

FUND EVALUATION GROUP
investment consultants

Growth vs. Value

Summer 2006



Table of Contents

- Definition of Styles
- Historical Overview
- Current Market Overview
- Summary

Definition of Styles

- Growth Stocks
 - High or above average growth of earnings and sales
 - High or above average price-to-book and price-to-earnings ratios
 - Paying low or no dividends
 - Higher reinvestment

- Value Stocks
 - Lower price-to-book and price-to-earnings ratios
 - Higher dividend yields
 - Slower growth of earnings and sales
 - Turnaround opportunities

Definition of Styles – Index Characteristics

as of June 30, 2006

	<u>Russell 3000 Growth</u>	<u>Russell 3000 Value</u>
Price-to-book ratio	3.9x	2.0x
P/E ex-neg earnings	20.9x	14.3x
5-yr EPS Growth	16.2%	13.2%
LT EPS Forecast	15.2%	9.4%
Dividend Yield	1.1%	2.5%

Top Sectors and Holdings

Russell 3000 Growth

	<u>Weight (%)</u>
Technology	25.5
Healthcare	17.9
Industrials	15.5
Consumer Discretionary	13.9
Consumer Staples	9.4

	<u>Weight (%)</u>	<u>P/E (ttm)</u>
General Electric	3.9	17.8
Microsoft	3.0	18.3
Johnson & Johnson	2.6	17.2
Procter & Gamble	2.6	20.8
Wal-Mart	1.8	17.6
Cisco	1.7	21.0
Intel	1.6	14.6
IBM	1.5	13.3
Pepsi	1.5	21.2
Amgen	1.2	18.5

Russell 3000 Value

	<u>Weight (%)</u>
Financials	36.1
Energy	13.3
Consumer Discretionary	8.9
Industrials	7.6
Consumer Staples	7.3

	<u>Weight (%)</u>	<u>P/E (ttm)</u>
Exxon Mobil	5.5	10.1
Citigroup	3.5	11.8
Bank of America	3.1	11.2
Pfizer	2.4	11.3
JPMorgan Chase	2.1	12.7
Chevron	2.0	8.5
AT&T	1.5	13.7
ConocoPhillips	1.5	6.1
Wells Fargo	1.4	14.4
Verizon	1.4	13.4

ttm – trailing 12 months

Performance through June 30, 2006

	<u>YTD</u>	<u>1 Yr</u>	<u>3 Yr</u>	<u>Annualized</u>		
				<u>5 Yr</u>	<u>10 Yr</u>	<u>20 Yr</u>
Russell 1000 Index	2.8%	9.1%	12.0%	3.1%	8.6%	11.0%
Russell 1000 Growth Index	-0.9%	6.1%	8.3%	-0.8%	5.4%	9.4%
Russell 1000 Value Index	6.6%	12.1%	15.7%	6.9%	10.8%	12.1%
Russell 2000 Index	8.2%	14.6%	18.7%	8.5%	9.0%	9.7%
Russell 2000 Growth Index	6.1%	14.6%	16.3%	3.5%	4.1%	6.6%
Russell 2000 Value Index	10.4%	14.6%	21.0%	13.1%	13.3%	12.4%

Large Cap Growth vs. Large Cap Value

Summary of Historical Returns 1928 – 2005*

	Annualized Return	Standard Deviation
Large Cap Stocks	10.3%	20.3%
Large Cap Growth	9.1	20.3
Large Cap Value	11.9	27.5

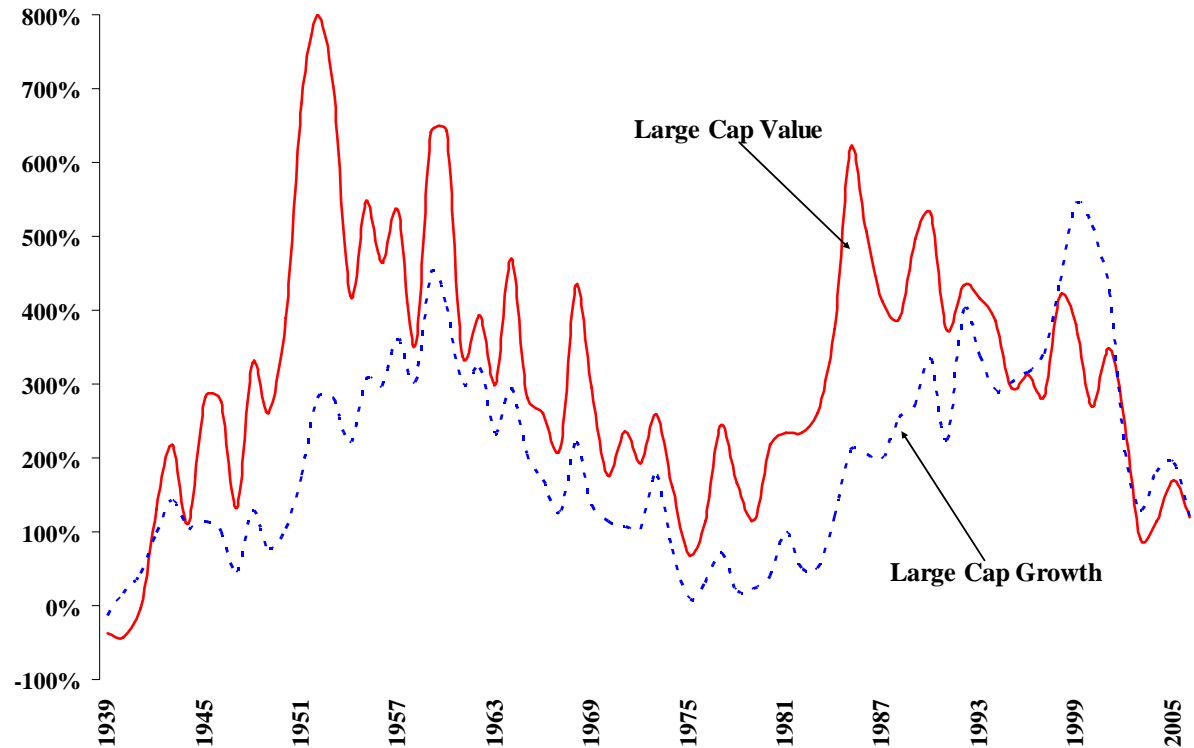
Compound Annual Rates of Return by Decade*

	1920s	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s
Large Cap Growth	8.1%	1.5%	7.3%	17.6%	7.9%	3.4%	15.8%	19.9%	-3.8%
Large Cap Value	9.0	-5.5	17.2	22.2	10.7	12.2	20.2	13.9	4.1

*Ibbotson Associates

Large Cap Growth vs. Large Cap Value

Rolling 10-Year Cumulative Returns



Small Cap Growth vs. Small Cap Value

Summary of Historical Returns 1928 – 2005*

	Annualized Return	Standard Deviation
Small Cap Stocks	12.8%	33.1%
Small Cap Growth	9.5	33.7
Small Cap Value	14.7	32.3

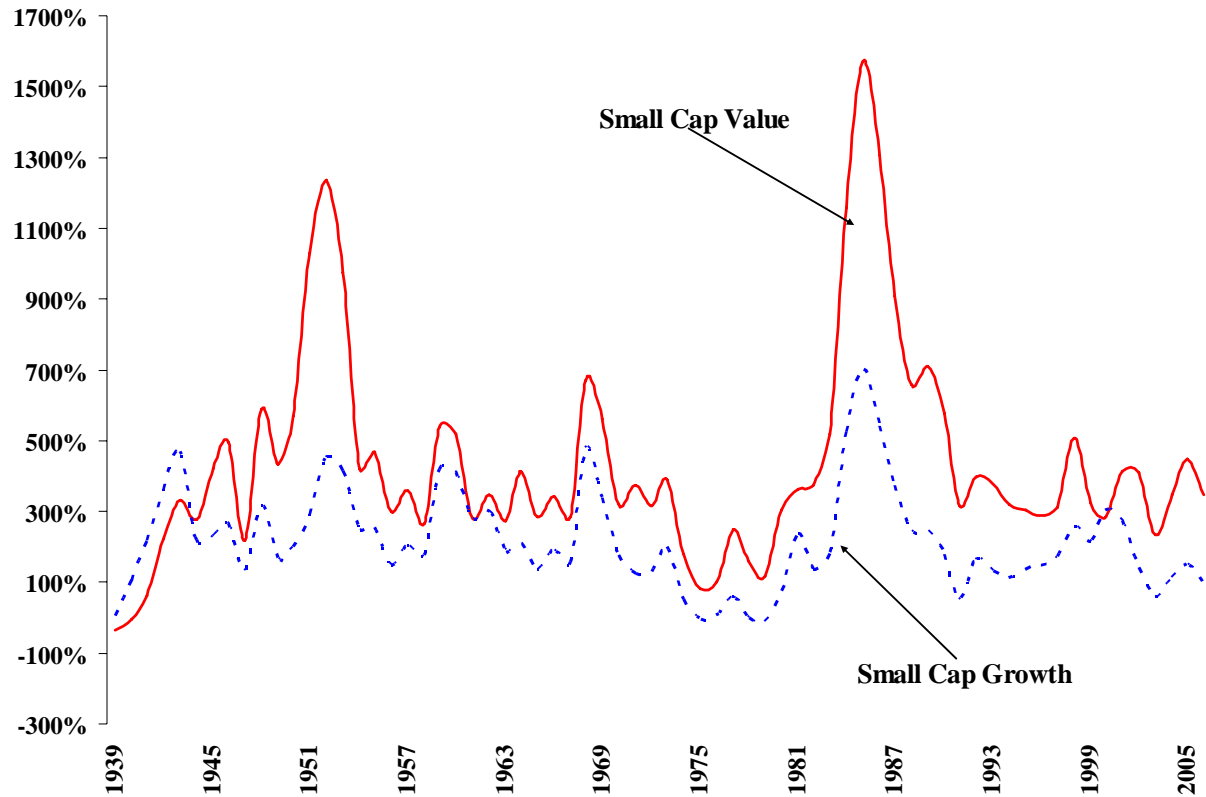
Compound Annual Rates of Return by Decade*

	1920s	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s
Small Cap Growth	-13.3%	7.4%	11.6%	17.7%	10.7%	5.8%	10.8%	15.0%	-0.8%
Small Cap Value	-4.8	-0.3	21.0	20.0	15.4	15.0	21.1	14.5	18.6

*Ibbotson Associates

Small Cap Growth vs. Small Cap Value

Rolling 10-Year Cumulative Returns



Environments that Favored Growth

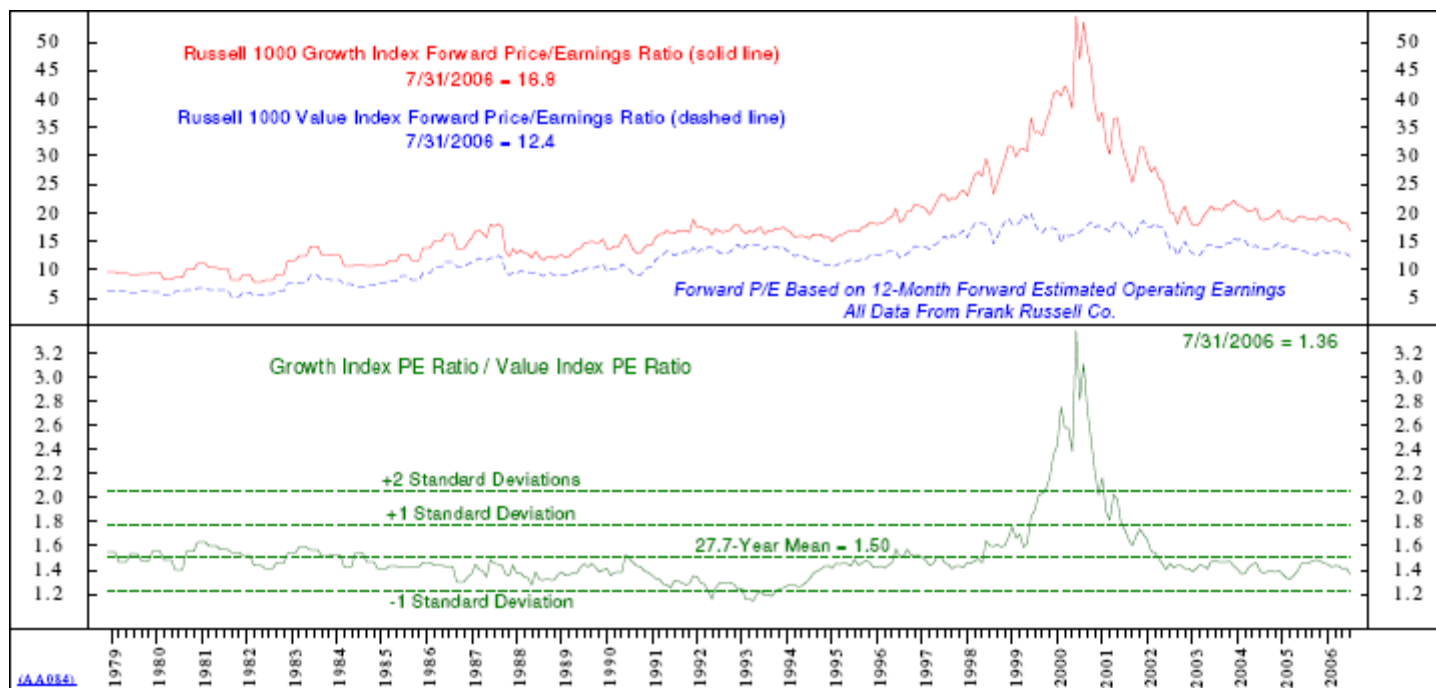
- Slowing GDP growth – corporate earnings growth begins to slow and stocks demonstrating sustainable earnings growth become more attractive
- Rising interest rates – cost of borrowing increases and companies that are able to reinvest profits to drive earnings growth are less sensitive
- Internet boom – rapid growth and emergence of Internet companies in the late 1990s led to speculative investing, which benefited stocks in the technology sector
- “Nifty Fifty” period – period when the 50 largest market capitalization stocks drove stock market returns due to high inflation and interest rates in the early 1970s, which caused investors to move into high quality stocks with demonstrated earnings growth

Environments that Favored Value

- Rising energy costs – increased oil and commodity prices benefit companies in the energy, utilities, and materials sectors
- Lower interest rates – decreases the cost of borrowing and increases the demand for capital, which drives profits for companies in the financial sector
- Strong GDP growth – expanding economic growth benefits cyclical stocks in the industrials, materials, and financial sectors
- Post Internet collapse – following the rapid appreciation of growth stocks in the late 1990s, investors moved into less speculative areas of the market that were seen as undervalued, such as in the financial services and energy sectors

Historical Market Overview – Large Cap Stocks

Russell 1000 Growth & Value Index P/E Ratios*

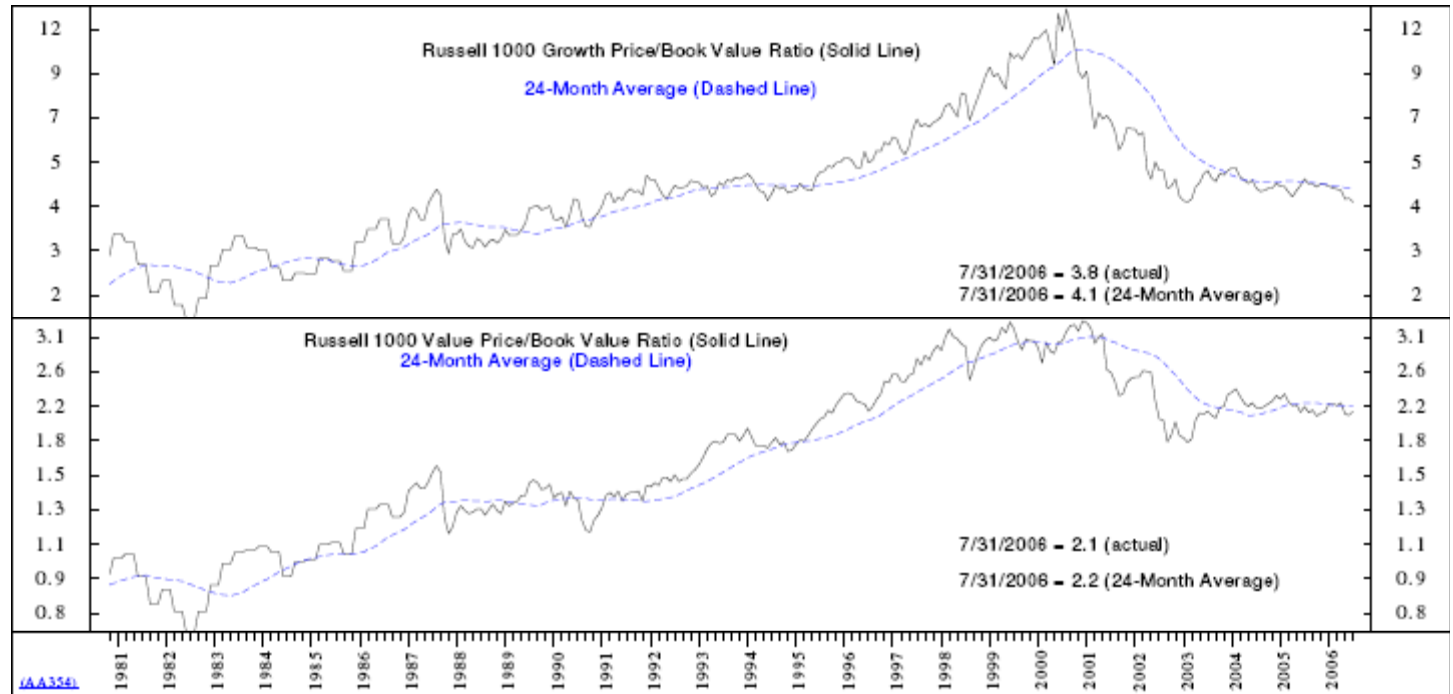


- Excluding valuations in the bubble period (1999-2000), the average is reduced by 0.05 - 0.10 bringing it essentially in-line with the current level of 1.36
- Current valuations appear to be near “equilibrium”

*Ned Davis Research

Historical Market Overview – Large Cap Stocks

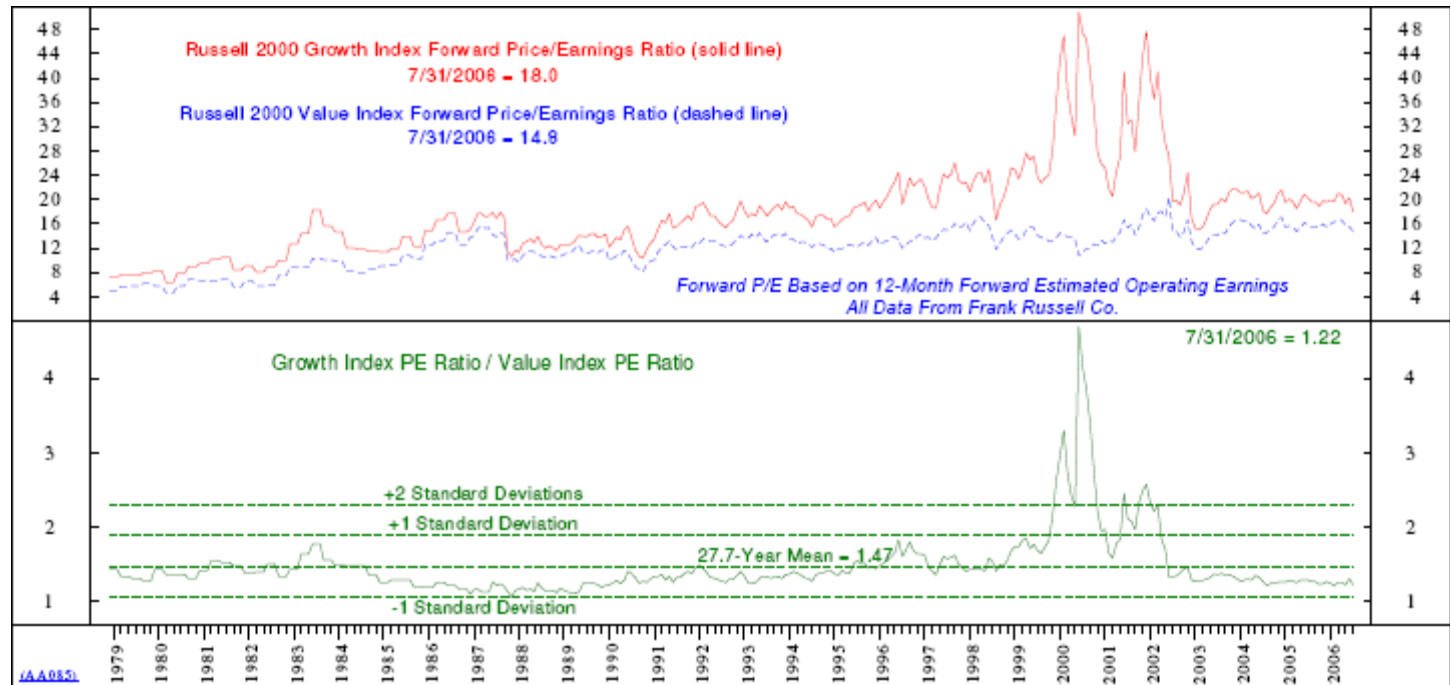
Russell 1000 Growth & Value Index P/B Ratios*



- Large cap growth has a price-to-book ratio slightly less than twice that of large cap value
- Historical valuations were closer to 3 times, indicating growth appears more attractive than recent years based on relative book value

Historical Market Overview – Small Cap Stocks

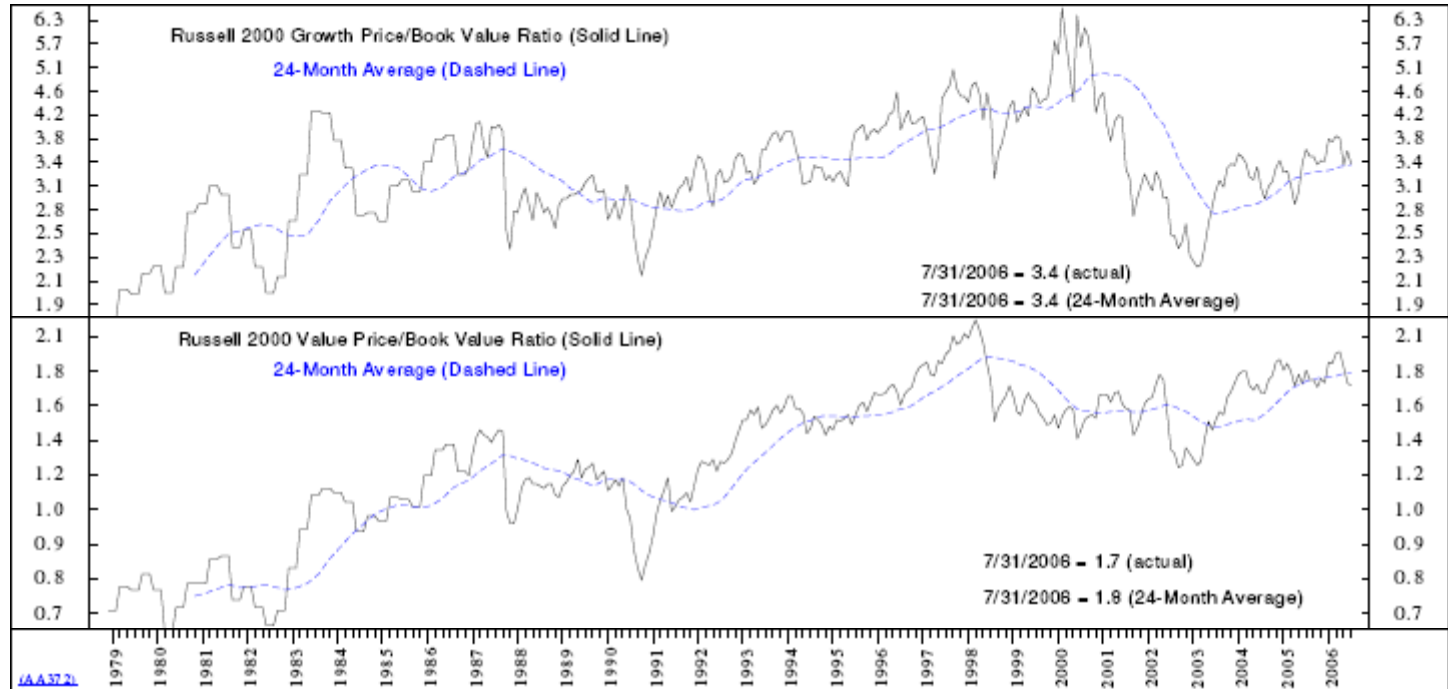
Russell 2000 Growth & Value Index P/E Ratios*



- Excluding valuations in the bubble period (1999-2000), the average is reduced to approximately 1.40, which is slightly above current valuations
- Current valuations appear to be near “equilibrium”

Historical Market Overview – Small Cap Stocks

Russell 2000 Growth & Value Index P/B Ratios*



- Small cap growth has a price-to-book ratio twice that of small cap value
- Historical valuations were closer to 3 times, indicating growth appears more attractive than recent years based on relative book value

Current Market Overview

- Economic Growth

- GDP growth began to slow during the second quarter of 2006 due in part to rising energy prices and Fed tightening (*favors growth*)
- GDP growth could slow further with higher interest rates, continued energy price increases, and large trade and budget deficits (*favors growth*)

- Interest Rates

- Federal Open Market Committee has steadily raised the target federal funds rate to 5.25%, although further increases are uncertain at this time (*favors growth*)
- Long-term yields remain low relative to short-term yields, near 5% (*favors value*)

- Rising energy and raw materials costs

- Oil prices remained high during the first half of 2006 (*favors value*)
- Recent turmoil in the Middle East and problems with U.S. pipelines could lead to further increases in oil prices (*favors value*)

Conclusion

- Value outperformed growth over the long-term and was more pronounced in small cap
- Value dominated growth over the last 6 years
- Growth dominated value the prior 5 years
- Growth and value (both large cap and small cap) are trading near historical relative valuations based on price-to-earnings ratios
- Growth appears more attractive (both large cap and small cap) based on price-to-book value
- The current market outlook is mixed as to which style is favored
- The overall analysis does not support the contention that growth is substantially undervalued, but rather, relative valuations are close to historical averages
- FEG recommends allocating growth and value at their target weights

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5. Performance results are calculated using information provided by the custodian.
6. Performance analysis is calculated using monthly and/or quarterly market values.
7. Performance analysis and asset valuations includes accrued interest and dividend income.
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