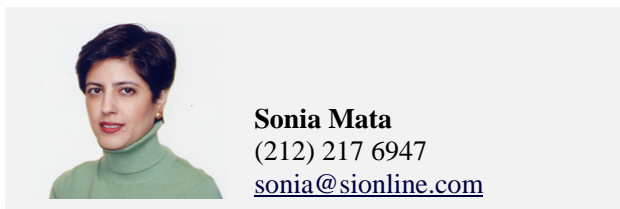
* Invest in unaffiliated funds. Source: Strategic Insight Simfund

FoFs focused on the international realm are benefiting from these converging industrywide forces: the increasing appeal of international investments and of diversification through asset allocation programs. The recent steep pullback in emerging markets may enhance the appeal of such one-stop international diversification solutions.

Some highlights of the investment strategies of recently launched international FoFs follow.

- **MFS's International Diversification's** targets these weightings for affiliated underlying funds with different style/cap and emerging vs. developed market orientation: Research International (35%), International Value (25%), International Growth (25%), International New Discovery (10%) and Emerging Markets Equity (5%).
- Similarly, the prospectus of **AIM's International Allocation fund** indicates its target allocations into underlying affiliated funds as: International Core Equity (35%), Global Value (27.5%), International Growth (22.5%), International Small Company (10%) and Developing Markets (5%). The fund specifies it will rebalance at least annually.
- The **ING Diversified International fund's** prospectus mentions a target allocation among sub-asset classes (not underlying funds): Int'l Core (40%); Int'l Growth (15%); Int'l Value (15%), Int'l Small Cap (13%), Emerging Markets (17%) and Int'l Real Estate (0%). As of 3/06, the fund was invested in six underlying funds, with 30% in a recently started internally managed enhanced index offering based on the MSCI EAFE, and the remainder in subadvised funds. The FoF plans to rebalance at least every quarter to maintain target allocations, and may also make tactical adjustments.
- **Oppenheimer's International Diversified fund tactically allocates** assets among up to seven underlying int'l/global Oppenheimer funds (six int'l/global equity funds and the Oppenheimer International Bond). It expects to typically invest in a minimum of three funds, with allocation percentages in each fund at the most 50%.
- The **Columbia Masters Int'l Equity Portfolio** allocates on a **fixed percentage basis** into two portfolios: i) the Columbia Multi-Advisor Int'l Equity (80%), and ii) the 'smid'-cap growth style Columbia Acorn Int'l (20%). (The Multi-Advisor fund divides its assets roughly evenly between international value specialist **Causeway** and Columbia-affiliated growth manager **Marsico**).
- The **TA IDEX Multi-Manager International FoF's** prospectus does not indicate any benchmark weightings. Portfolio allocation is conducted by **Morningstar** (which also provides ongoing analysis and portfolio "ownership zone" optimization in TA IDEX's \$6 billion lifecycle FoF series).
- The **Phoenix International PHOLIO** allocates, with an emphasis on style diversification (value, growth, blended etc.) among affiliated sub-advised multi-cap international/global equity and international bond funds.

Alternative Strategies in Open-End Funds



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The repeal in 1997 of the IRS “short-short” rule, which indirectly restricted mutual fund managers from generating more than 30% of their gross income from gains on stocks held less than three months or from short sales, led to the implementation of new hedge-like or “absolute return” strategies, including equity market-neutral or long/short ones. However, **in the eight years or so since open-end market-neutral and long/short funds have been in existence, the category has seen limited growth: currently, we track just about 60 such funds holding roughly \$15 billion in assets in aggregate (as of 5/06).** The sector’s returns lagged during the late nineties’ bull market and in the subsequent three-year bear phase, several of the funds didn’t provide much defensive protection. Only a few of the established fund providers have chosen to enter the market-neutral space so far, partly due to implementation and investor education challenges as well as reputational risks.

Lately, however, we have seen more complexes looking to venture beyond traditional and long-only approaches and include in their lineups various types of products with “absolute-return” themes. Over the past year, both **American Century** and **ING** have launched long/short offerings, and **Janus, John Hancock** and **Legg Mason** are among those that have “alternative” products under development.

We have also seen more **Global Tactical Asset Allocation** strategies filtering into the retail space, involving flexible mandates to invest in, and short, a wide range of asset classes globally, including commodities and currencies, sometimes in combination with an explicit “absolute return” objective. **UBS’s Dynamic Alpha** fund, for instance, seeks annual total returns of 5% on an inflation-adjusted basis net of management fees over five-year horizons. **Dreyfus’s** just-opened **Global Alpha** fund has a similar multi-asset approach but refers to a hybrid/balanced benchmark. Both funds have wide latitude to invest in derivatives as part of their investment strategy. The

UBS offering started in January 2005 is that firm’s highest cash flow fund over the past year.

Driving interest in such “alternative” products is lower equity returns (and projected future low returns), HNW investors’ desire for wealth accumulation combined with capital preservation, fund complexes’ desire to nurture existing HNW relationships by providing non-correlated complements to traditional strategies, fulfilling demand from institutional investors who are more focused than before on asset-liability matching, diversifying revenue streams across uncorrelated and higher-fee investment lines, and a search for new asset gathering opportunities.

Some of highest ‘06 cash flow alternative strategy funds included variations such as **flexible hybrid funds that hedge more occasionally** (Leuthold Core Investment) and funds engaging in **convertible arbitrage with call option-writing** (Calamos Market Neutral Income). The **Baron Partners** fund, which converted from an investment partnership in 2003, besides at times having a highly concentrated portfolio, can use leverage and sell short, although it intends to do both sparingly. The **Hussman Strategic Growth** fund may sell short but the total notional value of its short positions may not exceed the value of its stock holdings. Also shown below are some high cash flow “absolute return” type offerings packaged as **funds-of-funds**, with the underlying funds encompassing a broad spectrum of strategies / asset classes. **GMO’s Alpha Only** fund, for instance, invests in GMO equity funds and hedges equity market exposure through various derivatives, in order to seek cash-plus returns.

Selected High YTD Cash Flow “Alternative” Funds

Portfolio Name	Assets	Net	Total	3 Yr Beta*
	\$B	Flows \$MM	Rtm% 1 Yr to 5/06	
UBS Dynamic Alpha	2.5	907	10.22	
Hussman Strategic Growth	2.7	393	6.39	0.41
Diamond Hill Long Short	0.7	344	25.15	0.47
Calamos Market Neutral Inc	0.6	325	5.95	0.33
Leuthold Core Investment	1.7	321	19.12	0.90
Schwab Hedged Equity	0.7	188	9.54	0.66
Baron Partners	1.7	145	24.86	1.25
JPMrgn Hghbrdge Stat MktNeut	0.1	130		
Gateway Fund	2.9	121	6.25	0.32
JPMorgan Multicap Mkt Neutral	1.8	99	3.61	0.06
Funds-of-funds				
PIMCO All Asset	11.3	1,018	3.20	0.27
GMO Alpha Only	1.7	485	3.02	0.02
PIMCO All Asset All Authority	0.8	197	2.08	

*Versus S&P 500. Source: Strategic Insight Simfund

Inside FundFiling.Com: Evolving Investment Strategies



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Bending, twisting and flexing—investment strategy changes lately paralleled industry trends and focus. Some equity funds are **allowing higher investment percentages in foreign investment**; a number of international equity funds are **shifting more weight to emerging markets**. Several small cap funds raised **market cap mandates** to both help manage capacity and possibly prepare for a period of large cap rebound. Another change we are seeing more of is the move to control risk more flexibly with the **use of derivatives**.

Introducing/Increasing Foreign Investment

Both domestic equity and bond funds have been introducing (or increasing) investment abroad. For instance, the **Cohen & Steers Realty Income** fund introduced the ability to invest up to 20% in foreign securities. **John Hancock** increased the percentages allowed in foreign investment from 20% to 30% for its **JHF II Real Return Bond** fund, and from 15% to 20% for its **JHF II Mid Cap Stock** fund. Some asset allocation funds are raising weights assigned to foreign stocks as well: the **USAA Cornerstone Strategy** increased its target range in international stocks from “5-30%” to “5-70%”, and some of **Vantagepoint’s** risk-based lifecycle **Model Portfolios** increased allocation percentages to international funds. Click the following links to view all changes involving introductions / increasing allocations of foreign investment in 2006 (through May): [Advisors A-I](#) and [Advisors J-Z](#).

Introducing/Increasing Emerging Market Investment

The addition or increase of emerging market investment was also quite popular in the last few months. **Morgan**

Stanley Institutional Funds’ (MSIF) Advisory Foreign Fixed Income fund will now be able to invest in emerging markets; while the **MSIF Foreign Fixed Income II** (having removed the qualifying “to a limited degree” from its investment policy) will be able to invest without limitation in emerging markets. Also the **Morgan Stanley International Small Cap** will allow up to 10% of its assets to be invested in emerging market countries. The **Pioneer International Equity** and **Pioneer International Core** increased emerging market investment limits from 10% to 20%. To view all changes involving introductions / increasing allocations of emerging market investments in 2006 (through May), click [here](#) (in the PDF version).

Raising the Cap Level

Small cap funds, although many a times introducing or increasing foreign investment, more often have been raising their market cap limits. There are two ways in which they are accomplishing this. One is to simply increase the cap range: **American Funds** raised the **Small Cap World** fund’s market cap span, from a range of \$50 million to \$2 billion, to “\$3.5 billion or less”; the **Dreyfus Premier New Leaders** increased its market cap upper-limit from \$10 billion to \$15 billion. Another method is by changing from a fixed cap range to a range that includes the variability of an index: for instance, the **Columbia Small Cap Growth II** switched from investing in stocks with caps of \$2 billion or less, to investing in stocks whose caps are within the range of those included in the Russell 2000 Growth Index, thereby allowing (as of 4/28/06) market caps of up to \$5 billion. **Some mid-cap funds have been raising their cap levels as well.** Click on these links to view all cap movement filings in 2006 through May: [Advisors A-N](#), and [Advisors O-Z](#).

Adding Derivatives:

Fixed income funds led the way in adding derivatives to their investment strategies, with municipal funds topping the list. For instance, **Dreyfus** introduced high quality short-term structured notes to its **CA, MA, and NY Basic Muni Money Market** funds as well as to its **Municipal Reserves**. **John Hancock’s** **JHF II Global Bond**, **JHF II Real Return Bond** and **JHF II Total Return** funds may now enter into short sales. Equity funds were not completely left out: the **Prudential Strategic Partners Small Cap Value** and **Prudential Strategic Partners Large Cap Value**, and the **SEI SIIT International Equity** and **SEI SIIT World Equity exUS** funds all added derivatives to their investment strategies. Click the following links to view all changes involving additions of derivatives in 2006 (through May): [Advisors A-L](#), and [Advisors M-Z](#).

Fees & Expenses: 2005 Trends



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Our Fiscal 2005 Annual Fee and Expense Benchmarking studies are now posted on www.sionline.com. One report captures in detail fees by investment style and portfolio size (you can link in the PDF version of this report to this study), while the other illustrates management fee breakpoint schedules throughout the industry within 28 distinct investment strategies.

With rising industry assets (until a few weeks ago), resultant breakpoint implementation and other fee reduction arrangements, and cash flow concentration within lower-fee, high performance funds and management companies, the industry's effective fee ratios (asset weighted ratios paid by the 'average investor') have been inching downwards in recent years.

Actively Managed Equity Funds Effective Advisory Fees vs. Asset Growth Open-End Funds; Excluding Variable Annuities

	2001	2002	2003	2004	2005
Average Assets \$B	3,278	2,872	2,907	3,815	4,484
Avg. (Asset-Wgtd) Management Fee	0.611%	0.615%	0.606%	0.600%	0.584%

Source: Strategic Insight Simfund, SI Research

Actively Managed Bond Funds Effective Advisory Fees vs. Asset Growth Open-End Funds; Excluding Variable Annuities

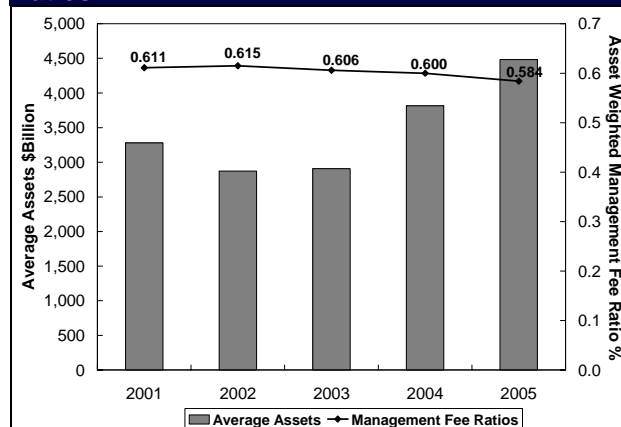
	2001	2002	2003	2004	2005
Average Assets \$B	844	975	1,139	1,173	1,231
Avg. (Asset-Wgtd) Management Fee	0.484%	0.478%	0.473%	0.469%	0.457%

Source: Strategic Insight Simfund, SI Research

The prior tables depicted the steady asset growth among both actively-managed equity and bond funds

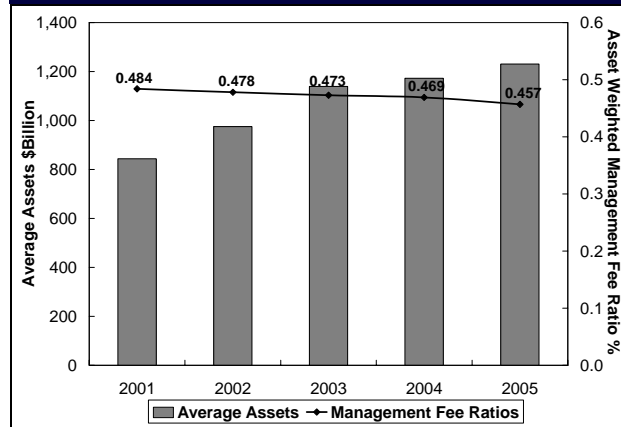
over the past several years, and the corresponding decline in management fees ratios. The same data is graphically depicted below.

Actively Managed Open-End Equity Funds Average Assets vs. Effective Management Fee Ratios



Management fee ratios are asset-weighted; annual assets managed are the monthly averages as calculated by SI.
Source: Strategic Insight Simfund, SI Research

Actively Managed Open-End Bond Funds Average Assets vs. Effective Management Fee Ratios



Management fee ratios are asset-weighted; annual assets managed are the monthly averages as calculated by SI.
Source: Strategic Insight Simfund, SI Research

With the global stock markets in widespread retreat lately, generally giving up their NAV gains since the beginning of the year, or more, and the likely slowdown of new cash flows, it is possible that aggregate management fee ratios may show slower improvement, if any, during 2006.

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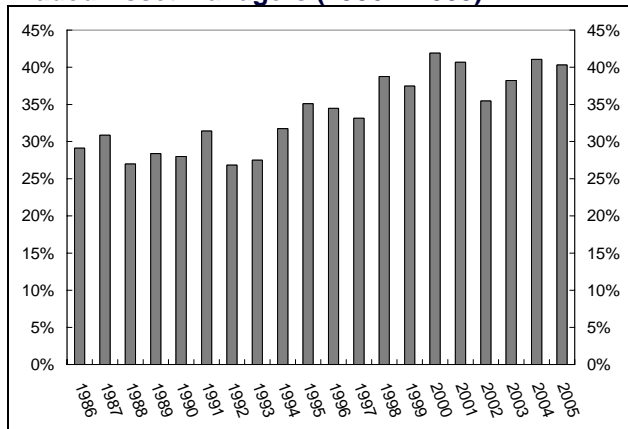


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2005 Financial Results of Publicly Held Money Management Companies

Fourteen large management companies surveyed by Strategic Insight (“Public Managers”) recorded 2005 year-end aggregate assets 14% above their year-earlier levels. Collectively, the group generated more than \$19 billion in revenue and slightly above \$3.7 billion in net after-tax profits last year, with the majority of individual managers chalking up record net income.

Median Pre-Tax Operating Margin for Publicly Traded Asset Managers (1986 ~ 2005)



Results for each year include the historical data of Public Managers during that year, based on SI's past surveys, which date back to 1986.

Source: Company reports, Strategic Insight

On average, the money management pre-tax operating margins (calculated by SI) climbed to an average 40%, with individual firm's margins ranging from 65% to 17% (stock based compensation including in SI's calculations lowered the profitability ratio for this institutional manager). More than two-thirds of the managers delivered steady or improving margins last year, and one-third had, by our computation, all-time high pre-tax operating margins in 2005.

Public Managers' 2005 Revenues

All but two of the 14 Public Managers experienced revenue growth last year. Fee revenues rose as a result of year-to-year asset gains from equity market appreciation, supported in many cases by organic cash flow growth.

Public Managers' Composite Annual Revenue Growth Rates

	2001	2002	2003	2004	2005
Operating Revenues	-3%	-7%	3%	18%	16%

Source: Company reports, Strategic Insight

Large diversified publicly-held asset managers focusing on the mutual fund marketplace generally maintained their ability to reinvest in their businesses so they can stay competitive, despite overall rising costs and an intensified focus on mutual fund fees (we have noted that contractual and non-contractual advisory fee reductions have remained limited in scope and breadth).

... And Their Expense Trends

Cohen & Steers and Janus Capital were the only two Public Managers that saw their operating expenses decrease in 2005's expanding fee environment.

Public Managers' Composite Annual Expense Growth Rates

	2001	2002	2003	2004	2005
Operating Expenses	6%	-3%	1%	15%	13%

Source: Company reports, Strategic Insight

Despite operating expenses that rose 13% in aggregate, seven of the Public Managers were able to keep the rise in their costs below the corresponding increase in fee revenues.

AUM Continues to see Double-Digit Increases

For the third consecutive year and the seventh time in the last ten years, composite AUM for the public managers has increased over 10% while pre-tax operating margins hit 40% for the first time since 2000.

Public Managers: AUM Percentage Change and Operating Margins

Fiscal Year End	2001	2002	2003	2004	2005
AUM % Change	3	-8	20	11	14
Operating Margins					
Pre-Tax	37%	36%	38%	37%	40%
After-Tax	34%	28%	25%	31%	22%

Source: Company reports, Strategic Insight

Board Talk



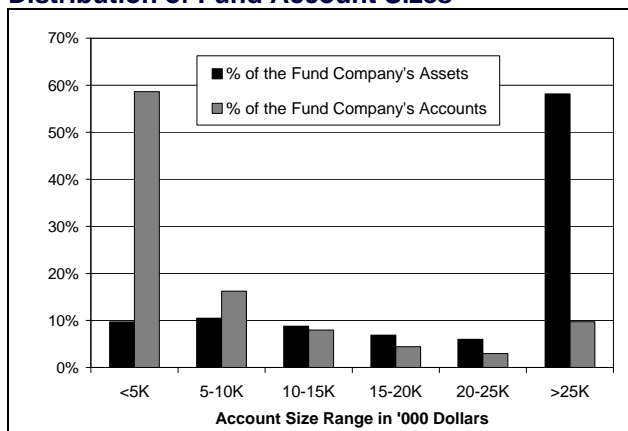
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Small Shareholder Accounts, High Costs

Some funds, and some management companies, experience a high proportion of small shareholder accounts. Among the many reasons for this: narrow sector-based (US or international) or aggressive funds (often, small accounts are created by a single exploratory purchase triggered by hot performance), affinity distribution, high dependency on insurance agent sales (at times accommodating small deposits with no follow-through), funds serving as building blocks for a lower-end mutual fund wrap (where multiple funds are used to seed a relatively small \$25,000-\$50,000 wrapped portfolio), and more.

Sometimes a management company has a shareholder account profile like the one captured below, with nearly 60% of accounts being of a tiny size, and such tiny accounts in aggregate controlling just about 10% of assets. Inversely, only about 10% of all accounts of this fund manager were of a size greater than \$25,000, and these larger, profitable accounts controlled in aggregate six in ten dollars managed.

Distribution of Fund Account Sizes



Source: SI Research

Funds with a high proportion of small accounts end up being more expensive for those of their shareholders holding larger accounts, as transfer agent fees (often

\$20-\$25 per account) are apportioned based on each account's assets, with larger accounts subsidizing smaller ones.

Illustrating the costs of smaller accounts, the following two tables—for US Large Cap Equity funds and for US Small Cap Equity Funds—reflect SI's Fiscal 2005 data for TA Fee Ratios. These ratios are summarized for funds with the smallest "average account" size (as captured in Simfund; estimated based on N-SAR disclosure of funds' number of accounts at fiscal-year end).

TA fee ratios for funds with the smallest retail-type accounts could be 0.30% (or more) higher than those among funds enjoying much larger average accounts.

Large Cap Equity Funds, Active

Average Account Size	Median TA Fee Ratio %
Up to \$5,000	0.396
\$5-10,000	0.285
\$10-15,000	0.210
\$15-20,000	0.184
\$20-30,000	0.138
\$30-50,000	0.102

Source: Strategic Insight Simfund

Small Cap Equity Funds, Active

Average Account Size	Median TA Fee Ratio %
Up to \$5,000	0.409
\$5-10,000	0.285
\$10-15,000	0.232
\$15-20,000	0.157
\$20-30,000	0.122
\$30-50,000	0.117

Source: Strategic Insight Simfund

Initiatives to reduce the occurrence of too many tiny accounts and thus lower TA costs for other shareholders may include "small account fees" (compensating for small accounts' TA costs), raising of account minimums, initiatives to aggregate multiple smaller accounts held by the same investor within a single fund-of-fund account, and others. Such efforts, while reasonable, sometimes meet with shareholder resistance, especially when there is little understanding that some of the costs of small accounts are borne by other shareholders of the fund.

Global FlowWatch



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Global Fund Flow Highlights

Investors around the world have contributed more than €350 billion of net flows to mutual funds in 2006 through April. Supported by continued stock market gains during this period, equity fund net inflows reached €250 billion, accounting for 70% of long-term fund flows worldwide. While the worldwide stock market pullback in recent weeks halted stock fund inflows, we believe that redemptions by fund investors overall in May and June were minimal (such was the experience in the US among equity fund investors, as discussed earlier in this issue).

Mixed, bond and other long-term programs including guaranteed funds continue to gather meaningful net inflows in Europe, where they accounted for 44% of long-term fund gains through April-end. Indeed, excluding money funds, the six highest cash flow funds in Europe this year were not equity vehicles but rather bond, absolute return, mixed asset, or guaranteed products. Only two of the top ten funds were equity products.

Global Mutual Fund Net Flows YTD January-April 2006, (€Billion)

	Equity	Mixed	Bond	Other	Subtotal L-T	Money Market	Total
Europe	95	40	17	17	169	28	197
US*	116	-3	24	-	137	-34	104
Asia**	36	0	1	2	39	9	48
World	249	41	46	19	355	1	356

* US data includes open-end, closed-end fund and variable annuities flows. ** Does not include Australia. Source: Strategic Insight.

Similar to 2005's experience, Europe domiciled funds again led in net inflows with €200 billion across all asset classes this year, almost double the level in the US. In the US, equity funds accounted for a far greater part of the business, garnering an amount

equal to about €120 billion so far this year. Int'l/global equity funds accounted for two-thirds of these net flows (during May, Int'l funds continued to attract positive flows, albeit at a slower pace; US centered equity fund suffered modest redemptions).

Investors in Asia contributed another €50 billion through April, which already exceeded three-fourths of full-year 2005 results. Similar to the US, equity funds represented the bulk of net activity in Asia with €6 billion of flows, mostly in Japan, but also with sizeable contributions in Korea (€ billion), India (€ billion) and Hong Kong (€ billion). May and June most likely triggered some redemptions in selected high-volatility markets. Money market programs (in Korea and India) took in € billion through April end, and the other asset classes saw only marginal inflows.

While slowing lately, long-term fund flows worldwide reached about €67 billion in April, substantially higher than 2005's average monthly pace.

Equity Fund Net Flows in Europe, (Selected Highest Cash Flow Categories) January-April 2006, (€Billion)

Category	Flows 1-4/06	YTD'06 Flows As % 12/05 AUM
Equity Asia Pacific *	19.4	10%
Equity Emerging Markets	17.4	15%
Equity Europe	15.3	2%
Equity North America	11.0	8%
Equity Sector	10.2	12%
Total Equity	95.0	5%

* Includes funds primarily investing in issuers located in the Pacific Basin, such as Hong Kong, Malaysia, Singapore, and Australia. Source: Strategic Insight, Lipper Inc.

Equity funds domiciled in Europe gathered €95 billion between January and April, led by Asia-Pacific equity funds, with €20 billion in net flows. In addition to the significant net flow contributions to these categories, looking at flows as a percentage of category assets highlights the strong relative expansion for some categories. For example, the €15 billion in net flows to Equity Europe funds represent just 2% of 2005 assets, while flows to categories such as Equity Sector, Asia-Pacific and Emerging Markets represent between 10% and 15% of overall category assets under management. Furthermore, the pace of monthly net contributions to the high cash flow categories shown in the table above is on average twice as high so far in 2006 as compared to last year. Especially Sector, North America, Emerging Markets, and Asia-Pacific categories ran at a higher monthly pace until the dramatic correction lately.

Global Horizons



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Absolute Return, Multi-Asset, or Enhanced Money Market?

Products with an absolute return theme are among the most visible and successful in Europe. They employ a very diverse range of investment strategies, may use derivatives or leverage, and depending on the product may be classified as Bond, Balanced, Asset Allocation, Hedge, or even Enhanced/ Leveraged Money Market.

Credit Agricole’s absolute return products, found amongst their “Arbitrage” and “Dynarbitrage” offerings, are among the highest cash flow mutual funds in Europe. Most are classified as Enhanced or Leveraged Money Market funds, but in some cases may also be found in Bond or Asset Allocation categories, depending on the classifier. Also, most of the strategies are offered within Credit Agricole’s France-domiciled CAAM range and Luxembourg-domiciled CA Funds line-up.

Selected CAAM/CA Funds Absolute Return Products, Main Features

CA Funds/CAAM...	Risk	Leverage	Return Target (over 2-yrs)*
Arbitrage VaR 2	VaR 2%	200%	Eonia +1%*
Dynarbitrage VaR 4	VaR 4%	200%	Eonia +2%
Dynarbitrage Forex	VaR 6%	200%	Eonia +2.5%**
Dynarbitrage Volatility	VaR 4%	100%	Eonia +2.6%**
CA Fds Dynarb. Inflation	Vol 3%	100%	Eonia +1%

*Arbitrage VaR 2 fund target over 1 year horizon. **for CAAM funds; Eonia +2% for CA Funds. Sources: Strategic Insight, Credit Agricole.

Most of the Arbitrage/Dynarbitrage funds are “managed with the goal of maximizing absolute performance using multiple arbitrages between financial markets with a **controlled risk budget namely the Value At Risk (VaR)**”, may invest in international bond and currency markets but “**may use all types of financial instruments**”, and employ

leverage. The strategies of **Dynarbitrage Volatility** “are set up using derivatives, convertible bonds and ... directional positions in markets through options”, while the **Arbitrage Inflation** fund “uses three sources of performance - directional strategies, tactical hedging and inflation carry” within the inflation-indexed bond universe.

Altogether, Credit Agricole’s Arbitrage and Dynarbitrage funds collected over €12 billion in net flows during the first four months of this year, already matching their total for all of 2005.

Indeed, **CAAM Arbitrage VaR 2 is the highest selling mutual fund in Europe so far through April; CA Funds Arbitrage VaR 2 and Dynarbitrage VaR 4 are among the top ten.** These three funds, plus most of the others from CA, are classified as Leveraged or Enhanced Money Market funds. The table below shows the top selling funds in this category, including offerings from other managers. Flows into Leveraged Money Market funds in Europe reached €20 billion so far in 2006, with 75% of that going to the 10 funds in the table below.

Highest Cash Flow Leveraged Money Market Funds*, Jan-Apr 2006, €Billion

Fund Name	Domicile	Est. Flows 1-4/2006
CAAM Arbitrage VaR 2	France	3.2
BBVA Monetario Dinámico, FI	Spain	2.3
CA Funds Arbitrage VaR 2	Luxembourg	2.2
CA Funds Dynarbitrage VaR 4	Luxembourg	2.2
CAAM Dynarbitrage VaR 4	France	1.6
Dexia Money + Risk Arbitrage	France	0.7
BNP Paribas ABS Euribor	France	0.7
SGAM Invest Total Return Credit	France	0.6
SGAM AI Credit Plus 40	France	0.5
Alternatime (HSBC/Sinopia)	France	0.5
Total Above		14.6

*As classified by Lipper Inc. Data includes all share classes of a fund. Sources: Strategic Insight, Lipper Inc.

The diversity of investment strategies extends beyond Credit Agricole. For instance, **Dexia Money + Risk Arbitrage** invests part of its assets in event-driven strategies trying to take advantage of European and Northern America mergers and acquisitions.

Clearly, “enhanced money market” can mean much more in Europe than what it refers to in the U.S. industry (i.e., ultra-short duration bond funds); and **given their marketing success, especially with “absolute return” overtones, may provide ideas for markets where they remain less visible.**

Variable Annuities



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Growing Regulatory Accord May Spur Changes in Industry

Regulation and compliance remain key attention areas in all sectors of financial services, but it is especially true among annuities, both variable and fixed, and especially fixed index (FIAs), which are a subset of fixed annuities. NASD has opined that disparate regulation of annuities creates an unfair marketplace for consumers, to whom all annuities look similar. In light of this, regulation ought to be more consistent than it is currently, NASD has posited.

Chief among NASD's stated concerns is the question of FIAs and their status as a fixed annuity.

Because they advertise an equity component, they ought more properly be registered and sold as securities, just like VAs, NASD has suggested. The SEC has so far remained silent on that topic (the SEC did conduct an investigation that resulted in a 1997 concept release, as well as a more recent but so far inconclusive ongoing inquiry).

Currently, all fixed annuities are overseen only by individual state insurance departments, so salespeople must have an insurance license but not a securities license. Thus, NASD only has jurisdiction over fixed annuity sales that are 1035 changes of VAs or are purchased with money liquidated from securities.

Note that some FIAs are registered with the SEC and are sold only through securities licensed brokers. Interestingly, MassMutual recently released a VA called Equity Edge, which incorporates the primary risk and performance components of an FIA into a very simply structured VA. Approaching from the other direction, several FIAs are now available with guarantees similar to guaranteed minimum withdrawal benefits (GMWBs) now ubiquitous within most popular VAs. One may hypothesize that the more FIAs

resemble VAs in features and benefits, the stronger the NASD's argument to other regulators, including the SEC, for greater control of FIAs.

A contrasting view suggests that FIAs are principally based on fixed instruments, not on equities (with premiums that reside in the carrier's general account and minimum guarantees established by state nonforfeiture laws). Furthermore, adding insurance guarantees like those found on VAs only underscores the underlying insurance aspects of the product, which reinforces their fixed annuities characteristics. Either way, this aspect of FIAs has not emerged on NASD's radar, and **the agency firmly asserts that the legal status of FIAs is less important than improving investor protection.**

According to sources, the SEC's inquiry is active and is delving into product specifics. Although the industry had anticipated a definitive response from the regulator earlier this year, the delay has been accompanied by additional research on the SEC's part. It is **possible that the SEC may compose a list of brightline tests describing which products should be registered and sold as a security.**

With the stated goal of furthering regulatory accord, NASD sponsored a May roundtable in Washington of state and federal regulators. The idea was to initiate dialogue, especially between the state insurance commissions and NASD/SEC, and **NASD has subsequently committed to establishing a series of working groups to further ideas presented at the roundtable. Specifically, the groups will address the topics of: sales force training; suitability; disclosure; supervision; and advertising oversight.**

One idea promulgated at the Washington roundtable was to create a core annuity-related curriculum that could be used by producers in all jurisdictions. This core curriculum could further be enhanced by state- or NASD-specific requirements, but it would establish a ground level of information for all sales people to work from. In addition, many participants acknowledged the need for clearer and more informative sales disclosures for annuities of all types.

This year, we look forward to the resolution of unanswered questions regarding annuity regulation, specifically regarding FIAs and NASD-required sales disclosures. Product development continues to be affected by overarching concerns over compliance, yet this has not yet hindered insurer creativity in innovating new products and features.

Tools Time: FundFiling.com



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We highlight this month one of the additional functionalities that was implemented in the recently released Fund Filing 4.0. In the **Daily Alerts** section of the www.fundfiling.com site, you can now request an email alert for filings by specific funds that you would like to track. (Previously, you could only track a specified firm’s entire fund line). Here’s how to go about setting up such an alert:

On the “Daily Alert” menu, click on “Fund Changes”: this will bring you to the “Fund Changes” dialog screen shown below. Clicking on the “Filter” button next to the Portfolio entry will take you to the “Select Portfolios” screen where you can specify the funds you wish to track.

The “Select Portfolios” screen has a filter box, which allows you to search by typing the first few letters of the Portfolio you are trying to find. Alternatively if you wish to view all “available” portfolios at once, click on the “View All Portfolio” link below the “available” box.

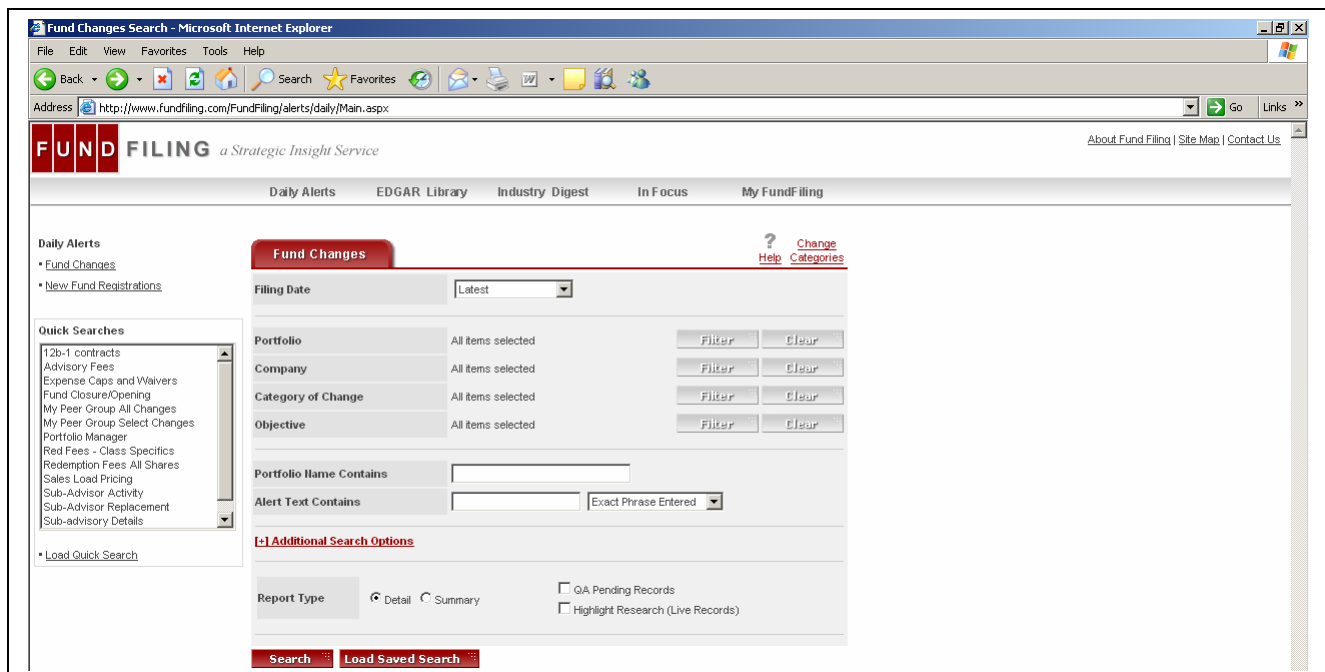
Note that a star symbol (*) next to the name of a fund indicates that this fund already has changes recorded. You can move any fund(s) from the “available” to the “selected” box by highlighting them and clicking on the “>” move button.

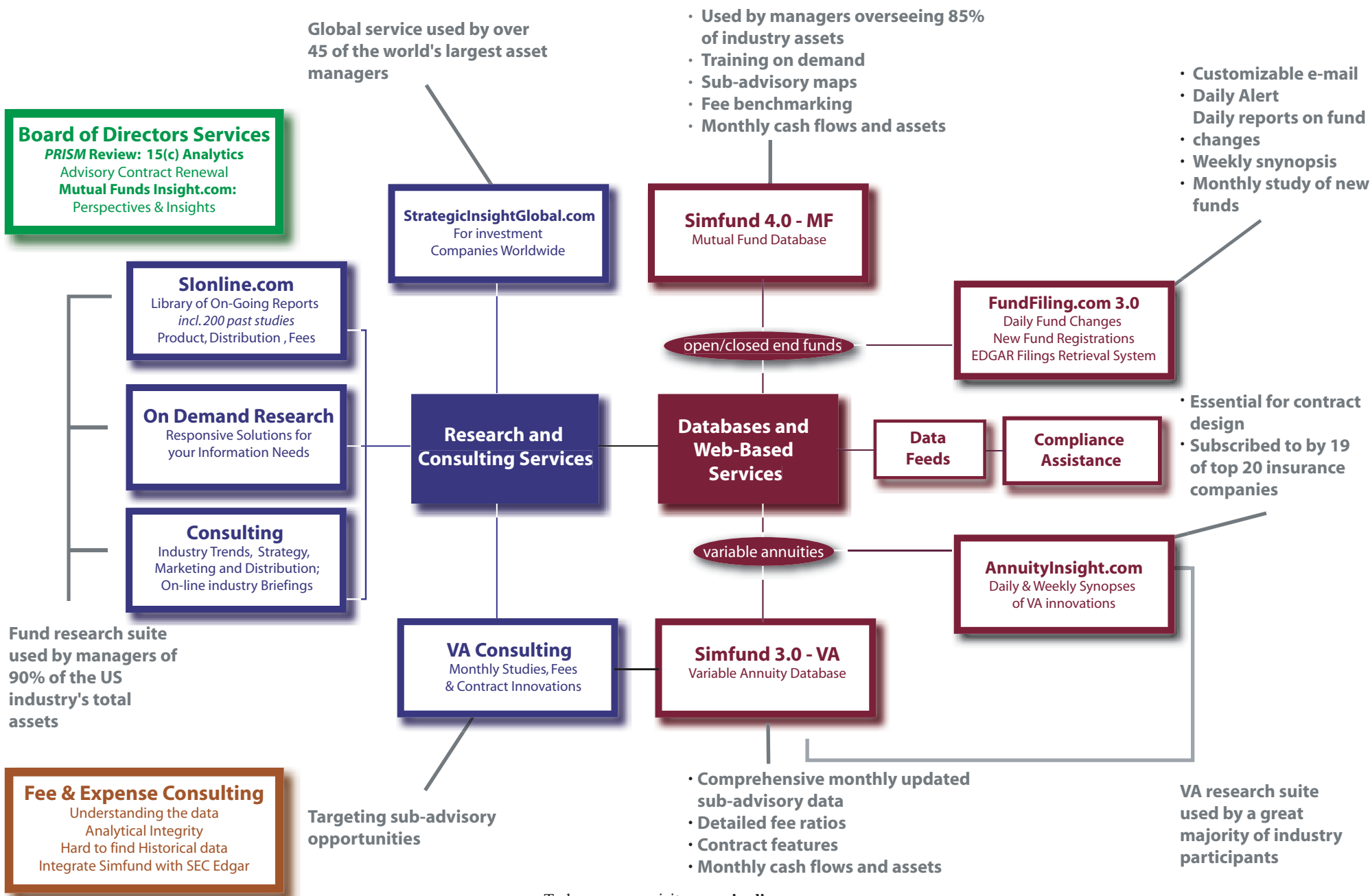
Once you have selected the funds you wish to track, click on the “OK” button. This will bring you back to the “Fund Changes” screen. Now click on the “Search” button to see the results of your query. In this result screen you can now save and create an email alert.

To create an email alert, you will need to save this search by clicking on “Save Search”. Give the query a name and make sure you specify the email alert frequency.

Each day, whenever we identify a filed change for any of the funds you have chosen, the Fund Filing service will send you an e-mail alert. Such an e-mail will be sent only during days of recorded changes.

We look forward to your feedback on this new functionality as well as other enhanced features of the FundFiling.com site.





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