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WINDOWS
Into the
Mutual Fund Industry
JUNE 2006

The latest issue of SI's Windows newsletter highlights some important industry trends, which were also discussed at length in our just-published "State of the Fund Industry – Mid-Year 2006" *Overview* report. In addition to commenting on key 1H06 themes and the recent slowdown in investor demand, we compare diversification through non-home country equity funds in the US and abroad, highlight some of the smaller fund management companies in the US that continue to expand, and discuss SEC's new rules and enhanced disclosure requirements for fund-of-fund investments. We also provide excerpts from the soon to be launched Global version of this Windows report, which will be available by subscription to SI's Global Research Service clients. The excerpted section combines a brief look at recent mutual fund flow trends worldwide, with details on cash flow developments in Europe.

We encourage you to share SI's *Windows* with your associates. You can access past articles and future editions by simply registering on www.sionline.com.

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Perspectives: State of the Industry

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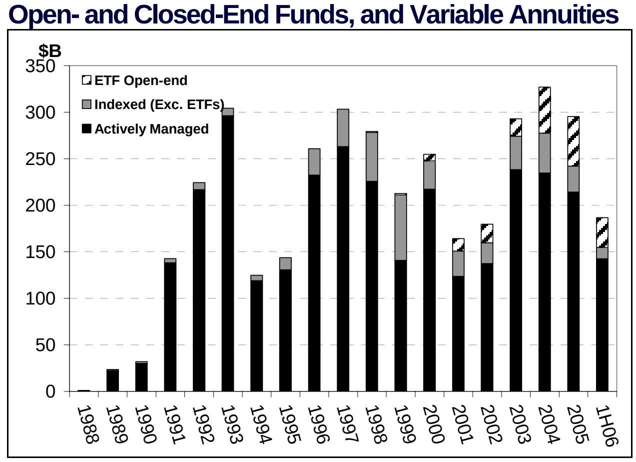
Below are some highlights from our just published, "State of the Mutual Fund Industry Mid-Year 2006." You can read the full report on www.sionline.com

- High investment confidence, especially early in the year, resulted in about $175 billion in inflows into stock and bond funds in the first half of 2006, on the heels of the nearly $300 billion added in 2005. Inflows into actively managed funds this year were somewhat higher than recent years' pace.
- **Increasing use of the mutual fund vehicle for investment and saving is also evident internationally.** SI Global research available on www.StrategicInsightGlobal.com shows that last year, inflows into mutual funds registered around the world (excluding the US) were nearly twice those into US-registered funds, and the faster growth of funds outside the US continued early this year. Many US-centered asset managers are already benefiting significantly from open-architecture and best-of-breed attitudes among Luxembourg / Dublin registered funds, and from greater distribution opportunities worldwide (SI's planned global database—Simfund Europe and Simfund Asia—should assist in such discovery and opportunity tracking efforts).
- **Back to the US**: Inflows into US-based internationally investing equity funds exceeded $100 billion in 1H06. Beyond past performance, for structural reasons, the secular shift towards higher allocation of portfolios to non-US centered funds (lately 21% of all equity fund assets, but still too low, in our view) should persist, and international equity funds will continue to attract significant inflows.
- Inflows into target-maturity funds-of-funds (FoFs), which offer simpler solutions to retirement investors, were 50% higher in 2005 than in 2004 and are on track for another 50% acceleration in pace this year.
- The acceptance of ETFs by individual investors and financial advisors has broadened. However, we suggest that for the time being, the great majority (by some estimates over 80%) of ETF purchases by advisors and individual investors are substitutions of stock- and SMA-ownership and trading, not a substitution of "buy-and-hold" mutual funds.
- Within broker-dealers and retirement plans, investment analysts' Gatekeepers (Fund Selection Units) empowered to screen funds based on advanced analytical screens, control a much larger share of fund selections. Such Gatekeepers, focusing on investment process and capacity management, constantly seek new money managers with alpha-generating ability and open capacity. As a result, smaller money managers are now finding room to grow in our industry, without having a large-scale, wholesaling force or retail name brand.
- About three-fourths of the nearly $2 trillion in equity fund inflows over the past decade were deposited into dedicated tax-deferred accounts.
- The average asset-weighted turnover ratio in 2005 for actively-managed equity funds was 51% [the (misleading) simple average ratio was nearly twice as high, at 97%]; these turnover ratios have been declining year-after-year—in 2001, the average asset-weighted ratio was 79%; by 2005 it had declined by one-third.

Long-Term Fund Net Flows*, Active vs. Passive Open- and Closed-End Funds, and Variable Annuities



Source: Source: Strategic Insight Simfund MF, Simfund VA

Fund FlowWatch: June Results, 1H06 Summary

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Recent Flow Trends Reassuring, Despite Pause in Inflows

The correction in global equity markets that began in May paused in June, but uncertainty slowed new sales and temporarily spiked redemptions somewhat. As a result, equity funds suffered modest net redemptions in June; domestic funds lost about $3 billion and international equity funds experienced very small net outflows of less than $1 billion, in aggregate.

These minimal withdrawals—0.05% of assets—should be put in the context of the nearly $200 billion in stock and bond fund inflows witnessed in the first seven months of 2006. We suggest the June data actually mirrors investor confidence and asset stability. Even Diversified Emerging Market equity funds net redeemed just $2 billion, or only 2.5% of assets—and still show 6% 1H06 total returns and $8 billion 1H06 net flows. Among all investment strategies, net redemptions rates were worse in only the tiny $7 billion Latin American equity fund segment.

Cash Flow Top and Bottom Investment Categories, June 2006
Actively Managed Funds Only

	Est. Cash Flows $B		
Morningstar Category	**Apr06**	**May06**	**Jun06**
Foreign Large Blend	4.0	3.5	**1.3**
World Allocation	1.6	1.6	**1.1**
Bank Loan	0.5	0.8	**0.8**
Foreign Large Value	1.6	0.6	**0.7**
Long-Short	0.2	0.5	**0.7**
Intermediate US Gov't	-1.1	-1.2	**-1.5**
High Yield Bond	-0.4	-1.2	**-1.7**
Mid-Cap Growth	1.2	0.1	**-1.7**
Diversified Emerging Markets	1.8	-0.4	**-2.0**
Large Blend	-1.6	-1.8	**-2.5**

Source: Strategic Insight Simfund, Morningstar

Interestingly, and observing activity outside the US, we note that mutual funds outside the US, which do not yet have the stable foundation provided by retirement assets, periodically experience redemption spikes higher than in the US, as a result of defensive investor actions.

For example, our preliminary data for Europe for the month of June suggests equity fund net redemptions were about 1% of assets, with higher withdrawal ratios in Luxembourg funds, as well as in Italy and Spain. US equity fund net redemptions in June were only 0.05% of assets, in aggregate.

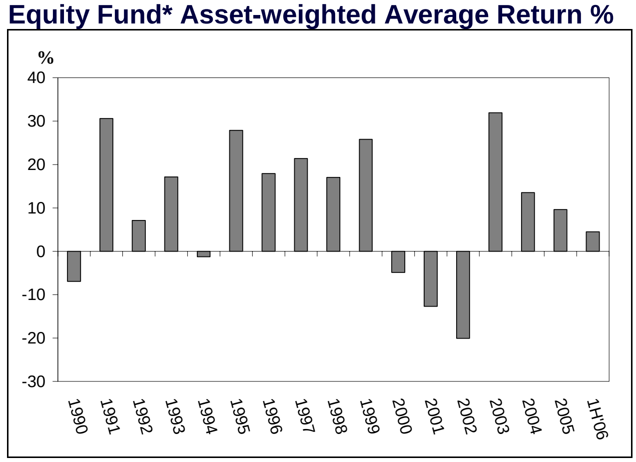
Among diversified US equity funds, a slow recovery in inflows into growth-style funds, partly at the expense of value-style funds, was apparent in early 2006. While growth funds benefited from rising inflows, value funds—in aggregate—suffered small net redemptions in early 2006. May and June data shows the natural negative impact of recent market volatility in terms of slowing sales and temporarily spiked redemptions, with both growth and value funds, in aggregate, witnessing net redemptions lately.

After the recent correction, year-to-date returns of Large Cap Value funds exceed those of Large Cap Growth funds by 10%. But we suspect that if stock markets stabilize in the second half, interest in growth-style investing may rebound.

Inflows into lifecycle and other kinds of funds-of-fund programs have been largely stable even after the market correction. Flows into such funds totaled $5.7 billion in May and $4.9 billion in June.

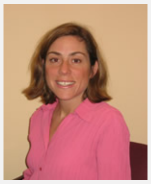
During the first half, the average investor in equity funds earned 4.4%; the average return (asset-weighted) of international equity funds was 7.8%.

Equity Fund* Asset-weighted Average Return %



** Does not include hybrid funds or VA-underlying funds*
Source: Strategic Insight Simfund; Standard & Poor's

New Fund Filings



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Quantitative Strategy Funds

Filings for funds that incorporate quantitative strategies to varying extents have been on the rise lately. We highlight below a few observed in the May-July period.

John Hancock's proposed JHF II Quantitative All Cap will use quantitative methods to rank stocks by financial attributes, followed by fundamental analysis to identify companies with "strong industry positions, leading market shares, proven management and strong financials." Stocks satisfying both quantitative and fundamental criteria will become candidates for investment. A John Hancock affiliate, **MFC Global**, will sub-advise.

Harbor Capital Advisors filed a registration statement for the **Harbor Global Value** fund, which will be subadvised by **Pzena Investment Management**. The fund will invest mainly in stocks with a market cap of at least $2 billion using a "deep value" approach. The subadvisors will use a combination of **quantitative screening** and **fundamental and qualitative analysis** to pick stocks.

Schroder registered the **Schroder International Diversified Value** fund. The fund's sub-advisor **Schroder Investment Management North America** will use a bottom-up approach to identify international stocks with high dividends and strong cash flows. Through quantitative analysis, the sub-adviser will attempt to build a portfolio of value stocks that has lower risk than the MSCI EAFE Index over the longer term, and to provide a dividend yield typically above the benchmark. The sub-adviser expects a sizable portion of the fund's investments to normally be in countries included in the MSCI EAFE Index, although the fund may invest in any country in the world, including "emerging markets" countries. (The sub-adviser anticipates investing a maximum of 25% of the fund's assets in emerging markets.)

The **Alpha** fund filed by Cincinnati-OH-based **Alpha Investment Management** will seek to "preserve capital and avoid large losses" by investing in the stock market only during periods when the adviser believes that it will appreciate at an above-average rate. When such market phases are identified, the adviser typically will use a quantitative and computer-driven methodology to invest in ETFs. During periods that the fund's adviser considers sub-optimal or as presenting "significant downside risk", the fund may be 100% invested in money market funds.

* * *

Funds Started in 2006 Raising Most Cash Flows in 2Q06*
Actively Managed Stock and Bond Open-end Funds $MM

	Assets	Net Flows	
	6/06	Jun'06	2Q06
Domestic Equity			
JPMorgan Highbridge Stat MktNtrl	337	204	**278**
Vanguard Structured Lrg Cap Eq	203	0	**202**
Vanguard Strategic Small Cap Eq	173	19	**175**
Rigel US Equity Lrg Cap Growth	123	123	**123**
Northern Multi Mgr Small Cap	87	87	**87**
Northern Multi Mgr Mid Cap	83	83	**83**
International Equity			
Northern Multi Mgr Int'l Eq	195	195	**195**
Northern Emerging Mkts Equity	137	7	**147**
Bond			
GMO Strategic Fixed Income	419	14	**421**
GMO Inflation Indexed Plus Bond	401	110	**404**
RVS Floating Rate	252	70	**178**

** Funds with trailing 3- month net flows > $75 MM.*
Excluding John Hancock.
Source: Strategic Insight Simfund.

International Equity Funds

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Diversification beyond one's home country, in increasing evidence in the US lately, has been apparent elsewhere. In developed countries in Europe or Asia, it is prevalent investment practice to invest in non-home country equity funds, even when ample opportunities for home country investment exist. The following table shows the home country equity fund net flows as a percentage of total equity fund net flows for selected European and Asian countries. Flows into non-home country funds comprised the majority of cash flows in these markets.

Cash Flows into Home Country Funds

Country		Net Flows (Billion) 2005	Net Flows (Billion) Ytd-5/06	*Unit*	Flows: Dom Eqty as % of Total Eqty 2005	Flows: Dom Eqty as % of Total Eqty Ytd-5/06
France	*Dom Eq*	2.4	-0.8	€	17%	neg.
	Total Eq	14.4	11.8			
Italy	*Dom Eq*	-2.0	-2.0	€	n.m.	neg.
	Total Eq	-4.5	1.0			
Germany	*Dom Eq*	-1.2	-0.3	€	neg.	n.m.
	Total Eq	3.3	-0.6			
UK	*Dom Eq*	0.9	1.7	*GBP*	22%	28%
	Total Eq	4.3	5.9			
Spain	*Dom Eq*	0.5	-0.5	€	7%	neg.
	Total Eq	6.8	11.9			
Japan	*Dom Eq*	2.1	7.2	*US$*	8%	19%
	Total Eq	26.7	38.2			
US	*Dom Eq*	102.1	32.5	*US$*	42%	25%
	Total Eq	243.6	132.6			

Source: Strategic Insight Global Flow Watch

[As a side note, Luxembourg and Dublin-domiciled funds are sold on a cross border basis in Europe. SI cannot break down flows going into offshore funds and identify in which country such purchases occurred. This, however, is mostly an issue for Italy and Germany; most of the activity in other European countries (in particular France and Spain) is carried out through local onshore funds. The only significant domestic activity in Luxembourg would come from Italy and Germany where local investors can directly invest in offshore funds that are meant to be distributed locally, i.e. round-trip funds. The figures above include those round-trip funds.]

In the US, the percentage of equity funds held in International and Global styles has been rising over time. International/Global funds pulled in very strong 1H06 inflows, and even with the recent market correction, outperformed US-centered funds over the first half. (Note that slowing sales and temporary higher withdrawals resulted in both US-centered and International/Global Equity funds suffering very modest redemptions, in aggregate, in June.)

US-registered Equity Funds
Domestic vs Int'l/Global: Share of Assets and Net Flows

Fund Type	2002	2003	2004	2005	1H06
% Share of Year-end Equity Fund Assets					
Domestic Equity	86.2	85.3	83.3	80.0	78.0
Int'l / Glbl Equity	13.8	14.7	16.7	20.0	22.0
% Share of Equity Fund Net Flows					
Domestic Equity	87.0	82.3	66.2	40.1	27.2
Int'l / Glbl Equity	13.0	17.7	33.8	59.9	72.8

Source: Strategic Insight Simfund MF; Exc. VA funds

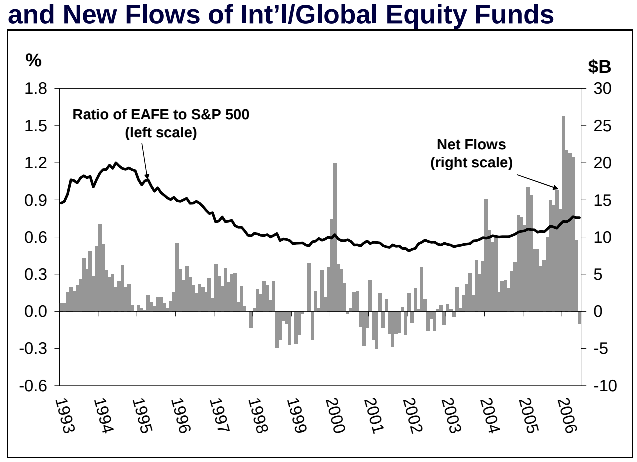
US-registered Equity Funds
Domestic vs International/Global: Monthly Net Flows

	Net Flows $B 1/06	2/06	3/06	4/06	5/06	6/06
Domestic Equity	6.7	18.1	11.0	8.0	-3.3	-4.1
Int'l / Glbl Equity	26.3	21.6	21.5	20.2	9.6	-1.8
Total Equity	***33.0***	***39.7***	***32.5***	***28.2***	***6.2***	***-5.8***

Source: Strategic Insight Simfund MF; Exc. VA funds

Looking forward, we expect international diversification to persist, despite recent performance and flow trends. Note for example, the out-performance of the EAFE Index vs. the S&P 500 Index. For the **trailing five years, international equity funds, on average (asset-weighted), show roughly 45 percentage point cumulative out-performance versus US equity funds**.

Relative Performance of US vs. Foreign Stocks and New Flows of Int'l/Global Equity Funds



Source: Strategic Insight Simfund MF; Exc. VA funds

Funds-of-Funds: Flow Stability, SEC Rules Change

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Boding well for long-term asset retention and expectations management within packaged asset allocation products, inflows into lifecycle and other kinds of FoF programs, which had been averaging $5.5 billion in the 12 months ending April'06, have held up rather well since the market correction, totaling $5.7 billion in May and $4.9 billion in June.

Funds-of-Funds Net Flows (Exc. VAs and 529 Plans) $B					
2002	**2003**	**2004**	**2005**	**1H06**	**Jun'06**
10.1	26.3	50.4	58.8	38.6	4.9

Source: Strategic Insight Simfund

New SEC Rules for FOFs

The SEC recently adopted three new rules that provide additional investment flexibility to affiliated and unaffiliated FoFs. According to the adopting release, (Fund of Funds Investments, SEC Release nos. 33-8713; IC-27399), these new rules codify, and in some instances, expand on various exemptive orders issued by the Commission over time allowing funds to invest in other funds. **The rules become effective July 31st.**

Some Background

Section 12(d) of the Investment Company Act of 1940 (1940 Act) contains provisions to restrict the ability of a fund to invest in other funds in order to curb possible abuses such as pyramiding schemes. The same provisions were also, however, recognized to have had the effect of restricting legitimate FoF arrangements. Congress, therefore, created some statutory exceptions. The new rules expand two of those exceptions—Sections 12(d)(1)(F) and 12(d)(1)(G)—besides adding a new exception for investments in money market funds (MMFs).

"Cash Sweep" Arrangements

New **Rule 12d1-1** will allow funds to invest, subject to certain conditions, up to 100% of their uninvested cash in registered, or certain kinds of unregistered MMFs (whether affiliated or unaffiliated) in excess of section 12(d) percentage limits.

Affiliated Funds-of-Funds

Section 12(d)(1)(G) of the 1940 Act is the exception that allows affiliated FoF arrangements, under which the acquiring fund and the acquired funds are part of the same "group of investment companies". A fund taking advantage of this exception is, however, currently restricted in the types of other securities it can hold—besides investments in affiliated funds, it is only allowed to invest in government securities and short-term paper. The just adopted **Rule 12d1-2** will permit funds relying on Section 12(d)(1)(G) to invest also in i) **unaffiliated funds** subject to the limits of sections 12(d)(1)(A) or 12(d)(1)(F) of the 1940 Act; and ii) **directly in stocks, bonds, and other types of securities**, provided such investments are consistent with the fund's investment policies. A fund that relies on rule 12d1-2 may also invest in MMFs pursuant to the rule 12d1-1 mentioned above.

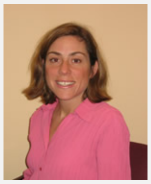
Unaffiliated Funds-of-Funds

Section 12(d)(1)(F) of the 1940 Act allows a registered fund to invest all its assets in other registered funds if the acquiring fund would own no more than 3% of any acquired fund and the acquiring fund's sales load is not greater than 1.5%, and provided certain other conditions are also met. New **Rule 12d1-3** will allow funds relying on Section 12(d)(1)(F) greater latitude in structuring their sales loads: it would lift the 1.5% cap provided the aggregate sales load an investor pays is not greater than NASD-set limits for FoF sales loads. This exemption would also be available to funds relying on Rule 12d1-2 to invest in unaffiliated funds.

New Fund Fee & Expense Disclosure Requirements

The SEC at the same time also put in place new disclosure requirements for acquired fund expenses. Under adopted form N-1A amendments, e.g., **any fund (unless it's a feeder fund) that invests in shares of one or more other funds, will be required to include in its prospectus fee table a separate line item titled "Acquired Fund Fees and Expenses".** The adopting release provides details and instructions to help determine the amount of acquired fund fees and expenses. Under a ***de minimis* exception**, the separate line item is not required, if acquired fund fees and expenses do not exceed 0.01% of the average net assets of the acquiring fund. **The new disclosure requirements apply to all new registration statements, and all post-effective amendments to currently effective registration statements, filed on or after January 2, 2007.**

Inside FundFiling.Com: Retirement Account Pricing Changes



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Adjusting Sales Charges

Cohen & Steers modified the Class A front-end waiver, from waiving sales charges for general retirement accounts, to waiving sales charges for those retirement accounts that have at least $1 million in assets and over 50 employees. **Rydex** also qualified the sales waiver for retirement accounts with the addition of, "at least $100 million in assets or 100 participating employees." **TA IDEX** funds' Class A and Class T shares removed the waiver for general retirement accounts and instituted specific retirement accounts eligible for sales charge and CDSC waivers. **John Hancock II** funds eliminated the front-end sales charge for retirement accounts with at least 100 employees. And **Eaton Vance** tax-managed and municipal funds added a CDSC to Class A shares of retirement accounts (1.00% if redeemed within one year and 0.50% if redeemed within two years, regardless of the purchase amount). **DWS** modified discount policies for retirement accounts to allow plans that reach the asset level to purchase shares at NAV the continued option to purchase shares at NAV even if the plan falls below the asset level. Also, **Fiduciary** and **Franklin Templeton** funds removed the CDSC from R shares in general.

Modifying Minimums

Historically, minimum initial investment amounts for different classes haven't exhibited drastic changes. Institutional shares are set high, retail shares linger in the middle, with retirement shares (or IRA accounts) traditionally requiring a low (or non-existent) minimum for initial investment. However, a number of funds are raising minimums. **Prudential** introduced a minimum initial investment amount of $1,000 for retirement accounts where none had existed in the past. The re-opened **John Hancock's Classic Value** fund ($6 billion in assets) instituted a minimum initial investment of $50,000, including retirement accounts (with an exception given to only those retirement accounts with service agreements with **John Hancock**). Previously, this fund did not charge a minimum for any retirement account with at least 350 employees. The **Vanguard Windsor II** and **Vanguard Wellington** funds raised Investor Class minimums from $3,000 to $10,000, including minimums for retirement accounts. **TA IDEX** and **Federated** went against the tide, removing the minimum initial investment from certain retirement accounts.

Introducing Retirement Share Classes

A quick look at new filings of dedicated Retirement share classes revealed interesting new offerings planned. **John Hancock's JHF II Lifestyle** series of funds filed to add R, R1, R2, R3, R4 and R5 shares, with 12b-1 fees of 0.75%, 0.50%, 0.25%, 0.5%, 0.25% and 0%, respectively. These R-shares will also have a fee for "various administrative, recordkeeping, communication and educational services for retirement plans" provided by the adviser directly or through third parties, the amount of the fee being 0.25% for Classes R, R1 and R2, 0.15% for Class R3, 0.10% for Class R4 and 0.05% for Class R5. Also, **JP Morgan** filed Class R shares for 14 funds; the R shares, which don't have any 12b-1 fees, would be for purchase by the manager's SmartRetirement funds; DC plans administered by the retirement plan services affiliate of JPMorgan Chase Bank would also be able to invest once aggregate investment by such plans is at least $5 million per fund.

Dealer/Distribution Changes

Class R shares of the **Fiduciary** and **Franklin Templeton** funds eliminated the prepaid commission of 1% for shares sold through Employer Sponsored Retirement Plans. **DWS Scudder** combined certain prior dealer compensation schedules for retirement shares into one new schedule, and added the following regarding distributor payments to dealers, "from time to time, [the distributor] may pay or allow to firms a 0.25% commission on the amount of Class R shares of a fund sold." **FAF Advisors** also added the possibility of additional payments to dealers for retirement shares sold. And finally, the **Morgan Stanley** money market funds have added payment to **Morgan Stanley DW** (the dealer) an amount equal to 0.20% annually of the value of fund shares held through 401(k) platforms in the Morgan Stanley Corporate Retirement Solutions program.

Fees & Expenses: Variable Annuities

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VA fund fee benchmarks (combining advisory and administrative fees) are summarized below. With rising assets year-to-year, VA funds' **management fees during Fiscal 2005 have generally decreased**, mostly due to realization of economies of scale due to asset gains and resultant breakpoints. Fee waivers impacted fee ratio results of some of the smaller funds below.

Actively Managed Divers. US Equity VA Funds
Median Expense Ratios by Portfolio Asset Size

Assets	Advisory / Admin 2005	Advisory / Admin 2004	Difference
$3Billion +	0.536%	0.552%	-0.016%
$1-3Billion	0.658%	0.684%	-0.026%
$500MM-1B	0.726%	0.727%	-0.001%
$250-500MM	0.750%	0.758%	-0.008%
$100-250MM	0.785%	0.783%	-0.002%
$50-100MM	0.788%	0.803%	-0.015%
$25-50MM	0.752%	0.749%	-0.003%
Median	**0.749%**	**0.750%**	**-0.001%**

Actively Managed Int'l Equity VA Funds
Median Expense Ratios by Portfolio Asset Size

Assets	Advisory / Admin 2005	Advisory / Admin 2004	Difference
$1Billion +	0.682%	0695%	-0.013%
$500MM-1B	0.847%	0.805%	0.042%
$250-500MM	0.859%	0.898%	-0.039%
$100-250MM	0.894%	0.885%	0.009%
$50-100MM	0.882%	0.913%	-0.031%
$25-50MM	0.751%	0.898%	-0.147%
Median	**0.851%**	**0.866%**	**-0.015%**

Actively Managed Bond VA Funds
Median Expense Ratios by Portfolio Asset Size

Assets	Advisory / Admin 2005	Advisory / Admin 2004	Difference
$1Billion +	0.530%	0.550%	-0.020%
$500MM-1B	0.554%	0.562%	-0.008%
$250-500MM	0.550%	0.550%	0.000%
$100-250MM	0.549%	0.564%	-0.015%
$50-100MM	0.600%	0.607%	-0.007%
$25-50MM	0.561%	0.585%	-0.024%
Median	**0.560%**	**0.569%**	**-0.009%**

Actively Managed Money Market VA Funds
Median Expense Ratios by Portfolio Asset Size

Assets	Advisory / Admin 2005	Advisory / Admin 2004	Difference
$1Billion +	0.390%	0.367%	0.023%
$500MM-1B	0.264%	0.343%	-0.079%
$250-500MM	0.460%	0.499%	-0.039%
$100-250MM	0.448%	0.450%	-0.002%
$50-100MM	0.471%	0.457%	0.014%
$25-50MM	0.214%	0.433%	-0.219%
Median	**0.426%**	**0.448%**	**-0.022%**

Source: Strategic Insight Simfund VA, SI Research

Methodology: data is based on annual or semi-annual reports filed by each portfolio with the SEC, researched and compiled by Strategic Insight; ratios are net of reimbursements; includes active funds only; excludes index and enhanced index funds; portfolios with average assets less than $25 million during the reporting period were excluded.

Actively Managed Variable Annuity Funds
Expense Ratios Weighted By Average Assets

Average Asset Weighted Ratio	Advisory / Admin 2005	Advisory / Admin 2004	Difference
US Equity	0.515%	0.530%	-0.015%
Int'l Equity	0.613%	0.637%	-0.024%
Bond	0.486%	0.493%	-0.007%
Money Market	0.366%	0.352%	0.014%

Average Asset Weighted Ratio	Total Expense 2005	Total Expense 2004	Difference
US Equity	0.630%	0.656%	-0.026%
Int'l Equity	0.764%	0.808%	-0.044%
Bond	0.555%	0.563%	-0.008%
Money Market	0.429%	0.419%	0.010%

Source: Strategic Insight Simfund VA, SI Research

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Without a doubt, many of the actively managed funds—and their very large management companies—that are enjoying the highest inflows lately—are well known for their below-average fee ratios, partly made possible by their mega size and scale. However, in reviewing the individual actively-managed funds that received the most inflows for managers attracting the most aggregated flows, we found that **in almost all cases relative risk-adjusted return superiority over multiple years, not just lower fees, was a precondition for high inflows** (little inflows were garnered by low-fee mediocre funds).

And **many smaller fund managers with superior perceived performance also grew rapidly** lately. A few of these fastest-growing smaller managers, their trailing one-year net flows, and the rate of such inflows (flows as a percentage of beginning-assets, indicating rate of organic growth) are shown below.

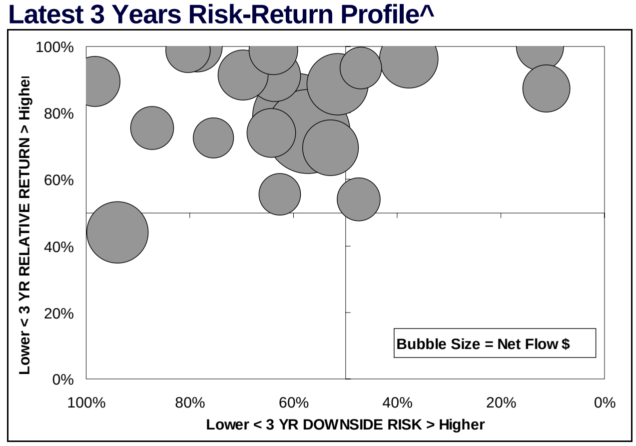
Fastest Growing Active Equity Fund Managers Latest 12 Months (Managers With Trailing 1 Year Flows > $1 Billion)

Manager	12 Mth-6/06: Net Flows as % of 6/05 Assets	Net Flows $B	Assets $B 6/06
Diamond Hill Capital	**380**	1.2	1.6
Cambiar	**363**	1.5	2.0
Keeley Asset Mgmt	**275**	1.6	2.4
Kinetics Asset Mgmt	**236**	1.2	1.8
LSV Asset Mgmt	**192**	1.5	2.4
Fairholme Cap Mgmt	**181**	1.5	2.6
The Boston Co.	**163**	1.7	3.1
Henderson Global	**141**	1.1	2.2
Rainier Investment	**122**	2.1	4.3
Bridgeway Capital	**92**	1.4	3.2

Excludes funds underlying variable annuities and sub-advisor relationships of the managers above. Source: Strategic Insight Simfund MF

The performance characteristics of the above 10 fast-growing managers—and the next 10 fastest-growing ones—each attracting at least $1 billion in the past 12 months—is portrayed in the following chart. Each bubble represents a manager, with the bubble size corresponding to the trailing one-year (to 6/06) net inflows into the manager's actively-managed equity funds, and the bubble center corresponding to that manager's risk-return composite (see methodology below). **Most of the managers depicted in the chart delivered superior high relative return, low relative risk (top left quadrant) for these winning funds. Some provided great returns but with above average risk; one experienced very low risk and just average returns within its distinctive international specialty.**

Fastest Growing Open-End Active Equity Fund Managers*: Trailing 1 Year (to 6/06) Flows and Latest 3 Years Risk-Return Profile^



** Each manager attracted more than $1B in active open-end equity fund net inflows over the trailing 12 month-period; each manager's "bubble" position is based on the asset-weighted contribution of each fund*
^Ranking determined by percentile total return and risk rankings, over the prior three years, compared with Morningstar Category peers. The bubble's size correlates to the trailing 12-months' cash flows (7/05 to 6/06) into the company's open-end active equity funds.
Source: Strategic Insight Simfund MF

Not surprisingly, for these smaller managers, fees are above average (asset-weighted advisory/admin 0.91%, roughly 50% above the industry's corresponding ratio.) **Bottom line: extraordinary relative low-risk/high-return ranking (not just low fees)**, coupled with an organizational culture focusing on investors' long-term returns and values, **correlate with the funds attracting large new investments.**

Global Horizons

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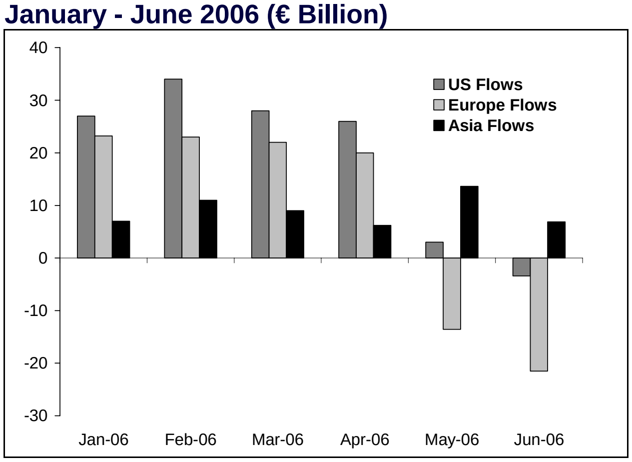
*SI's Global research team is launching a new publication, **Windows into Global Asset Management**, providing observations and recommendations from around the world; below is a typical segment; also, SI is planning to introduce Simfund / Europe and Simfund / Asia, mirroring the unique content, integration, and software of Simfund US modules already used within nearly 200 financial service companies.*

Stock market declines led to a sharp slowdown in industry net growth in May and outflows in June across most markets, with Asia being the exception where inflows persisted. Net redemption activity was strongest in Europe, but even there, long-term fund outflows amounted to just 0.8% of assets in June.

After getting over €20 billion monthly in the first four months of the year, equity funds in Europe experienced net outflows of €14 billion in May, widening to €21 billion in June.

Estimated Equity Fund Net Flows
January - June 2006 (€ Billion)



Source: Strategic Insight

Meanwhile, equity funds in the U.S. industry, **benefiting from a more stable foundation of retirement investing**, recorded €3 billion of inflows in May despite a sizable market contraction, and only a marginal €3 billion of net redemptions in June.

The pace of investment remained strong in Asia, however, with €14 billion going into stock funds in May, plus another €7 billion of inflows in June (data excludes Australia).

Global Mutual Fund Net Flows
June 2006 (€ Billion)

	Equity	Mixed	Bond	Other	Subtotal L-T	Money Market	Total
Europe	-21	-1	-7	2	-27	-2	-29
US*	-3	0	1	-	-3	13	10
Asia**	7	0	1	0	9	-1	8
Total	***-18***	***-1***	***-5***	***3***	***-21***	***10***	***-11***

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

Some additional highlights in the context of annual growth:

- Despite recent outflows in Europe, on a year-to-date basis, the region still achieved €176 billion in flows across all asset classes. In contrast, funds in the U.S. gained €162 billion, and in Asia funds collected €78 billion. **Thus, European mutual funds still accounted for roughly half of all global net contributions in 1H06.**
- **Total net flows worldwide** to mutual fund vehicles in 1H06 approached €425 billion, **37% higher than in the same period last year.**
- **Mutual fund flows in Asia have already surpassed 2005 levels**, driven by growing local demand and stronger relative performance of local markets, with gains most prominent in Japan.
- **Equity fund flows in 1H06** exceeded €240 billion worldwide, **60% higher than during the first half of 2005.**

Global Mutual Fund Net Flows
January - June 2006 (€ Billion)

	Equity	Mixed	Bond	Other	Subtotal L-T	Money Market	Total
Europe	64	44	7	19	136	40	176
US*	119	-4	26	-	142	21	162
Asia**	57	3	-1	4	62	15	78
Total	***241***	***47***	***36***	***24***	***350***	***74***	***424***

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

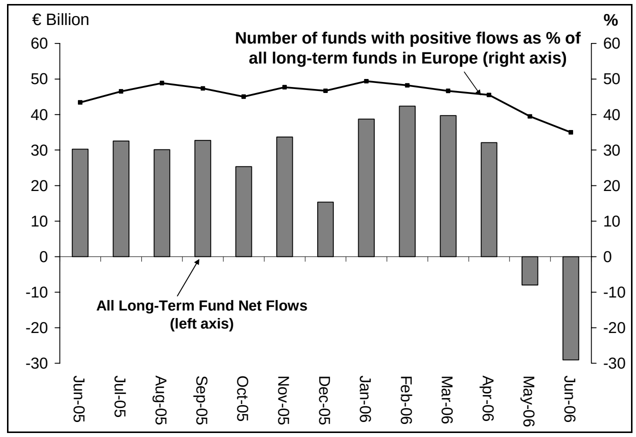
Europe Highlights

Long-term mutual funds in Europe witnessed €27 billion of net redemptions in June, a marked widening of outflows from €8 billion in May and a sharp turnaround from strong gains over the past year.

However, the repercussions are likely not as negative as some headlines in the media will inevitably suggest. Worth noting:

- **During June, more than 40% of all fund managers in Europe experienced positive net flows** (outside of money market programs).
- **Of those that suffered outflows, 40% did not experience net redemptions worse than 1% of beginning assets.**
- **Overall, long-term fund outflows in June amounted to 0.8% of assets.**
- **Just over seventy management companies each suffered net outflows exceeding €100 million** from their long-term funds, but even among them, outflows averaged 3% of assets.
- Seven managers each experienced net redemptions over €1 billion, but outflow rates averaged just 2% of assets.
- Equity Europe & Europe Smallcap funds collectively gave up nearly €9 billion to net outflows, followed by Equity Asia Pacific and Equity Emerging Market, each witnessing €5 billion in net redemptions.
- Money market funds outside of France benefited from inflows of €14 billion, partly as a result of defensive switching. In France, recurring seasonal activity resulted in €14 billion in net outflows. Thus, across Europe, money market funds recorded a marginally negative flow.
- At an individual fund level, **65% of long-term mutual fund portfolios were in net redemptions during the month, while 35% achieved inflows** (see chart on the right). While the share of funds capturing inflows is not surprisingly lower in June than at any point in the past year, the more apparent change in the aggregate volumes comes through compression of inflows and expansion of outflows among individual funds and categories.
- Furthermore, equity fund outflows in Europe were in part counterbalanced by the **continued and growing appeal of absolute/ total return, asset allocation, and similar investment themes with a focus on income and protection**. Thus, the focus on diversification and delivery of packaged investment solutions is likely to **reassure investor needs for security and income generation, but also act as a buffer for specialized funds and keep redemption levels within historical limits.**

Long-term Funds in Europe
June 2005 - June 2006



Source: Strategic Insight

Europe Mutual Fund Net Flows by Country January – June 2006 (€ Billion)

	Equity	Mixed	Bond	Other	Money Market	Total
Europe Total	***64***	***44***	***7***	***19***	***40***	***176***
Lux/Dublin*	51	20	28	13	18	130
France	12	15	0	1	24	**53**
Scandinavia**	6	3	4	5	2	**19**
U.K.	8	2	5	-	1	**16**
Germany	-3	3	2	-4	9	**8**
Switzerland***	0	3	1	4	-1	**6**
Spain	7	2	-5	-1	2	**5**
Greece	0	1	-5	-	0	-4
Italy	-3	0	-16	21	-7	-5

*Source: Strategic Insight, Industry Associations, Lipper Inc., and EuroPerformance (France). * Includes round trip funds.*
*** Includes Denmark, Sweden, Finland and Norway.*

Two-thirds of 1H06 flows in Europe went to Luxembourg- and Dublin-domiciled funds, reflecting the continuing rise in importance of offshore centers for cross-border distribution as well as offshore "round-trip" funds in certain markets. For instance, in Germany, offshore funds collected €16 billion in flows, while net redemptions from local funds totaled €9 billion. Yet, local funds continue to play an important role in Europe, especially among new domestically-tailored fund offerings (e.g. guaranteed funds), local institutional funds, and various offerings by local boutiques.

Foreign Fund Managers: Germany

The industry associations of some European mutual fund markets over the last five years have continuously expanded their statistical coverage to increase transparency in their respective marketplaces.

For example, the German asset management association, BVI, earlier this year started to break out **asset and flow information for the portion of Luxembourg-based cross-border funds of foreign fund managers sold in Germany**.

Top 5 Foreign Managers in Germany Ranked by AUM in € Billion*

	AUM - 03/2006			Flows – Q1/2006		
	Germany	Lux RFS**	% share	Germany	Lux RFS**	% share
Fidelity International	15	57	**27%**	0.4	4.2	**9%**
Franklin Templeton	10	21	**47%**	0.2	0.9	**21%**
UBS	3	88	**4%**	0.6	-0.7	**>100%**
Nordea	2	8	**20%**	-0.1	-0.6	**11%**
Pioneer	1	9	**14%**	0.3	0.6	**44%**
Total Above	***32***	***184***	***17%***	***1.3***	***4.5***	***30%***

** Data includes cross-border funds sold in Germany and reported in BVI statistics only. ** Funds registered for sale in Germany and elsewhere. Sources: Strategic Insight, BVI, Lipper Inc.*

Above we estimate the share of assets sourced from Germany within Luxembourg funds that are registered for sale in Germany and elsewhere.

For example, **Fidelity International had €57 billion in total assets in Luxembourg cross-border funds registered for sale in Germany and elsewhere, with €15 billion, or 27%, of that total coming from Germany.** Fidelity funds or share classes not registered for sale in Germany (but registered for sale elsewhere in Europe and/or Asia) are not included in the analysis.

The largest five foreign fund managers in Germany offer around 400 Luxembourg-domiciled cross-border funds, which collectively took in €4.5 billion worldwide, of which 30% came from Germany.

The data also shows that a **large portion of the assets in cross-border Luxembourg flagship funds of leading fund managers comes from Germany**, in many cases well over 50%. Nordea is somewhat of an exception, with only 13% and 26% of total assets in its North American Value and European Value funds being held in Germany.

Ten Largest Funds by AUM, as of 03/2006 in €M Lux-domiciled cross-border funds sold in Germany

	AUM – 03/2006		
Fund Name	Germany	Lux Total	% Share
Fidelity Funds - European Growth	9.8	23.5	42%
Templeton Growth (Euro)	6.4	7.3	88%
Fidelity Funds - Germany	1.0	1.7	60%
Templeton Asian Growth	0.9	1.3	73%
UBS (Lux) Equity Fund - European Opp.B	0.8	2.2	38%
Nordea 1, SICAV European Value	0.7	2.8	26%
Templeton Global Bond	0.7	1.0	69%
Templeton Global (Euro)	0.6	0.8	77%
UBS (Lux) Bond Fund - Euro High Yield B	0.5	0.7	73%
Nordea 1, SICAV North Amer. Value	0.5	3.7	13%
Total Above	***21.9***	***44.8***	***49%***

Sources: Strategic Insight, BVI, Lipper Inc.

Similarly, the largest proportion of first quarter net inflows from Germany went to a handful of products at each company, including one or two **flagship products with long track records and brand recognition, and two or three niche funds, often focusing on Asia-Pacific**.

For example, Franklin Templeton offers forty-five Luxembourg funds in Germany, with total assets of €11 billion. **Templeton Growth (Euro) Fund** has more than €7 billion, but **nearly 90% of assets were sourced from Germany.** Also, during Q1'06, Templeton's Asian Growth and Global Bond funds each attracted €120 million. In a recent press release Templeton stated that its €15 billion in total assets in Germany (the Lux funds plus other assets) increased 43% during 2005, underscoring the importance of the market for the firm.

Unicredito Pioneer, with 117 Luxembourg share classes available for purchase in Germany, has a high concentration of flows among two funds. Out of the €0.3 billion in aggregate flows from Germany in Q1'06, 80% went to its flagship Top European Players fund.

Note also that **UBS** in late 2004 as part of its expansion strategy in wealth management purchased German family office **Sauerborn Trust**; adding a local fund range marketed to HNW investors, which now has €3.5 billion in total assets, brings total fund assets for UBS in Germany to €7 billion.

Variable Annuities



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Trends in Spousal GMWBs

For the past several years, guaranteed minimum withdrawal benefits (GMWBs) have become virtually ubiquitous and the focus of additional innovation in VAs. In recent months, we have observed rapid growth in the area of spousal GMWBs, which guarantee income for the life of both married spouses. **This new iteration of GMWB has clearly found appeal with brokers and consumers because of its ability to deepen the value of the GMWB by providing more comprehensive longevity insurance to a couple.**

We recently examined 15 spousal GMWBs offered by 13 carriers. Most were already on the market, but a few had not been released as of July 25. Although the contract language defining marriage varies, all the riders appear to cover legally married spouses as defined by the IRS. We did observe wide variety on the effect of divorce; in some cases, it automatically invalidates the feature, while in others a contract owner can remove one spouse and add a new one while retaining the benefit. A divorced spouse will generally not receive the lifetime benefit if a divorce occurs before the guarantee begins.

There are two basic approaches to the income guarantee: a flat 5% guarantee for life, regardless of the age of first use, and a variable percentage guarantee that increases the older policyholders are at first use. The number of contracts that adopt each strategy is roughly evenly split. The age where the benefit can first start ranges from a low of 45 for Nationwide to a high of 65 for Guardian, Jackson National and Phoenix. Most benefits can be used at around age 60.

Benefits with a rising percentage of income guarantee range from a low of 4% to a high of 8%. Both that range and the schedule of increases vary considerably among different carriers' designs. The appeal of each individual design varies according to the ages of the owners and the anticipated use of the feature.

For example, Transamerica offers an incentive for policyholders to delay use of the benefit until an advanced age by providing the regular increases of benefit percentage for the greatest amount of time of any of these features. Starting at 4.5% at age 59, Transamerica's guarantee increases by 0.5% to a maximum of 8% at age 95.

Another area where we see significant differences is the treatment of benefit base increases and step-ups. The rich variation in spousal GMWBs exemplifies the degree to which VA sales increasingly focus on the insurance aspects of the product.

Spousal GMWBs

Insurer	Benefit name	Income Guarantee	Current Fee	Max Fee
AIG/SunAmerica	MarketLock for 2*	rising	0.40%	0.80%
American Skandia/Prudential	Spousal Lifetime Five	5%	0.75%	0.75%
AXA Equitable	Retirement Income for Life	rising	0.80%	
Genworth	Lifetime Income Plus †	rising	0.75%	2.00%
Guardian	Spousal AssetAccess	5%	0.75%	1.25%
Hartford	Lifetime Income Foundation	rising	0.30%	
	Lifetime Income Builder II	rising	0.40%	
Jackson National**	LifeGuard Protector	5%	0.90%	1.45%
	LifeGuard Protector Plus	5%	1.10%	1.70%
ING	Joint LifePay †	rising	0.65%	1.20%
Lincoln	SmartSecurity Advantage (1 year step-up option, joint life)	5%	1.50%	1.50%
MetLife	Lifetime Withdrawal Guarantee (Joint Life Version)	5%	0.70%	1.40%
Nationwide	Lifetime Income Option (with Spousal Continuation Benefit)	rising	0.60%	1.00%
Phoenix	Lifetime GMWB for 2	5%	0.70%	1.00%
Transamerica	Income Select for Life	rising	0.60%	1.50%

* Marketlock for Two charges 0.40% prior to first withdrawal; 0.80% after
** Charges for features vary according to age; charge at age 60 listed
† Not on the market, as of 7/25/2006

Source: Strategic Insight

Tools Time: FundFiling.com



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"In the News"

Fund Filing provides you with quick readings of digested information extracted from daily filed documents. At times you need to connect a mutual fund "story" with actual filings, and our "*In the News*" section does the same. This section, which you can find on the right hand side of the home page of FundFiling.com, is refreshed once every week.

In our up-coming new Fund Filing 4.0 interface, you will also be able to access archived "In the News" stories in an easy format.

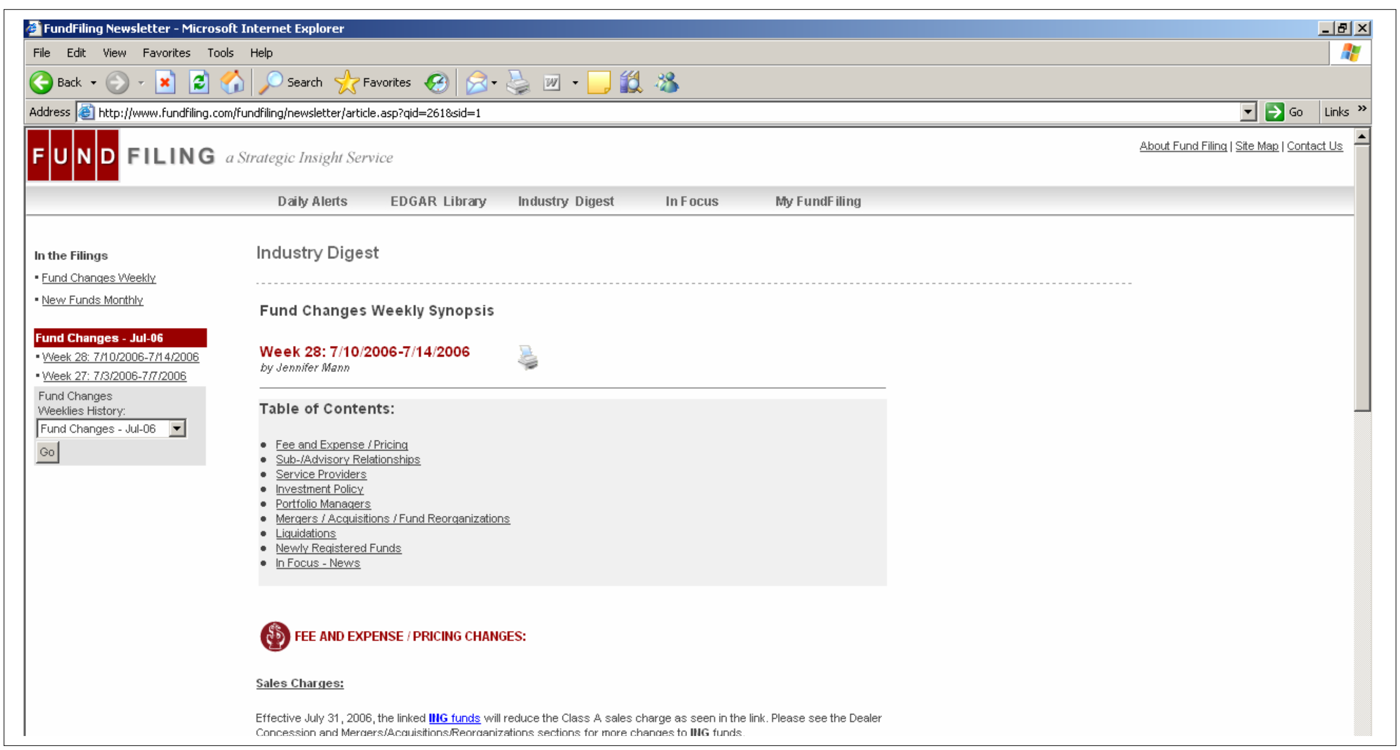
Industry Digest: Fund Changes

Every week, we scan all fund changes that occurred during that week and compile them for you for an easy read. This **Fund Changes Weekly Synopsis** report (see screen shot below) available in the "Industry Digest" section of the site allows you to stay abreast of important changes happening in our industry.

We catalogue the filed changes into many sections, such as "Fee and Expense / Pricing", "Sub-Advisory Relationships", "Service Providers" and "Investment Policy", to name a few. The Table of Contents allows you to easily go to the desired section by clicking on it.

Also note that if you want to read the entire document on paper, just print on the printer icon next to the table of Contents.

You can always access past issues of the Weekly Synopsis from the left side of the page. (Our weekly coverage started in early 2003.) A new feature just added allows you to be notified via e-mail when the weekly synopsis becomes available on-line.



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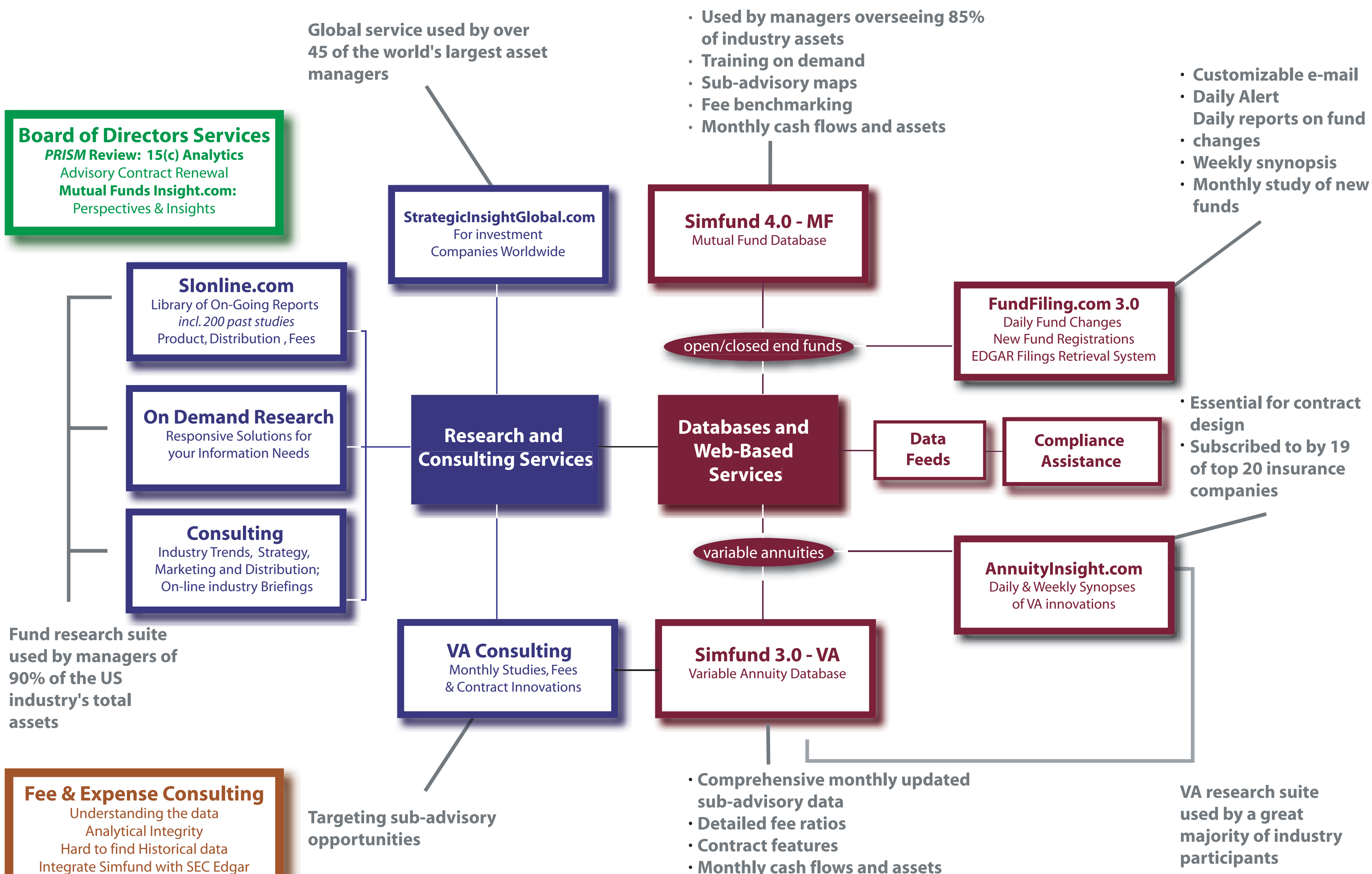

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