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WINDOWS

Into the

Mutual Fund Industry

APRIL 2006

The rapid growth of many funds has triggered an accelerating pace of closing or limiting investor access to such funds. This edition covers a number of dimensions of closed funds. We also touch on some of the benefits of growth and scale, including the decline in advisory fees and brokerage commissions for securities trading. Sales success in Europe and international distribution trends are discussed. Other important themes captured in this issue are the rising demand for Emerging Markets investments, updates on life cycle funds, ETF trends including new launches, and risk management evolution among sponsors of variable annuities.

With fund management companies sharing more SI research with their independent trustees, and observing directors' interest in reading *Windows* regularly, we are looking forward to facilitating such collaborative education. Contact us to learn more.

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Perspectives

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Accelerating Industry Growth: Some Implications

Rapidly expanding assets due to market appreciation in recent years and in 2006; extraordinary, record inflows to international and emerging market funds, to highly rated small / mid cap funds, and to sector funds benefiting from NAV sharp gains, all combined to trigger closing or investment restrictions as of late among many funds.

In April, a number of flagship funds from Fidelity, running in total over $100 billion, were closed to new investors. Vanguard closed, restricted access to, or increased minimums for a number of its actively managed funds. Recent other closings included funds focusing on Asian Small Cap, High Yield Munis; Gold; Real Assets; Micro, Small and Mid Cap strategies. **We discuss in this issue a number of considerations regarding fund closing**. (The Inside FundFiling.com section articulates many examples of funds controlling new inflows; FundFiling.com subscribers may screen for a complete listing and closing stipulations.)

Note though that most closed funds remain open to many individuals already owning such a fund, to DC plans, and to financial advisors already doing business with the fund or the manager. Thus such soft closure only slows new inflows, and does not eliminate them

We have anticipated some of these trends, and the increasing periodic flows to a smaller group of funds in our December 2005 *Windows* edition, discussing the increasing power of 'gatekeeper' investment analysts **"***Concentration of selection power by a small number of [investment] analysts, many using similar technologies and screening, will regularly trigger cash flow concentration within a small number of funds, forcing more frequent fund closures, and constantly leading to new openings for other highly rated funds. [we recommended] Staying close to such investment analysts' teams and analytical process will help to proactively identify such opportunities and benefit from them."*

Recognizing the value of slowing fund growth, we also detail in this edition some of the benefits of asset expansion. Such growth helps reduce fees: the effective fee ratios for diversified, actively managed US Large Cap funds fell in 2005 to 0.58% from over 0.60% during fiscal 2004; for small cap funds the ratio also fell 2 basis points to 0.89% last year. **The Fees & Expenses section in this *Windows* summarizes fee benchmarks for various investment** strategies and shows the decline in fee ratios in that occurred over the 2004-2005 period.

Similarly, brokerage commission costs also tend to decline with asset growth, especially if such expansion is accompanied by falling turnover. In the 15(c) section we **detail brokerage commissions for the industry's** 25 largest actively managed equity funds (which controlled about 30% of all actively managed fund assets). For these mega-size funds, brokerage commission ratios fell to just 6.2 basis points last year, down from 9.3 basis point in fiscal 2003 (median ratio).

Of course, brokerage commissions and related trading costs for smaller funds investing in less liquid securities, or experiencing higher trading and custody costs overseas, are significantly higher. Key industry themes remain reducing the costs of trading securities, including for new investments or redeemed assets; greater understanding and transparency of such costs; alternative, innovative ways to manage volatile cash flows; and efficient tax management of securities trading.

Strategic Insight Global's research team provides in this issue **insights to the fastest selling funds in Europe and the successful new offerings of many funds**. In 2005, about 1500 new funds launched in Europe attracted €110 billion, significantly more than the gains of new funds introduced in the US. Other European distribution themes discussed, partly mirroring trends in the US, include **growing importance of fund selection units (FSUs)** and "select lists" and **wider distribution opportunities** as banks, wealth managers and other intermediaries increasingly seek to offer external investment expertise.

Other important themes captured in this Windows issue are demand for Emerging Market investments, updates on life cycle funds, ETF trends including newly launched ETFs, and risk management evolution among sponsors of variable annuities.

US Fund FlowWatch

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First Quarter Review

Flows into long-term fund funds (excluding ETFs and VAs) rose sharply to $86 billion. Record international equity fund inflows, again exceeding US equity fund flows; record fund-of-fund inflows; and a rebound of growth style demand, partly at the expense of value funds, were noted.

Fund Industry Overview (Excluding VA Underlying Funds and ETFs)

	Flows $B			Assets $B	Rtrn* %
	Q3'05	Q4'05	Q1'06	3/06	Q1'06
Domestic Equity	9.1	9.7	26.7	3,772	5.81
Intl Equity	25.0	35.4	60.0	1,098	8.99
Hybrid/Alloc	2.4	-0.7	-0.7	367	3.28
Total Equity	***36.4***	***44.4***	***86.0***	***5,238***	
Taxable Bond	12.3	0.1	16.9	1,004	0.24
Tax-Free Bond	3.3	-2.6	5.9	439	0.48
Total Bond	***15.5***	***-2.5***	***22.8***	***1,442***	
Money Market	38.9	87.7	-5.3	1,991	0.93
Industry	***90.9***	***129.6***	***103.5***	***8,671***	

**Asset Weighted by Average Assets; Source: Strategic Insight Simfund MF; Standard & Poor's*

Also noteworthy lately was the stability of selected bond fund demand.

Best and Worst Selling Categories 1Q'06

	Flows ($MM)		Ret %*
Morningstar Category	**1Q'06**	**4Q'05**	**1Q'06**
Foreign Large Blend	**16,350**	6,659	9.22
Intermediate-Term Bond	**12,316**	6,265	-0.49
World Stock	**8,509**	5,520	7.01
Large Growth	**8,102**	7,030	3.97
Diversified Emerging Markets	**7,757**	4,400	11.73
High Yield Bond	**-865**	-2,462	2.67
Moderate Allocation	**-876**	125	3.46
Technology	**-950**	-1,048	7.04
Intermediate US Gov't	**-1,585**	-2,444	-0.43
Large Blend	**-2,557**	-2,328	4.56

**Asset Weighted by Average Assets; Source: Strategic Insight Simfund MF; Morningstar; Standard & Poor's*

- Outflows were most pronounced in the Large Blend category, which has continued to suffer overall redemptions since the second half of 2004.
- Intermediate-term bond funds were bifurcated, with US government-securities-oriented funds experiencing outflows, while many funds that invest in a mix of corporate and government bonds showing meaningful inflows.
- The Precious Metals category posted the best 1Q'06 performance followed by Latin America Stock (average-asset weighted returns of 21% and 17%, respectively).
- Only three closed-end funds were launched in 1Q'06 (IPO proceeds of $754 million, combined), a significant drop from $2 billion in 4Q05 and way down from the pace in 2004 and early 2005.

Fund Closures

With accelerating industry inflows and NAV appreciation, portfolio management capacity considerations become more common, and funds increasingly close to new investors. Some mega funds, notably from Fidelity, closed in April. Below is a select list of smaller funds, which grew rapidly in 2005 and early this year, and stopped offering their shares to new investors lately.

Select Fast Growing Funds that Closed to Investors in 1Q'06

	Assets	2005		1Q'06	
Portfolio Name	**$MM 3/06**	**Flows $MM**	**Rate % ***	**Flows $MM**	**Rate % ***
Leuthold Select Industries	111	49	**247**	30	40
Dreyfus Prem SmCapVal	776	454	**177**	-22	-3
Rainier Sm/Mid Cap Equity	3,146	1,174	**159**	694	33
Lord Abbett Sm Cap Blend	1,707	697	**156**	323	26
Vanguard Prcs Mtls & Min	3,484	993	**111**	447	18
CRM Mid Cap Value	2,720	1,004	**102**	413	19
Wells Fgo Avtg Sm Co Val	385	119	**82**	73	26
Masters Select Smaller Co	310	98	**61**	7	3
Berwyn Fund Income	207	61	**53**	10	6
Birmiwal Oasis	16	4	**50**	3	21

** Growth Rate as a percentage of beginning assets; Source: Strategic Insight Simfund MF; FundFiling.com*

The Birmiwal Oasis and the Masters' Select Smaller Companies funds closed right before reaching their three year anniversary. Another story of rise to riches includes the Schwab Premier Equity (not on the list above), which only began operations in March 2005 and closed to investors in April 2006 after reaching close to $1.5 billion in total assets.

New Fund Filings



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Selected Recently-filed ETFs

SSgA registered **17 sector ETFs** in March. Fifteen of these ETFs will bear the SPDR brand name and will be based on S&P indexes tracking these sectors: aerospace and defense, building and construction, computer hardware and software, healthcare equipment and services, leisure, metals and mining, oil/gas equipment and exploration, outsourcing and IT, pharmaceuticals, retail, finance, telecommunications and transportation. Two additional ETFs are planned to track regional banking and mortgage finance indexes developed by Keefe, Bruyette & Woods: these two ETFs will carry the StreetTracks brand name. (State Street already runs three financial sub-sector ETFs based on KBW benchmarks).

WisdomTree Investments (formerly **Index Development Partners**) is looking to make its debut as an ETF sponsor. The company registered six domestic and fourteen international dividend-focused ETFs based on indexes it has developed. All 20 ETFs will be sub-advised by the **Bank of New York**.

First Trust Advisors has filed for three new ETFs: one will try to track the **Amex Biotechnology Index** and another the **Dow Jones Internet Index**. The third ETF will be based on the **Deutsche Bank CROCI US+ Index**, which comprises of 40 stocks picked from the 251 largest market cap stocks in the S&P 500 Index, excluding financial companies, based on economic value added.

In February, the newly organized **Ferghana-Wellspring** signaled its plans to enter the ETF market through its filing for 12 narrow sector ETFs called DAISies (short for "D" Arrayed Investment Securities). The ETFs will be based on various healthcare, life sciences or biotechnology indexes administered by S&P. All 12 DAISies will be sub-advised by the **Bank of New York**. [Note: Wellspring BioCapital had previously partnered with First Trust Advisors to offer similar products as unit investment trusts. The five UITs are called VIOLTS (Vertical Investments Of Life Sciences Trusts)].

Selected Recently-filed Closed-end Funds

Claymore Advisors' proposed Claymore/Raymond James SB-1 Equity fund will be subadvised by **Raymond James**, and will build a portfolio consisting of equity securities rated Strong Buy 1 by Raymond James. Per the filing, SB-1 constitutes the highest of four ratings currently used by Raymond James analysts. An interesting feature of the fund: **Beginning after 18 months from the date of its prospectus, if the fund's common shares close on the NYSE for 75 consecutive trading days at a price that is a 10% or greater discount from the NAV, the fund will start a process of conversion into an open-end fund.** In such event, a special meeting of the fund's shareholders would be summoned and the conversion to an open-end fund would happen automatically unless a majority of the outstanding voting securities vote to keep it as a closed-end fund.

First Trust filed the First Trust Tax-Advantaged Preferred Income fund, which would normally invest at least 80% of its managed assets in securities that sub-adviser **Stonebridge Advisers** believes are eligible to pay dividends that qualify for certain favorable federal income tax treatment when received by fund shareholders. Per the filing, such tax-advantaged treatment would extend to dividends from the fund eligible as "qualified dividend income" for individuals and subject to federal income taxes at rates applicable to long-term capital gains (which for individuals currently are capped at 15%), and/or dividends eligible for the "dividends received deduction" available to corporate shareholders. The fund and its individual and corporate shareholders would need to meet certain holding period and other requirements to be eligible for the benefit of the favorable tax treatment. The sub-adviser **expects the weighted average rating of this proposed fund's portfolio securities to be investment grade.**

Cohen & Steers, which successfully launched open-end (International Realty fund) and closed-end (Worldwide Realty Income) global real estate products last year, has now registered the Asia Pacific Realty fund.

Emerging Market Equity Funds

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Inflows to emerging markets equity funds (diversified or narrow region or single-country) rose sharply lately, exceeding $15 billion for 1Q'06, and accounting for an atypically high one-quarter share of all international equity fund inflows. High demand among mutual fund and institutional investors both in the US and elsewhere has triggered liquidity-pressures and was partly the cause of price appreciation over the trailing three years (as of 3/06) of over 210% (asset weighted).

Emerging markets equity funds hold equity securities from countries having an underdeveloped or developing commercial and financial infrastructure and low per capita GNP. Portfolio holdings of these funds are generally considered to be risky or even speculative due to risk factors, including:

- Instability of political environment and markets
- Potential corruption
- Nationalization/expropriation
- Currency devaluation
- Lack of transparency
- Low trading volumes resulting in lack of liquidity, price volatility.

Despite their risks, emerging markets funds can offer investors the benefits of partaking in wealth creation in such countries, beyond portfolio diversification. Emerging markets funds (and others with a high concentration of emerging markets holdings) have outperformed other equity styles in recent years.

Note that even some US diversified equity funds invest to an extent in emerging markets. Overall, as of 3/06, US diversified equity funds invested 1.8% of assets, on average (asset-weighted), in emerging markets. Diversified international/global equity funds allocated 7.2% of assets, on average (asset-weighted), to emerging markets lately.

This year through May 12, Diversified Emerging Funds earned, on average, over 20%, with even higher gains among Latin America funds. For the first four months of 2006, some countries gained notably more—listed below are the top-performing emerging markets, based on MSCI country-specific index data.

MSCI Standard Index Performance (Price)

Country	Ytd-4/06 Total Return %
Morocco	**58.32**
Argentina	**52.92**
Venezuela	**44.80**
Russia	**43.16**
Indonesia	**43.09**
Brazil	**30.71**
China	**27.20**
Peru	**27.18**
India	**25.35**
Poland	**22.96**

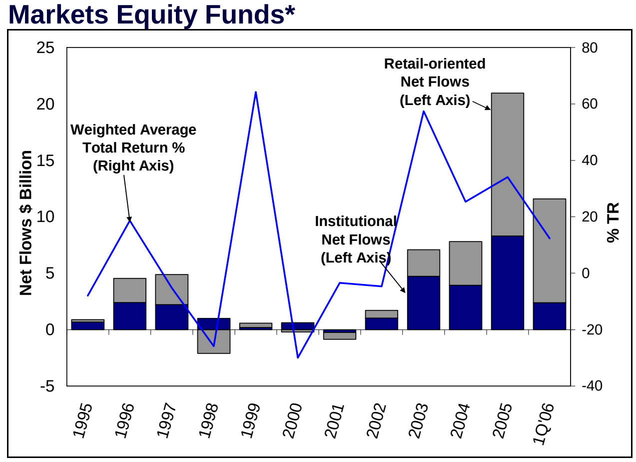
Source: MSCI

After selling successfully internationally, "BRIC" funds—those that invest in Brazil, Russia, India and China—are migrating to the US: two new BRIC funds were recently registered by Goldman Sachs and Templeton.

The extraordinary gains lately among emerging market funds, partly triggered by hyper liquidity pressure, raises the possibility of future reversal as a result of large liquidations and liquidity-driven sharp price declines in such funds, as experienced in past years.

The fluctuating and volatile performance of emerging markets and the unexpected political turns these markets tend to experience have triggered high redemptions at times within funds devoted to them. Nevertheless, one may argue that **as more of these funds are incorporated in asset allocation strategies as a core segment, some of the flow volatility fueled by performance-chasing (or fleeing) investors will be replaced by structural ownership of wealth participating opportunities in every capital market, not just the very mature ones**.

Retail vs. Institutional Flows into Emerging Markets Equity Funds*



*Source: Strategic Insight Simfund MF, Lipper Inc. (classifications). *Institutional share classes also includes ETFs; Emerging markets includes Diversified, regional, and single-state funds*

Lifecycle Funds

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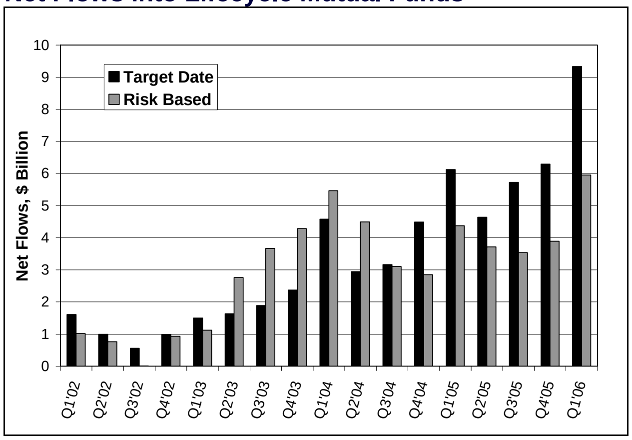
Flows into lifecycle mutual funds accelerated in 1Q'06 to a record $15 billion; both target-based and risk-based mutual funds experienced unprecedented high cash flow volumes.

Net Flows into Lifecycle Mutual Funds*



** All investors (DC and non-DC); excludes variable annuities.*
Source: Strategic Insight Simfund MF

Since the last quarter of 2004, the target-date category has been capturing a majority of cash flows into the lifecycle fund area.

Lifecycle Funds (Excludes Variable Annuities)
All Investors (DC and Non-DC)
$ Billion

	Assets	Net Flows			
	3/06	2003	2004	2005	1Q'06
Target-date	82.8	7.4	15.2	22.8	9.3
Risk-based	140.9	11.8	15.9	15.5	6.0
Total above	***223.6***	***19.2***	***31.1***	***38.3***	***15.3***

Source: Strategic Insight Simfund MF

While the target-date field continues to be dominated by bundled DC plan providers, the risk-based lifecycle fund segment has relatively broader participation. According to preliminary ICI data, DC plans and IRAs accounted for the lion's share (90%) of assets within target-date funds at the end of 2005, but a lower 60% or so of assets within risk-based lifecycle funds.

Highest 1Q'06 Cash Flow Lifecycle Fund Managers
All Investors (DC and Non-DC); Excluding VAs

	Assets $B	Net Flows $B		
	3/06	2004	2005	1Q'06
Target-date				
Fidelity	49.1	7.0	9.4	**4.1**
Vanguard	10.7	2.3	5.4	**2.1**
T. Rowe Price	10.4	2.8	4.3	**1.6**
Princor	4.4	0.8	1.5	**0.7**
State Farm	1.5	0.5	0.5	**0.2**
Others	*6.6*	*1.8*	*1.6*	*0.5*
Risk-based				
John Hancock	18.2	-	0.5	**1.2**
AllianceBernstein	3.9	1.0	1.3	**0.6**
OppenheimerFunds	1.3	-	0.7	**0.5**
TA IDEX Funds	5.8	1.4	0.9	**0.4**
Vanguard	22.2	2.0	1.6	**0.4**
Others	*89.5*	*11.5*	*10.5*	*2.9*

Source: Strategic Insight Simfund MF

Twenty-odd **new lifecycle fund series** were launched in the past 12 months: among these, the top three in terms of **1Q cash flows** were risk-based series run by **John Hancock** (gaining $1.2 billion; manager mix consulting by Deutsche Asset Mgmt), **OppenheimerFunds** ($491 million) and **Thrivent** ($309 million). (The John Hancock series came to market in October 2005 with $15 billion in existing assets, as a result of a reorganization from the manager's annuity and 401(k) business.) Within **Oppenheimer's Portfolio Series**, the distinctive **Active Allocation** option, which has a 20% tactical component, proved to be the most popular, drawing about $730 million in new money since inception in April last year, or about 60% of the net flows the four-option series has garnered in total over that period.

Fine-tuning Investment Strategies

Lifecycle fund providers are considering various strategy changes to make their offerings more robust and stand out from the rest of the field. **Fidelity** and **Vanguard**, for instance, recently increased and filed to increase respectively, the equity exposure of their target-date offerings, and within equity, allocation to international equity. Both also added new underlying funds in non-traditional asset classes (Fidelity added its Strategic Real Return fund as an underlying fund for its Freedom series, and each of Vanguard's Target Retirement funds will soon assign some assets to emerging markets equity.) Both managers also filed to expand their respective series by adding new target dates.

Principal added within its Lifetime portfolios an "active rebalancing strategy" that allows shorter-term tactical shifts within target asset class ranges. Also, **Wells Fargo's** target-date Outlook series filed to switch to an indexing strategy and a FoF structure, and replace subadvisor BGI with Global Index Advisors.

ETF: 1Q Update

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Open-end ETFs attracted a record $20 billion in net flows in the first quarter, helped by the largest-ever quarterly flow gains within open-end international equity products.

ETF Assets and Flows $B: By Structure

	Assets	Net Flows			
	3/06	2003	2004	2005	1Q06
Open-End	235.6	18.7	49.5	53.2	**19.7**
UIT/Others	94.1	-4.7	5.0	0.6	**-10.6**
Total above	**329.7**	**14.0**	**54.6**	**53.7**	**9.1**

Source: Strategic Insight Simfund MF, Company reports

UIT ETFs, which are mostly used by institutional investors, gave back nearly $11 billion in aggregate, owing to redemptions within some of the largest funds with this structure. Such volatile flow trends are typical during rising stock market periods among UIT products, possibly due to unwinding of short positions.

ETF Assets and Flows: By Investment Area

	Assets $B	Net Flows $B			# of
	3/06	2004	2005	1Q06	ETFs
US Equity	**232.7**	35.6	24.3	-1.4	160
Int'l Equity	**81.0**	15.3	23.0	9.4	49
Bond	**15.5**	3.6	6.3	0.7	6
Money Mrkt	**0.5**	-	0.1	0.4	1

Source: Strategic Insight Simfund MF, Company reports

Although BGI continues to occupy a commanding position in the ETF space, **Vanguard, PowerShares** and the **World Gold Trust** are also growing their assets noticeably. Five of PowerShares' 37 (as of 3/06) offerings had 1Q flows in excess of $100 million; another three gained between $50 million to $100 million each. Also, **Rydex** collected nearly $380 million over the quarter within its innovative currency-based product, the **Euro Currency Trust**, incepted in December. The manager also added six new products in 1Q (based on S&P/Citigroup "pure style" indexes), expanding its lineup to nine ETFs. Furthermore, it has six exchange-traded currency trusts in registration.

ETF Assets and Net Flows $B: By Manager

	Assets	Net Flows		
	3/06	2004	2005	1Q'06
Barclays Global	196.2	43.5	42.7	**13.1**
Vanguard	15.0	2.7	4.7	**2.9**
PowerShares	5.5	0.3	2.8	**1.9**
World Gold Trust	6.5	1.4	2.6	**1.5**
Rydex Global Advisors	2.2	0.5	0.7	**0.5**
DB Commodity Services	0.3	-	-	**0.3**
First Trust Advisors	0.0	-	0.0	**0.0**
Fidelity	0.1	-0.1	0.0	**0.0**
Bank of New York	30.4	-4.8	-1.5	**-0.9**
State Street Global	73.4	11.0	1.7	**-10.3**

Source: Strategic Insight Simfund MF, Company reports

A new entrant to the ETF arena in 1Q was **Deutsche Bank** affiliate **Deutsche Commodity Services**, whose pioneering **DB Commodity Index Tracking Fund** (DBC) was the first US exchange-traded vehicle based on a diversified commodities index (the Deutsche Bank Liquid Commodity - Excess Returns Index). Like the two gold- and one currency-based commodity ETFs that preceded it, DBC is not a registered investment company, but a **grantor trust**. But unlike them, it does not have physical holdings of the commodities it seeks to track, but rather draws on futures to achieve its commodities exposure. In a **master-feeder structure** atypical for ETFs, DBC has been set up as the feeder fund that invests its assets into a master fund that is structured as a **limited partnership**. The master invests in futures contracts based on these six commodities: Light Sweet Crude Oil, Heating Oil, Aluminum, Corn, Wheat and Gold.

ETFs Listed in April 2006

- Close on the heels of DBC came another futures-based vehicle: newcomer **Victoria Bay Asset Management's US Oil Fund** started trading on the AMEX on April 10th and had grown to $230 million in assets as of May 17th. The fund is set up as a limited partnership.
- BGI's **iShares Silver Trust** (a grantor trust) started trading on April 21st, and had accumulated close to $970 million in assets by May 17th.
- Vanguard's new **Dividend Appreciation VIPERs** held about $50 million as of May 18th.
- **First Trust Advisors** came to market with three new ETFs based on these indexes: IPOX-100 Index (tracks top 100 recent initial public offerings), Nasdaq-100 Equal Weighted Index and Nasdaq-100 Technology Sector Index.

Inside FundFiling.Com: Fund Closing

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Funds close for a variety of reasons. They close ahead of liquidation / mergers; sometimes certain share classes are closed ("e.g., "B" shares lately). **Generally, fund closure to new or all investors is associated with portfolio management capacity constraints and efforts to stem asset growth.**

Asset size was behind the April 28th closing of four **Fidelity** funds: Fidelity Contrafund, Fidelity Advisor New Insights, Fidelity Growth Company and Fidelity Mid Cap Stock. At the time of its closing, the Contrafund had nearly $65 billion in assets. A fifth Fidelity fund, Fidelity Japan Smaller Companies, closed in February.

At times, funds discuss a ***future*** **close by giving the asset level at which new investment will no longer be accepted** (e.g., Sentinel Small Company—asset ceiling of $1.6 million; Schwab Laudus Rosenburg U.S. Discovery—$1 billion). **Vanguard** recently closed three funds; the small cap Vanguard Explorer ($12.7 billion, closed to new investors; and also limited its current shareholders to a $25,000 annual investment per fund account). Vanguard also closed its Precious Metals and Mining fund to new accounts ($3.5 billion); and its Strategic Equity fund ($6.9 billion), but without limiting additional share purchases by current shareholders.

High Yield Munis is one bond fund sector where frequent closings are common due to limited securities supply. One example: **AIM High Income Municipal** fund (after being closed since August 2005, it re-opened for a one week period on April 17, and then closed again).

Higher Minimums to Slow Growth

Instead of closing a fund to control asset growth, some managers increase minimum investments to control growth. Just this past month, Vanguard Windsor II and Vanguard Wellington, each holding over $40 billion in total assets, raised minimum initial investment for their Investor shares from $3,000 to $10,000 for all new accounts, including IRAs and custodial accounts for minors. The funds also closed to certain retirement plans that do not currently invest in the fund and to new accounts and additional purchases in certain non-retirement accounts not held directly at Vanguard.

The Bank of New York's Hamilton Money and Hamilton Treasury Money funds raised the minimum initial investment for new investors in the "Hamilton" share classes to $10,000,000 (from $1,000,000), and in their "Premier" share class to $1,000,000 (from $500,000). Lately, **Columbia Management Advisors'** Acorn fund, which holds $18 billion in assets, and Acorn USA fund raised their minimum investment to $75,000 (from $1,000) for classes A, B and C, and to $75,000 (from $50,000) for class Z.

OppenheimerFunds' International Small Company and Developing Markets funds raised their minimums from $1,000 and $5,000 respectively, to $50,000. Effective March 1, 2006, **Third Avenue** raised the minimum initial investment of its Value, Small-Cap Value, and Real Estate Value funds from $1,000 to $10,000. Finally, **Amcore's** Vintage funds increased their minimums to $10,000 (an aggregate for all Vintage funds) from $1,000.

Funds Re-Opening

In January, the **Blackrock Schnieder Small Cap Value** ($112 million), re-opened. **Morgan Stanley's Special Value** ($687 million), reopened in February. And the **Van Kampen Small Cap Value** ($317 million) and **Prospect Japan Smaller Companies** ($97 million) reopened in March and April, respectively.

Funds and Classes Being Introduced

The pace of new fund introductions has spiked in the past few months, with an average of 92 funds being registered per month, compared to 57 per month in 2005. Of the 277 new funds filed in 1Q'06, 40% were international equity funds. Among new share classes registered this year, Classes A, R and Institutional came in on top with 13%, 25% and 34%, respectively.

Fees & Expenses

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The tables below update SI's industry benchmarks for management fee ratios (combining advisory and administrative fees). With rising funds' assets year-to-year, **management fees during fiscal 2005 have generally decreased**, mostly due to a realization of economies of scale due to appreciation and breakpoints kicking in as funds assets increase. Use of fee waivers impacted fee ratio results of some of the smaller funds below.

Diversified US Equity Funds
Median Expense Ratios by Portfolio Asset Size

	Advisory / Admin		
Assets	**2005**	**2004**	**Difference**
$1Billion +	0.673%	0.681%	-0.008%
$500MM-1B	0.750%	0.761%	-0.011%
$250-500MM	0.782%	0.800%	-0.018%
$100-250MM	0.803%	0.819%	-0.016%
$50-100MM	0.799%	0.824%	-0.025%
$25-50MM	0.715%	0.757%	-0.042%
Median	**0.752%**	**0.776%**	**-0.024%**

Source: Strategic Insight Simfund, SI Research

International Equity Funds
Median Expense Ratios by Portfolio Asset Size

	Advisory / Admin		
Assets	**2005**	**2004**	**Difference**
$1Billion +	0.803%	0.864%	-0.061%
$500MM-1B	0.864%	0.872%	-0.008%
$250-500MM	0.945%	0.952%	-0.007%
$100-250MM	0.906%	0.958%	-0.052%
$50-100MM	0.901%	0.860%	0.041%
$25-50MM	0.723%	0.898%	-0.175%
Median	**0.871%**	**0.902%**	**-0.031%**

Source: Strategic Insight Simfund, SI Research

Specialty Equity Funds
Median Expense Ratios by Portfolio Asset Size

	Advisory / Admin		
Assets	**2005**	**2004**	**Difference**
$1Billion +	0.640%	0.609%	0.031%
$500MM-1B	0.616%	0.694%	-0.078%
$250-500MM	0.871%	0.769%	0.102%
$100-250MM	0.749%	0.812%	-0.063%
$50-100MM	0.807%	0.835%	-0.028%
$25-50MM	0.833%	0.850%	-0.018%
Median	**0.748%**	**0.752%**	**-0.004%**

Source: Strategic Insight Simfund, SI Research

Bond Funds
Median Expense Ratios by Portfolio Asset Size

	Advisory / Admin		
Assets	**2005**	**2004**	**Difference**
$1Billion +	0.463%	0.492%	-0.029%
$500MM-1B	0.503%	0.507%	-0.004%
$250-500MM	0.500%	0.527%	-0.027%
$100-250MM	0.471%	0.499%	-0.028%
$50-100MM	0.461%	0.501%	-0.040%
$25-50MM	0.362%	0.420%	-0.058%
Median	**0.478%**	**0.500%**	**-0.022%**

Source: Strategic Insight Simfund, SI Research

Money Market Funds
Median Expense Ratios by Portfolio Asset Size

	Advisory / Admin		
Assets	**2005**	**2004**	**Difference**
$1Billion +	0.270%	0.320%	-0.050%
$500MM-1B	0.356%	0.385%	-0.029%
$250-500MM	0.350%	0.393%	-0.043%
$100-250MM	0.338%	0.413%	-0.075%
$50-100MM	0.250%	0.326%	-0.076%
$25-50MM	0.247%	0.250%	-0.003%
Median	**0.318%**	**0.355%**	**-0.037%**

Source: Strategic Insight Simfund, SI Research

Methodology: Data contained in this report 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. The data includes open-end actively managed funds only. Portfolios with average assets under $25 million during the reporting period were excluded. We also excluded portfolios with single, all-inclusive fees, hub & spoke funds, and funds sponsored by not-for-profit managers.

15(c)

Economies of Scale in Brokerage Commissions: The Largest Funds

One area receiving increased attention in recent years is the cost of securities trading and brokerage commissions among equity funds. In this section, we offer some observations on the commission costs of some of the nation's largest equity funds.

The following table shows **brokerage commission costs for the largest actively-managed equity funds.** Commission costs, as a percentage of fund assets, were tabulated during each of the latest three fiscal years (the dollar amount spent on brokerage commissions is disclosed in the Statement of Additional Information (SAI) of funds; that number was divided by the average size of the fund during each reporting fiscal period to arrive at the commission ratio). We also averaged the turnover ratio of each fund since 2003, as captured in our Simfund MF database.

Brokerage Commission Costs in the Fund Industry: 25 Largest Actively Managed Equity Funds

	Brokerage Commissions (in Basis Pts. of Fund Assets) 1 Basis Point = 0.01%			Past 3 Yrs Turnover Ratio
	2003	2004	2005	Average
Median Ratio Largest Active Equity Funds	9.3	7.1	6.2	25
Lowest	2.5	2.4	2.0	6
Highest	21.8	21.4	15.0	64

Source: Strategic Insight Simfund MF

For these large equity funds, commission costs in recent years generally declined, as fund sizes increased and turnover slowed down. The median values fell from 9.3 basis point in Fiscal 2003 to 6.2 basis points in Fiscal 2005 (a 10-basis-point ratio implies that an amount equal to one-thousandth of the value of the fund was spent on trading commissions that year – e.g., a $1 billion fund spent $1 million in direct costs of brokerage trading commissions).

Between 2003 and 2005, 13 of the 20 largest actively managed equity funds (see table below) decreased brokerage commission costs (as a percent of average assets) by more than 30%, with the median decrease equaling 35%. Only one of the 20 funds experienced a rise in its commission ratio from 2003 to 2005. Not surprisingly, turnover is clearly correlated with commission costs. Smaller cap stock or international funds also tend to present higher commission costs.

US index funds, with their minimal trading activity, experienced less than one basis point in brokerage commission costs. International index funds do sometimes experience higher commission costs (5-7 basis points in one such large fund), probably due to rebalancing needs and higher trading costs.

Below are brokerage commission trends among 20 largest actively managed equity funds, as estimated by SI.

Commissions as a % of Avg Assets during Fiscal Year

	2003	2004	2005
Growth Fund of America	0.112%	0.078%	0.054%
Investment Company of America	0.055%	0.034%	0.035%
Europacific Growth	0.113%	0.119%	0.118%
Washington Mutual	0.084%	0.043%	0.028%
Income Fund of America	0.166%	0.101%	0.086%
Fidelity Contrafund	0.179%	0.139%	0.121%
Capital Income Builder	0.130%	0.086%	0.073%
Capital World Growth & Income	0.128%	0.127%	0.119%
Dodge & Cox Stock	0.077%	0.036%	0.026%
American Balanced	0.105%	0.073%	0.063%
Fidelity Magellan Fund	0.058%	0.035%	0.031%
New Perspective	0.104%	0.070%	0.081%
Vanguard Windsor II	0.090%	0.057%	0.074%
Franklin Income Series	0.058%	0.032%	0.045%
Vanguard Wellington	0.065%	0.036%	0.025%
Fidelity Low Priced Stock	0.137%	0.114%	0.080%
Fidelity Diversified Intl	0.218%	0.214%	0.150%
Davis New York Venture	0.025%	0.024%	0.020%
Fidelity Growth & Income I	0.076%	0.071%	0.064%
Fundamental Investors	0.093%	0.069%	0.061%

Source: Strategic Insight Simfund MF, SI research

Naturally, trading costs for smaller funds with higher turnover, and especially international funds with higher custody, transaction costs, and market impact are significantly higher. Trading costs and market impact in such smaller funds are estimated at many multiples of the costs suggested above. Market forces will necessitate continuing attention to such shareholder expenses and increasing efficiency in managing investors' cash flows.

Board Talk

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Funds Closed to New Investors

Some Background

Among the many reasons, some inter-related, that funds temporarily close are:

- Investment capacity constraint, especially among smaller cap or specialized stock or bond strategies
- A portfolio management team's persistent failure to find new investments priced within the fund's valuation model
- A large and growing cash hoard
- Inflows that come in too large and too quickly to be invested
- A realization that too many investors are flocking to a fund at the wrong phase of its investment cycle
- Organizational "stress" due to hyper growth throughout a management company, not just one of its funds (where mutual funds' fast growth is paralleled by large institutional investments within the same style).

Since many attractive funds may experience a surge in new accounts and investments once their future closing is announced, some funds exercise a sudden, 'hard' close, where no additional investments are permitted after the announcement of closing. Such a 'hard' close can be very disruptive, though, especially for investors focusing on prudent dollar-cost averaging, retirement plans, and financial advisors using the fund to manage their clients' on-going, dynamic asset allocation needs.

Thus, **most 'closed' funds remain open for many of their existing shareholders, to financial advisors who already have clients invested in the fund, and to DC plans utilizing the fund, among others**. Some funds exercise a 'soft' close by significantly increasing the size of additional investments (e.g., to $25,000-$50,000).

It is often to the advantage of shareholders to keep some steady inflows into the funds, in order to balance regularly occurring redemptions, running at 1-2% of fund assets each month. With such balancing inflows, the need to liquidate securities is lessened.

Illustrating the 'semi' closed nature of funds, allowing them to continue to capture significant inflows from existing investors or advisors as well as DC plans, one such fund, Dodge & Cox Stock, which closed to new investors two years ago (1/04) has since its closing averaged $447 million in monthly net flows; these flows in combination with the fund's NAV gains since closing have led to a near doubling of asset size, to $57 billion.

A Status Report: Closed to Investors March 2006

As of March 2006, we identified 245 portfolios closed to new or all investors. Together these portfolios managed $716 billion. (Note that this data excludes the April and May closures of a number of very large funds from Fidelity and Vanguard, as well as other funds, which together manage over $100 billion.)

These 245 portfolios are summarized below: **only** 59, or **24%, are offered by managers who principally sell through financial advisors with traditional load funds**. (These funds controlled roughly **15% of all closed-to-investors funds' assets.)** The other **funds are offered by managers focusing on direct, fee-only RIA, or institutional distribution, including to DC plans** (e.g., Fidelity, Vanguard, T. Rowe Price, Dodge & Cox, Artisan, Baron, Hotchkis & Wiley, RS Funds, Royce, Tweedy Browne, Third Avenue, etc.).

Closed to New Investors 3-06: Actively Managed Equity Funds

Morningstar Category 3-06	Assets $B	% of Total
US Large Cap	171	24%
US Mid Cap	151	21%
US Small Cap	148	21%
Subtotal Diversified US	***470***	***65%***
Asset Allocation	44	6%
Sector / Niche Strategies	41	6%
Int'l/Global Large Cap	101	14%
Int'l/Global Small / Mid Cap	39	5%
Int'l Regional	5	1%
Emerging Markets	18	3%
Subtotal International	***163***	***23%***
Total Closed funds $B	**$718**	**100%**

Sources: SI Research, FundFiling.com, Simfund

Global FlowWatch



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Europe's Top Selling Mutual Funds and New Product Launches

In the first quarter of 2006, long-term mutual funds in Europe collected over €130 billion in net flows. Over half of that total went to the 100 highest cash flow funds, which gathered a combined €70 billion in net new money.

Highest Cash Flow Funds

Net inflows to the ten best selling long-term funds in Europe reached €14 billion during 1Q'06 (as shown by the table below, which does not include new fund launches).

Ten Highest Cash Flow Funds in Q1'06, € Billion Excluding Money Market Funds and New Funds

Fund Name	Category	Est. Flows Q1'06
Activest TotalReturn	Bond Global	2.0
INVESCO Bond Return Plus	Bond Euro	1.6
Julius Baer Absolute Return Bond	Bond Global	1.6
UOB Kinetics Paradigm	Mixed Assets	1.4
Fortis L Absol Return Bond Euro Plus	Bond Euro	1.3
MLIIF World Mining	Equity Sector	1.3
MLIIF US Flexible Equity	Eqty N. America	1.3
JPMF Global Capital Preservation	Mixed Assets	1.2
PIMCO GIS Total Return Bond	Bond Other	1.2
MLIIF New Energy	Equity Sector	1.1
Total Above		**14.1**

Source: Strategic Insight, Inc.; Lipper Inc. Data includes all share classes of a fund.

Absolute/total return continues to be a visible theme across Europe. Five of the ten funds shown above used such a strategy, adding a combined €7.7 billion in flows. Unicredito/Pioneer's Activest TotalReturn alone gathered over €2 billion in new money during the first quarter, making it both the largest and currently best selling fund in Germany. Another noteworthy trend was **rising flows to cross-border equity funds with distinct niche investment strategies**. For instance, **Merrill Lynch has been able to attract in excess of €5 billion in net new money to five of its flagship funds during 1Q'06:** MLIFF World Mining, MLIIF US Flexible, MLIIF New Energy, MLIIF Emerging Europe and MLIIF World Energy. As shown in the highest cash flow table, three of these funds (World Mining, US Flexible and New Energy) added over €1 billion each.

Highest Cash Flow New Launches

Over 300 new funds were launched across the key markets in Europe in the first quarter of 2006. Together these funds collected over €25 billion in net new money. Close to 35% of that total went to the ten highest cash flow long-term funds

The top ten fund introductions gathered a total of over €9 billion in flows in 1Q'06, and included a mix of locally registered funds, as well as roundtrip Luxembourg funds, with a focus on capital guaranteed, equity Europe and diversified bond strategies. The three highest selling new funds in Europe so far in 2006 have been in Italy, with capital guaranteed and absolute return approaches. **Credit Agricole's Intesa Garanzia Attiva I Semestre 2006, a capital guaranteed fund, has so far raised €2.6 billion in net flows. The SPI Fund Abs Attivo and SPI Fund Abs Prudente, the two absolute return products launched by Sanpaolo, attracted over €3 billion in net new money combined through March 2006.**

New Funds Launched in Q1'06 Ten Highest Cash Flow Funds in Europe, €Billion Excluding Money Market Funds

Fund Name	Category	Est. Flows Q1'06
Intesa Garanzia Attiva I Semestre 2006	Guaranteed	2.6
SPI Fund Abs Attivo	Mixed Assets	1.8
SPI Fund Abs Prudente	Bond Global	1.5
Al Dente 3	Guaranteed	0.5
Deka-KickGarant 2006	Guaranteed	0.4
ZIF Aktien Schweiz	Equity Europe	0.4
Tonga 2	Guaranteed	0.4
Deka-WorldGarant 1/2012	Guaranteed	0.4
DWS Zukunftsressourcen	Equity Global	0.4
Dexia bonds Euro Corporate	Bond Corp	0.3
Total Above		**8.8**

Source: Strategic Insight, Inc.; Lipper Inc. Data includes all share classes of a fund.

Global Horizons

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Fund Distribution: Getting on Select Lists, Securing Partnerships, and Increasing Sales

Over the past year, our global research team conducted many discussions with senior executives at a wide range of fund management and distribution organizations in Europe, Asia and the US on the topic of how fund distribution is changing and what it means for asset managers. We identified several developments impacting our industry and the wholesaling, marketing, prospecting, and client services strategies of fund managers. Among them:

- **Growing importance of fund selection units (FSUs)** and "select lists";
- **Centralization of fund and manager selection** within distribution organizations;
- **More intensive demands for fund information and support;**
- **Wider distribution opportunities** as banks, wealth managers and other intermediaries increasingly seek to offer external investment expertise;
- **Increasing conflicts and linkages between retail and institutional sales efforts;**
- **Selective re-evaluations of investment management and distribution competencies,** and associated industry M&A decisions.

Although varying in degree and detail across markets, these changes are nevertheless noticeable around the world suggesting that the global distribution landscape will continue to evolve rapidly, creating organizational and strategic challenges for most fund managers, but also opportunities for business development. We discuss these and other issues in our recent in-depth study, *"Fund Distribution: Getting on Select Lists, Securing Partnerships, and Increasing Sales"*.

Some of the highlights:

- Several large banks in Europe moved towards distribution platforms featuring a limited number of **"preferred provider" partnerships**. While these have created meaningful asset gathering opportunities for a few top tier managers, they have also made distribution more challenging for other smaller, less well-known money managers. Looking across the lists of preferred fund vendors in Europe, one tends to see largely the same names.
- On the other hand, some distribution groups, among them private banks and smaller intermediary organizations, continue to **differentiate their platforms by offering lesser known but distinctive specialist investment managers**, partly to help promote perceived exclusivity.
- Responding to the growth of FSUs, wholesalers are seeing the **need to build and maintain multiple relationships within a distribution organization**—on the one hand, working with the centralized FSU, and on the other, continuing to service local advisory units or branches to ensure sales.
- Nurturing such relationships over a long period of time has led asset managers to **rethink the setup of wholesaling teams and appropriate sales approaches and objectives**. A number of asset managers are focusing on fewer, potentially more profitable distribution agreements and attempting to reduce or eliminate smaller cost- and service-intensive relationships.
- The institutionalization of mutual fund selection alongside more complex products and shorter turnaround time has led a number of successful fund vendors to reorganize wholesaling teams and structures, as well as **build up dedicated research teams and support units that deal with ongoing requests and sophisticated analytics.**

Variable Annuities



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Risk Management as a Competitive Factor

Effective risk management facilitates the various guarantees that accompany VA contracts, from the more predicable nature of death benefits to the significant uncertainty of the un-hedgeable aspects of the various living benefits currently dominating VA purchases. Clearly, **VA innovations will continue to depend on carriers' ability to control the embedded variability of such costs—and tolerating a degree of uncontrollable risk—within a band of probable outcomes acceptable to insurers and their public shareholders**.

The recent bear market endangered the financial well-being of some carriers because of secondary guarantees. It also served to raise awareness of the gravity of the risk that VA issuers assume. Thus, rating agencies, investors and regulators increasingly are keen to the potential harm mismanaged risk could trigger, and have become more attentive to risk management practices.

With the predominance of new hedging techniques, capital market solutions and a reinvigorated reinsurance market, carriers have been able to continue their historical pattern of competing with innovation of secondary benefits, as we have captured in the AnnuityInsight.com pages of the past few years. Yet, these enrichments further "enrisk" the insurer. For example, Professor Moshe Milevsky in Toronto suggests that some guaranteed minimum withdrawal benefits (GMWBs) may well be underpriced (yet some carriers may not rely just on the fee charged for a rider alone to cover its cost, dipping also into the mortality and expense fee revenues).

Approaches to the risk of Living Benefits vary, so **carriers that accept a higher level of risk in certain areas are able to offer a broader array of product innovations** related to secondary guarantees in a sharply competitive environment.

Risk Management via Fund-of-Funds

A growing predominance of fund-of-funds among VA sub-accounts is supported by requirements of many carriers that investment limitations such as allocation programs or fund-of-funds are a condition of electing certain Living Benefits; this mitigates the risk of investors over-allocating in either excessively aggressive or underperforming (fixed income) options.

Of the top 10 VA contracts by FoF flows over the past year, six have asset allocation requirements. Furthermore, some carriers that do not currently have an asset allocation or other investment requirement associated with Living Benefits are exploring changing that.

Secondly, the shift away from the immediate appeal of the hottest "fund-*du-jour*" to options that satisfy longer-term needs is part of a dynamic where customers are less likely to experience "buyer's remorse" that can fuel faster redemptions, instead **increasing investor satisfaction and reducing asset mobility**.

Required use of funds-of-funds plays a significant role in FoFs' growth. **But our data also demonstrates that at times investors are using these strategies even in the absence of forced FoF use** (see chart below).

Top Contracts By Fund of Funds Net Flows 3/06

Contract Name	Trailing 1Y to 3/06, $B Sub-account Net Flows Only FoF	Total	Asset Allocation Required For Living Benefit
John Hancock Venture III	**3.8**	4.7	Yes
John Hancock Venture	**1.8**	1.9	Yes
Equitable Accumulator Elite 2004	**1.2**	2.5	No
Equitable Accumulator Plus 2004	**1.2**	2.9	No
Equitable Accumulator 2004	**1.0**	2.3	No
Am Skandia Apex Annuity II	**1.0**	2.3	Yes
Am Skandia XTra Credit SIX	**0.9**	1.5	Yes
Metlife Investors USA XC	**0.9**	0.9	Yes
Thrivent Variable Annuity	**0.8**	0.3	n/a
ING GoldenSelect Premium +	**0.8**	1.6	Yes

Source: Strategic Insight Simfund VA

Tools Time: Simfund



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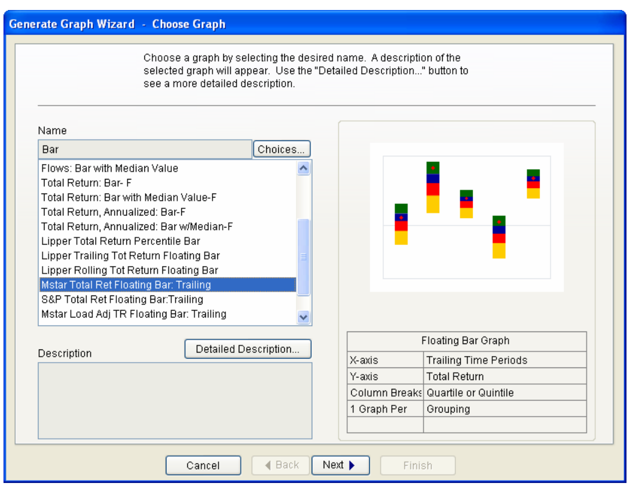
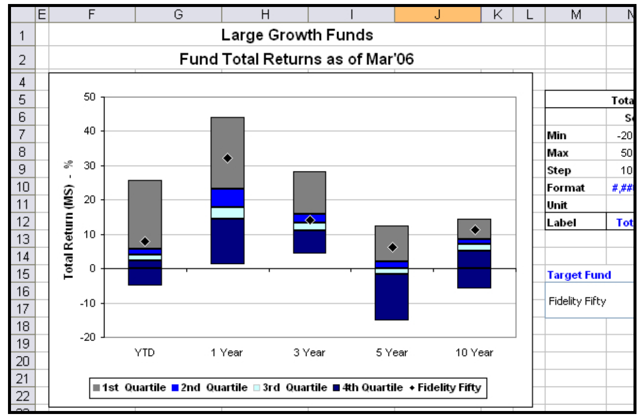
The **choice of peer group can significantly impact a fund's relative performance ranking**. Two widely used fund investment style measurements—Morningstar Category and Lipper Classification—exemplify this point. Simfund integration of multiple datasets offers the ability to quickly identify and assess performance ranking differences based on measurement universe.

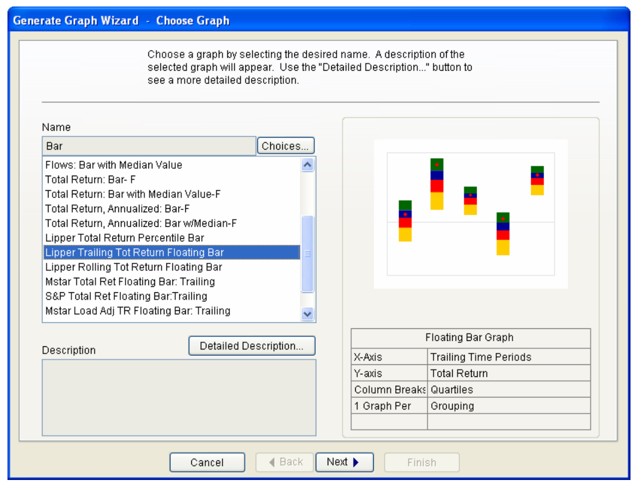
Report 1 - Using **Morningstar's Large Growth universe**: choose all Large Growth funds (only their primary share class) and run the following graph in Simfund:

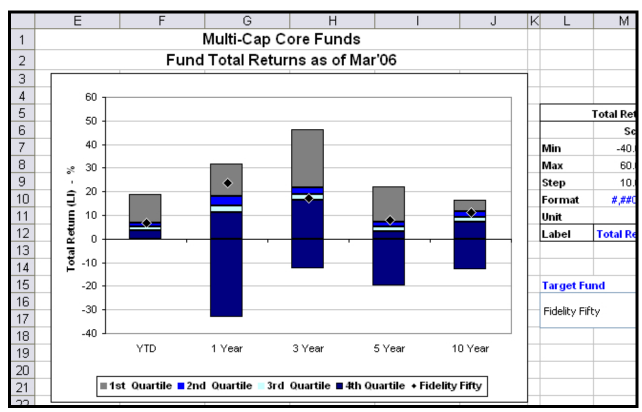


The resulting report shown below will be available to you in Excel. Within the EXCEL spreadsheet, you can choose the Fidelity Fifty fund as the "target" fund to be plotted against other funds, from the drop-down list to the right of the chart.



Report 2 - Using **Lipper Multi-Cap Core universe** – choose all such funds (only primary share class) and run the following graph in Simfund:





Clearly, **relative performance** over a short term horizon and on a long-term basis **can vary significantly**. This is true even when the fund is classified similarly by the various ranking services, since the peer fund universe is inevitably not identical.

Note that in this example we **controlled for one type of bias in performance benchmarking—multiple share classes—by selecting only the 'primary' share class**.

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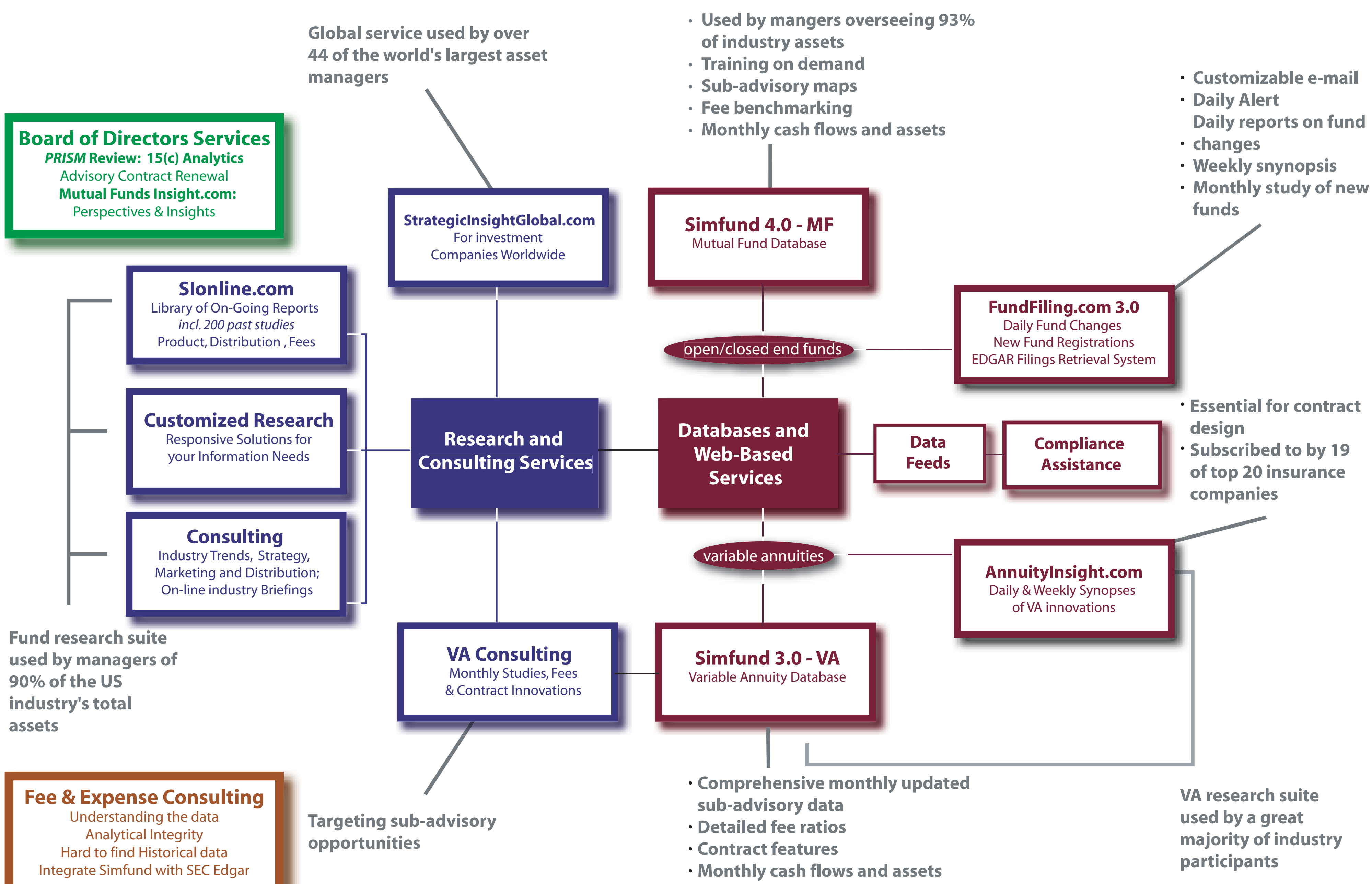

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