An annual review of Morningstar Indexes in 2004 and relevant market activity affecting Index performance.

Morningstar® Indexes Yearbook 04



Introducing the Morningstar® Indexes Yearbook.

Morningstar is pleased to present you with the inaugural issue of the Morningstar Indexes Yearbook.

This annual year-in-review will highlight Morningstar Index performance from the previous year, provide Index data, and include commentary from Morningstar staff. This year's edition examines companies that made and lost the most money for investors by identifying those that created or eroded the most value for shareholders. We look back on memorable dividend-paying stocks and whether actively managing small caps and indexing large caps paid off in 2004. This issue includes a Client Spotlight with Barclays Global Investors.

We launched our family of 16 indexes in 2002, tracking the U.S. market by capitalization and investment style to create a cohesive, integrated framework. The Indexes provide a solid foundation that can be used at all stages of the investment process, including stock research, portfolio assembly, and market monitoring. Distinct and style-pure Indexes are a natural extension of Morningstar's mission to create great products that help investors reach their financial goals.

We hope you find this year's Morningstar Indexes Yearbook a valuable resource. To further discuss Morningstar Indexes, please call 1 312 696-6507 or e-mail sanjay.arya@morningstar.com.

Sanjay Arya | Director of Morningstar Indexes

Table of Contents

Highlights of the 2004 Markets	**2**	Industry Issue: Purity of Indexing
	3	What Drove the Market? Trends in 2004
	8	Market Value Creators and Destroyers
	10	Searching for Yield
	12	Active Vs. Passive: How the Two Strategies Fared
Morningstar Indexes Data Overview	**14**	2004 Performance Wrap-up
	16	US Market℠ Index Report
	17	Large Value℠ Index Report
	18	Large Core℠ Index Report
	19	Large Growth℠ Index Report
	20	Mid Value℠ Index Report
	21	Mid Core℠ Index Report
	22	Mid Growth℠ Index Report
	23	Small Value℠ Index Report
	24	Small Core℠ Index Report
	25	Small Growth℠ Index Report
	26	Morningstar Market Barometer℠: Three Year Review
Appendices	**28**	Morningstar Indexes Methodology
	30	Morningstar Indexes Glossary
Client Spotlight	**32**	Barclays Global Investors

Industry Issue: Purity of Indexing

By eliminating core stocks and abolishing holdings overlap, Morningstar® Indexes provide distinct portfolio building blocks.

Don Phillips
Managing Director

Not all indexes are created equal: Even seemingly interchangeable ones such as "domestic large-cap value" indexes can differ significantly. We created the Morningstar style indexes as pure distillations of style, not as re-creations of active managers' behavior. We know that active managers deviate from their mandates when their styles go out of favor. Why try to replicate such imperfections in an index when the opportunity to create a more disciplined alternative exists?

By eliminating core stocks and abolishing holdings overlap, we end up with very distinct style characteristics in our value and growth indexes. Our value index has lower price ratios for forward earnings and cash flow and a higher yield than the overall market and conventional value indexes. Our value index sports a price-to-forward earnings ratio that is more than 10% lower than that of a conventional value index, and it produces a dividend yield that is 50% higher. In short, with the Morningstar Indexes, value really means value.

Similarly, our growth index holds stocks whose revenue and cash flow are growing much faster than those of the broad market or conventional growth indexes. Moreover, the market's earnings expectations for the stocks in our large-growth index are more than 25% greater than for those of standard growth indexes. Simply put, investors seeking growth stocks will find them in a purer fashion in our index than in most alternatives.

Style-pure indexes can be used to form index funds or exchange-traded funds that allow investors to more easily reposition a portfolio. It would take a much smaller sampling of our growth index than of a more conventional index to bring a value-heavy portfolio to style neutrality.

Value Means Value 06-30-04

Index	Price/Earnings	Price/Cash Flow	Div Yield %
Morningstar Large Value	13.1	5.4	3.0
Conventional Large Value	14.8	5.9	2.0
Overall Market	17.2	8.0	1.6

Growth Means Growth 06-30-04

Index	Fwd Earn Grwth	Cash Flow Grwth	Sales Grwth
Morningstar Large Growth	15.8	14.2	11.7
Conventional Large Growth	12.3	11.1	7.3
Overall Market	11.0	7.2	4.8

By doing the basic blocking and tackling of portfolio construction more efficiently, our indexes allow a higher percentage of client assets to be placed in alpha-generating active managers, giving investors the best of both worlds—the ability to deploy disciplined passive strategies, while still allowing for active management.

As investors become more modular in their portfolio construction, index-oriented investment options can play a powerful role in building or adjusting a client's market posture. Rather than seeking to imitate active management, we've sought to create something new: a highly disciplined, style-pure set of tools to allow for more efficient portfolio construction. By complementing, rather than displacing, active management, we set the stage for better integration of passive and active strategies.

What Drove the Market? We Analyze the Trends in 2004

Investors grappled with uncertainty for most of the year, but the U.S. stock market closed out 2004 with a decent showing after all.

Amy C. Arnott
Director of
Securities Analysis

For the first three quarters of the year, a litany of doubts seemed destined to keep returns in a holding pattern: the threat of higher inflation driven by surging oil and natural gas prices, steadily rising interest rates, questions about the outcome of the presidential election, a slumping U.S. dollar, and mixed news about the strength of the economic recovery. By the end of the third quarter of 2004, Morningstar's US Market℠ Index had gained only about 2% for the year.

But optimism ultimately won out, as the market quickly shook off its doubts following decisive Republican wins in the November election. Thanks to a 10.1% gain during the fourth quarter, the US Market Index finished the year up 12.4%. Investors not only took comfort in the firmer political landscape, but also seemed reassured by the Federal Reserve's slow-and-steady policy of gradual interest-rate hikes, which have so far kept inflation in check without choking borrowers accustomed to easy, low-cost money. A spate of merger news late in the year—including Sears/Kmart, Johnson & Johnson/Guidant, Sprint/Nextel, Oracle/Peoplesoft, and Symantec/Veritas, to name a few—also gave the market a shot in the arm.

Style Performance

Value Stocks Continue to Dominate

Reversing the trend shown in 2003, growth stocks lagged behind their value counterparts by a huge margin. In 2004, Morningstar's US Growth Index gained just 4.4%, compared with a 16.9% runup for the US Value Index.

Morningstar® US Value Index℠ +16.9%

Except for some middling results in the second quarter, the US Value Index dominated the Style Box map for most of 2004 as cautious investors shied away from pricier growth stocks. A 15% stake in the buoyant Energy sector was a definite plus. Top holding ExxonMobil, for example, gained 28% for the year. Formerly troubled TXU Corporation was another major positive contributor to returns. The stock surged more than 170% as it continued to make significant operational improvements and pay down debt. Kmart Holding Corporation was another positive contributor to the Value Index. The stock tripled in value during 2004 as it emerged from bankruptcy and announced plans to merge with Sears.

At the same time, the Value Index sidestepped most losses from the sagging Healthcare sector. Merck and Bristol-Myers Squibb were the two biggest negative contributors to index returns for the year, but the damage was relatively limited, as Healthcare stocks—and drug stocks in particular—occupy a relatively small weighting in the index.

Because it also held up better than the Growth Index during the bear market from 2000 to 2002, the Value Index also ranks as the top performer of the three style-based indexes for the trailing three- and five-year periods.

Morningstar® US Core℠ Index +15.6%

Thanks to a strong showing late in the year, the US Core Index—which includes stocks that demonstrate a mix of value and growth characteristics—finished the year just slightly behind the US Value Index. Top holding General Electric, which makes up about 7% of the index's value, was the biggest positive contributor to index returns for the year. Shares of GE

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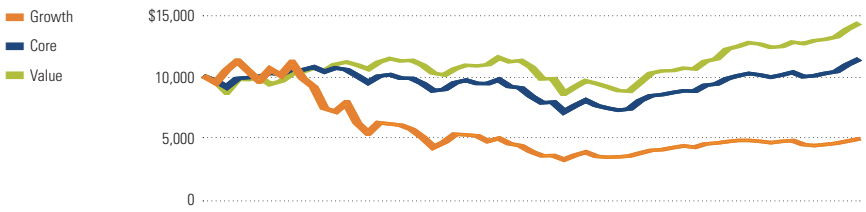
rose about 20% in 2004, as the company has made numerous acquisitions in an effort to boost future top-line growth. Consumer stalwarts such as Johnson & Johnson, Procter & Gamble, Target, and Home Depot were also strong contributors to the US Core Index for the year.

On the negative side, insurer Marsh & McLennan was a drag on returns; the shares dropped about 30% following news that New York Attorney General Eliot Spitzer had filed civil charges against the company for charging contingent commissions to insurance companies in exchange for getting more business. Drug maker Eli Lilly & Company, which made up about 1% of the index's value near the end of 2004, was another negative contributor. Shares in the stock fell in concert with other major drug makers, even though the company has one of the stronger new-product pipelines in the industry.

Morningstar Style Indexes: Five Year Growth of $10,000



Total Returns %	2000	2001	2002	2003	2004
Value	10.06	–0.68	–13.68	29.75	16.85
Core	7.10	–9.31	–21.18	28.63	15.62
Growth	–28.45	–26.32	–33.20	34.12	4.37

Morningstar® US Growth℠ Index +4.4%

After a brief moment in the sun in 2003's market rebound, the US Growth Index fell behind by a country mile again in 2004. The Index finished the year up just over 4%—more than 10 percentage points behind the Value and Core Indexes. Index returns were plagued mainly by losses on blue-chip growth stocks, such as Pfizer, Intel, Cisco Systems, and Coca-Cola. Aggressive growth stocks, such as Apple Computer, eBay, Qualcomm, Starbucks, and Yahoo!, kicked in impressive gains in 2004, but those returns were generally overshadowed by lackluster results among several of the top holdings in the Index.

Following 2004's disappointing showing, the US Growth Index has generated an annualized loss of 2.2% for the trailing three years, and is still nursing deep losses for the trailing five-year period. On the bright side, however, the price tags on growth-oriented stocks have dropped significantly over the past five years. The average price/earnings ratio for the Growth Index stood at 33.5 at the end of 2004. That's still well ahead of the P/E for core and value stocks, but more appealing than it was in 2001, when the Growth Index had a P/E of 47.4.

Best-Performing Style Index: Mid Value +24.3%

Morningstar's Mid Value℠ Index beat out the Small Value℠ Index by a hair in 2004. The Index is light on Healthcare and Hardware stocks, so it sidestepped most of the damage from those areas. At the same time, it has a 36% weighting in financial services stocks, which generally performed well despite the Fed's interest rate hikes during the year. TXU, Monsanto, Valero Energy, Norfolk Southern, and Simon Property Group were among the biggest positive contributors to returns for the Mid Value Index during the year.

Worst-Performing Style Index: Large Growth +0.2%

The Large Growth℠ Index just barely finished the year in positive territory. That's probably cold comfort to anyone who had hoped to take refuge from market uncertainty in classic growth stocks. Hardware and Healthcare stocks—which make up a combined 41% of the benchmark's value—were the main culprits. Among individual stocks, Pfizer, Intel, Cisco Systems, and Coca-Cola were the biggest negative contributors.

Cap Performance

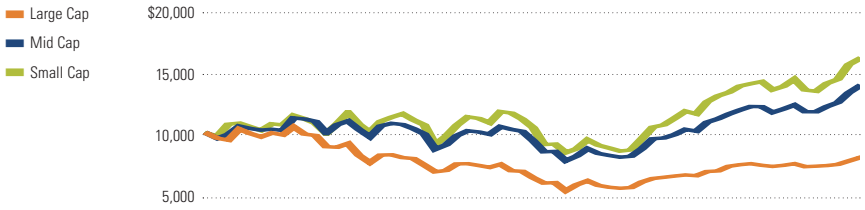
The Smaller the Better

There was also a gaping span in returns for the size-based indexes. With beleaguered blue chips weighing heavily on the benchmark, Morningstar's Large Cap Index gained 9.5% for the year, compared with a 20.4% gain for the Small Cap℠ Index.

Morningstar Large Cap℠ Index +9.5%

Despite finishing the year with positive returns, the Large Cap Index—which Morningstar defines as the largest 70% of outstanding market capitalization—again fell behind its small- and mid-cap counterparts by a big margin in 2004. Returns on blue-chip stocks were particularly disappointing because they should have had a headwind from the

Morningstar Cap Indexes: Five Year Growth of $10,000



Total Returns %	2000	2001	2002	2003	2004
Large Cap	–11.38	–15.10	–23.47	27.04	9.54
Mid Cap	6.94	–4.63	–18.06	38.38	19.66
Small Cap	7.66	5.26	–20.36	47.70	20.44

weak dollar. Indeed, most multinational companies enjoyed at least a couple of percentage points in extra sales growth thanks to currency movements. But many blue-chip firms have been struggling to generate organic growth, and investors have been more interested in smaller stocks that are better poised to benefit from the ongoing economic recovery.

Hardware stocks, including Intel, Cisco Systems, Texas Instruments, and Applied Materials, were among the biggest negative contributors to index returns during the year. Major drug makers, including Merck, Pfizer, and Eli Lilly, also contributed deep losses to the Index in 2004. Because large-cap stocks have consistently fallen behind smaller-cap issues for the past several years, the Large Cap Index has posted annualized losses of 4.3% for the trailing five-year period—about 14 percentage points behind the performance of the Small Cap Index over the same period. While smaller-cap stocks now look relatively pricey, Morningstar's analyst-driven fair value estimates for individual stocks suggest that large-cap issues offer more appealing valuations. As of late 2004, we found a clear pattern based on market capitalization: The larger the stock, the cheaper the price tag.

Morningstar® Mid Cap℠ Index +19.7%

Mid-cap stocks didn't fare quite as well as small-cap issues in 2004, but they still finished the year well ahead of lagging large-cap names. The Mid Cap Index has close to one-third of its assets in Morningstar's manufacturing super sector, which allowed it to benefit from stronger economic growth and healthy commodity prices. An additional 22% of Index assets are in the financial services sector, which generally fared well despite rising interest rates.

Apple Computer, which now ranks as the top holding by market capitalization in the Mid Cap Index, was by far the biggest positive contributor to returns, as soaring iPod sales helped drive the stock to a 200% gain (following December 2004 index reconstitution, Apple is now a member of the Large Growth Index). TXU, Autodesk, and Chicago Mercantile Exchange Holdings also contributed triple-digit gains for the year. On the negative side, a number of mid-cap growth stocks, such as Univision Communications, Sanmina-SCI, Tiffany & Co., and Mylan Laboratories, suffered sharp losses for the year. Because these stocks generally occupied smaller positions in the index, however, the damage was relatively limited.

For the trailing five-year period, the Mid Cap Index has generated relatively strong performance, with an annualized return of 6.7%. While large-cap stocks have fallen behind by a huge margin, the gap in performance between small- and mid-cap issues has been less pronounced.

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Morningstar Style Correlation Matrix

	Morningstar Large Value	Morningstar Large Core	Morningstar Large Growth	Morningstar Mid Value	Morningstar Mid Core	Morningstar Mid Growth	Morningstar Small Value	Morningstar Small Core	Morningstar Small Growth
Large Value	1.000								
Large Core	0.836	1.000							
Large Growth	0.521	0.696	1.000						
Mid Value	0.885	0.717	0.338	1.000					
Mid Core	0.863	0.780	0.573	0.919	1.000				
Mid Growth	0.451	0.619	0.891	0.349	0.573	1.000			
Small Value	0.763	0.641	0.435	0.891	0.904	0.499	1.000		
Small Core	0.685	0.678	0.703	0.732	0.878	0.796	0.875	1.000	
Small Growth	0.311	0.513	0.825	0.233	0.486	0.950	0.448	0.767	1.000

The matrix above shows the correlation coefficient between Morningstar Style Indexes. High correlation coefficient indicates a high linear relationship between two indexes.
All correlations calculated using 5-years of monthly return data.

Morningstar® Small Cap℠ Index +20.4%

The much-heralded "small-cap effect" was alive and well in 2004, as small-cap stocks continued to dominate the Index landscape for most of the year. Smaller-cap stocks normally outperform during periods of economic recovery; in addition, smaller-cap issues (which Morningstar defines as the bottom 7% of outstanding market capitalization of the Morningstar US Market℠ Index) have continued to generate both revenue growth and bottom-line profits while many blue-chip firms have struggled to sustain growth.

Drilling down to the individual stock level, the Small Cap Index also benefited from triple-digit gains in numerous gaming and retail stocks, including Wynn Resorts Limited, Boyd Gaming Corporation, American Eagle Outfitters, and Urban Outfitters. Winning stocks like these were more than enough to offset losses on downtrodden tech names such as Conexant Systems, Electronics for Imaging, and Integrated Device Technology.

Small-cap stocks have outperformed their larger brethren for four of the past five calendar years—an unusually long winning streak. Because of this consistent outperformance, valuations on many small-cap stocks are now relatively steep. That's not to say that investors shouldn't keep some assets in smaller-cap stocks, but we'd be wary of piling a lot of new assets into small-cap stocks at this stage in the game.

Sector Performance

Energy on Top

With a gain of 33%, the Energy sector was far and away the best performer of Morningstar's 12 economic sectors for 2004. Oil services stocks, such as Tesoro, Ultra Petroleum, and Valero Energy, posted the most eye-catching gains. But shares of the major integrated oil companies, such as Exxon Mobil and ChevronTexaco also generally enjoyed solid returns thanks to rising oil and natural gas prices during most of the year. Following its strong performance in 2004, the Energy sector now ranks as the top performer for the trailing three-year period.

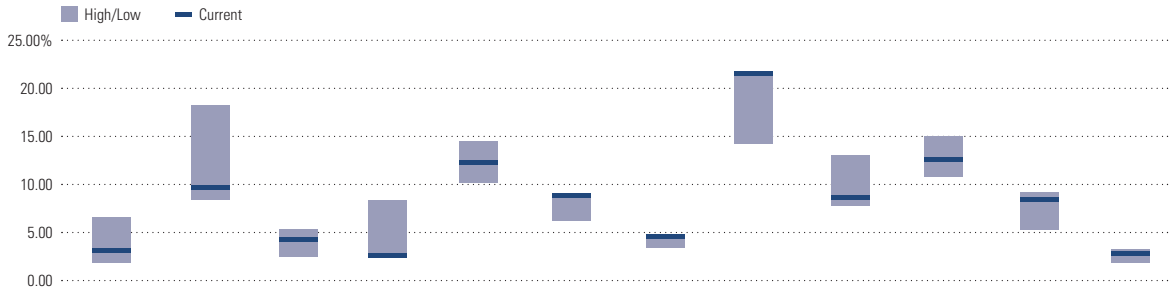
Morningstar Sectors Trailing Period Return

Sector	3-Month	1-Year	3-Year
Information	**13.83**	**3.62**	**–2.91**
Software	15.29	10.68	–2.51
Hardware	14.57	–3.65	–2.12
Media	14.73	4.81	–1.87
Telecommunications	8.54	17.96	–5.86
Service	**9.29**	**11.84**	**5.65**
Healthcare	6.02	3.76	–0.86
Consumer Services	12.67	17.71	8.04
Business Services	13.03	14.95	3.22
Financial Services	9.10	13.99	9.84
Manufacturing	**8.98**	**20.15**	**9.39**
Consumer Goods	10.10	11.75	9.60
Industrial Materials	9.85	18.71	7.67
Energy	5.05	32.99	13.88
Utilities	12.12	23.40	5.64

The Utilities sector was another strong performer for the year—generating total returns of 23.4% as companies in the sector have continued to benefit from favorable regulatory changes. Exelon, Southern, and Duke Energy led the sector with well above-average gains. The Industrial Materials sector, which benefited from strong global economic growth and firmer pricing power, was the third-best performer in 2004, with total returns of 18.7% for the year. Overall, the Manufacturing super sector fared far better than the Services and Information super sectors in 2004—again underscoring the impact of generally strong economic growth and rising commodity prices.

With a –3.7% return, the Hardware sector brought up the rear in 2004. That was a sharp contrast to 2003's heady market, when Hardware stocks hit the top of the performance charts with a 66% total return for the year. Chip equipment makers fell deeply out of favor because of rising inventory levels and weak pricing power. Network equipment maker Cisco Systems was another major drag on returns. After an 85% run-up in 2003, the stock lost about 20% of its value in 2004, as revenue growth began to show signs of slipping and margins deteriorated. Intel, which ranks as the second-biggest stock in the industry by market capitalization, was another negative contributor. Intel lost about 26% of its value over the year.

Morningstar US Market Sector Weight % from 1997–2004



	Software	Hardware	Media	Telecomm	Healthcare	Consumer Services	Business Services	Financial Services	Consumer Goods	Industrial Materials	Energy	Utilities
Max	6.53	18.87	5.22	8.13	14.84	8.93	4.73	21.46	12.78	14.90	7.72	3.62
Min	2.83	8.75	2.58	3.05	10.22	6.27	3.47	14.47	7.41	10.44	4.87	2.55
Current	3.94	9.80	4.15	3.05	12.48	8.93	4.73	21.46	8.45	12.18	7.29	3.22

The Healthcare sector remained in a slump for most of 2004, finishing the year with a paltry 3.8% gain. Healthcare stocks fared relatively well, but that was far outweighed by deep losses on major pharmaceutical stocks. First, Merck lost close to 30% of its market value after it pulled its pain and arthritis drug Vioxx from pharmacy shelves at the end of September. Pfizer's stock also suffered deep losses during the year as investors worried about industry-wide issues such as growing competition from generic drugs, the potential for heavier regulation, and the increased bargaining power of managed-care organizations. After much speculation, the company also announced that its arthritis drug Celebrex was found to have similar—though less severe—cardiovascular side effects to Vioxx.

Despite a solid showing in the fourth quarter, the Media sector was another relatively weak performer for the year, generating a 4.8% total return. While some stocks in the sector fared well, weak returns on bigger names such as Comcast and Viacom dragged down performance for the sector overall. The sector makeup of the Morningstar US Market Index underwent some changes during the past 12 months as well. Thanks to a surge in the Energy and Utilities sectors, the Manufacturing super sector increased its share of the US Market Index from 29.1% to 31.4%. A decline in the Hardware sector, meanwhile, led to a drop in the Information super sector's share of the US Market Index from 23.5% to 21%. The Service super sector, which contributed 47.4% at the beginning of 2004, was almost unchanged.

Market Value Creators and Destroyers

These firms created or destroyed the most equity market value in 2004.

Peter Smith
Stock Analyst

Despite the uncertainty that weighed on the market for much of 2004, most well diversified investors are probably pretty satisfied with the performance of their portfolios. The economy generated solid GDP growth of about 4%, inflation remained in check at less than 2%, and corporate profits grew at a torrid pace of around 20%. These factors boosted the share prices of many widely held companies and, by the end of the year, pushed the Morningstar US Market℠ Index to levels it hadn't reached since before 9/11. Not every stock blossomed, however. To shed more light on those that flourished and those that faltered, we've taken a look at the components of the US Market Index that were the biggest value destroyers and creators of the year, as measured by total change in market capitalization, or the total dollar value of shares outstanding.

We used the absolute change in market capitalization as our measure for gauging which companies made or lost the most money for investors in 2004. However, there are a few caveats about our approach: We only included firms whose success or failure could generally be attributed to their operating performance. We omitted firms that boosted their market caps mainly through a large, transformational acquisition, such as J.P. Morgan's $58 billion purchase of Bank One. Our goal was to identify firms that created value for shareholders rather than those that purchased value through big acquisitions.

Top 10 Stocks by Largest Losses in Market Value

	Market Cap on 12-31-04 ($mil)	Market Cap on 12-31-03 ($mil)	Market Cap Change %	Market Cap Change ($mil)	% Weight in US Market
Pfizer PFE	202,508.50	269,622.76	–25.98	–70,051.38	1.42
Intel INTC	147,895.00	209,350.60	–29.42	–61,582.09	1.12
Cisco Systems CSCO	127,217.20	167,267.88	–24.02	–40,182.42	0.95
Merck MRK	71,273.20	103,434.15	–31.50	–32,582.32	0.49
Coca-Cola KO	100,745.30	124,407.85	–19.00	–23,638.36	0.73
Viacom B VIA.B	62,046.00	77,631.36	–19.72	–15,312.52	0.43
Eli Lilly & Company LLY	64,220.50	78,973.86	–18.07	–14,266.74	0.41
Texas Instruments TXN	42,541.50	50,845.77	–19.12	–9,721.16	0.31
Clear Channel Com. CCU	19,207.80	28,827.67	–32.99	–9,510.87	0.14
Applied Materials AMAT	28,714.90	37,191.86	–23.24	–8,644.56	0.21

Value Destroyers

In looking at the year's largest value destroyers, it's worth noting that several of these companies were on last year's list of the largest value creators. Not all of these companies performed poorly in 2004; they just didn't meet the unreasonable expectations that had driven their share prices up in 2003. Collectively, these top 10 firms destroyed more than $285 billion of shareholder value during the year, a substantial increase from last year's top 10, which destroyed a little more than $97 billion.

It should come as no surprise that our list of the largest value destroyers includes a smattering of pharmaceutical companies. Both Pfizer and Merck have been running around with bull's-eyes on their backs ever since studies uncovered an increased risk of heart trouble with their drugs Celebrex and Vioxx, respectively. What isn't as well documented, though, is that these firms, as well as peer Eli Lilly, were also facing stiff headwinds prior to the pain drug debacle. With the patents on several blockbuster drugs such as Zoloft (Pfizer) and Zocor (Merck) expiring over the next two years, and a lack of clarity on what would replace the revenue from these products, pharmaceutical stocks were out of favor for most of 2004. The market recognized that uncertain product pipelines, along with looming regulatory changes and an increasing threat from the production of generic drugs, would likely cut into future earnings for these firms.

In a startling reversal of fortunes, tech leaders Intel and Cisco Systems also made our list of value destroyers after taking the number one and number three slots, respectively, on last year's list of the largest value creators. In the case of Intel, the migration to more efficient manufacturing techniques contributed to the company building up excess chip inventory, which is also typically a harbinger of an industry downturn. Intel executed poorly during the year as well, encountering a number of glitches and product delays that ate into shareholder profits. Fellow chipmaker Texas Instruments, also a top value destroyer, suffered similar inventory problems.

As for Cisco, the company actually put together a fairly decent year, but as often happens with technology names, the expectations that drove the share price up last year overshot what the firm could conceivably deliver over the long term.

Value Creators

Three things jump out from 2004's list of value creators. First, it didn't hurt to be an oil company in 2004. Second, the Internet boom is still very much alive for certain companies (some investors seem to have forgotten the lessons learned from the bubble years). Third, not every company that dabbles in pharmaceuticals destroyed value during the year.

Given the record-high level of oil prices throughout most of 2004, which made energy the best-performing sector of the year, it would be shocking if names such as ExxonMobil and ChevronTexaco didn't appear on a list of the year's largest value creators. ExxonMobil, in particular, is one of the most efficient energy companies around, with huge economies of scale and a great balance sheet to boot. The key driver for its success, though, is that it doesn't hedge its exposure to oil prices. Management feels that because the company is so large, it can afford to absorb losses during downturns. But when the energy cycle peaks, as it did in 2004, ExxonMobil rakes in the profits. Though ChevronTexaco does engage in hedging activities, it still benefited thoroughly from the high oil prices that persisted during the year.

This past year was also great for Internet icons eBay and Yahoo, whose share prices appreciated considerably. Yahoo created value in 2004 by leveraging its brand, riding the wave of the resurgence in online advertising, and setting the model for front-end service to high-speed connectivity providers.

Given the recent performances of Pfizer and Merck, it might be a little surprising to see a name like Johnson & Johnson on a list of the largest value creators. It's important to understand, though, that J&J is far more diversified than the other two names, and Pfizer and Merck's performances had just as much to do with a shift in market perception as actual performance. In addition to pharmaceuticals, J&J also has medical products and consumer products divisions, both of which performed well this year. Although Pfizer and Merck, as well as Eli Lilly, are almost pure plays on pharmaceuticals, Johnson & Johnson is more like a diversified Healthcare mutual fund that can ride out volatility in specific areas of the Healthcare sector.

Conclusion

These lists suggest two key lessons for investors to bear in mind: First, a great company is not always a great investment. It's crucial to take a firm's underlying valuation into account before deciding if, and when, to invest in its stock,no matter how wonderful it might seem right now. Second, it's also important to remember that just because a company's share price drops, that doesn't mean it will immediately bounce back. Merck, for example, made our list of the top 10 value destroyers in both 2003 and 2004, losing almost half of its market value in the process. (We'd be pretty surprised to see it on the list again in 2005, however.)

Top 10 Stocks by Largest Gains in Market Value

	Market Cap on 12-31-04 ($mil)	Market Cap on 12-31-03 ($mil)	Market Cap Change %	Market Cap Change ($mil)	% Weight in US Market
General Electric GE	385,882.90	311,065.84	24.29	75,557.06	2.97
ExxonMobil XOM	330,693.40	271,001.78	21.12	57,240.14	2.63
Johnson & Johnson JNJ	188,213.20	153,334.26	22.96	35,205.39	1.50
eBay EBAY	77,122.80	41,647.48	79.64	33,168.37	0.31
Qualcomm QCOM	69,497.10	43,147.82	65.02	28,053.89	0.47
Yahoo YHOO	51,803.20	29,599.75	75.29	22,285.93	0.32
UnitedHealth Grp. UNH	57,538.90	34,130.90	64.06	21,865.46	0.46
Tyco International TYC	71,894.60	52,975.92	36.74	19,461.85	0.57
ChevronTexaco CVX	111,248.30	92,347.37	19.32	17,841.65	0.90
Dell DELL	104,688.60	87,003.26	19.19	16,691.59	0.72

Searching for Yield

Dividend yields are still low in absolute terms, but the trends are generally positive.

Sanjay Arya
Director of
Morningstar Indexes

Once upon a time, people bought stocks mainly for the dividends that they paid. A large component of stock's total return came from dividends. The bull market of the 1990s, which saw a sharp rally in stock prices, diminished the lure for dividends. Yields—annual dividends per share divided by share price—experienced a steady decline as companies saw little incentive in paying big dividends. However, a change in tax code in May 2003 that lowered the maximum tax rate on dividends to 15% has helped broaden their appeal to investors. A lower tax helps in two ways: First, it encourages companies to return cash to shareholders, thereby reducing potential misuse of excess cash. Second, the penalty for holding high-yielding stocks in taxable accounts relative to capital gains goes away, increasing the attractiveness for dividend-paying stocks.

So, has this led to a dividend windfall for investors? In 2004, 54% of the stocks in Morningstar's US Market℠ Index—a proxy for the U.S. markets—paid a dividend, which is slightly higher than 52% in 2003. Dividends seem to be getting more respect in general. A total of 761 companies, or 33% of the components of the US Market Index, increased their annual dividend payment or paid a dividend for the first time, compared to 52 that reduced or eliminated dividends in 2004. Furthermore, the average payout ratio—dividend per share divided by earnings per share—rose from 33% in 2003 to 45% in 2004.

However, compared with long-term trends, dividend yields are still near historic lows. The average yield for stocks in the Morningstar US Market Index has dropped from 2.5% in 1994 to roughly 1.5% in 2004. Companies have preferred to use surplus cash to buy back shares, retire debt, or reinvest in business.

2004 Dividend Yield by Style

	Value	Core	Growth
Large Cap	2.83	1.45	0.47
Mid Cap	2.32	1.10	0.28
Small Cap	2.15	0.62	0.10

Dividend yield expressed as a percentage; figures represent the average yield paid by a company in the index portfolio.

Across the Morningstar Style Box™, value stocks have significantly higher dividends than growth stocks. And more established and mature large-cap companies tend to pay higher dividends than their younger peers. No surprise then that the Large Value℠ Index consistently ranks as the index with the highest dividend yield. In 2004, the Index had a dividend yield of 2.8%. The Mid Value℠ Index and Small Value℠ Index also sport healthy dividend yields above 2%. On the other extreme, the Small Growth℠ Index, which represents young, fast-growing companies, ranks consistently as the Index with the lowest dividend yield—it paid a paltry 0.10% in 2004.

Among the 12 Morningstar sectors, Utilities are safe havens for capturing dividend yields. In 2004, the average yield for Utilities was 3.35%. Telecommunications—a sector with several mature firms that have few growth opportunities—was a close second with a yield of 3%.

All told, with cash reserves on the rise and favorable tax treatment for dividends expected to continue until at least 2009, expect companies to be more generous with their future dividend payments.

Dividend Leaders

We screen stocks from the Morningstar US Market Index to find those with the highest dividend yields and a consistent track record of dividend payment—those that paid a dividend in each of the last five years and increased the dividend amount over the same time period. We exclude Real Estate Investment Trusts because they don't get the same tax benefit on dividend income under the new tax code.

Holding Name	Style	Sector	Dividend Yield %	Dividend TTM	Dividend Growth 5-Yr	Payout Ratio	Market Cap ($mil)	Total Ret 1-Yr %
Progress Energy Inc.	Large Value	Utilities	5.10	2.29	2.90	86	18,397	5.30
SBC Communications Inc.	Large Value	Telecommunications	4.90	1.32	0.30	71	85,438	3.74
Peoples Energy Corp.	Small Value	Utilities	4.90	2.14	2.00	86	1,654	9.82
Merck & Co. Inc.	Large Value	Healthcare	4.70	1.49	6.30	55	71,273	–27.76
New York Community Bancorp Inc.	Mid Core	Financial Services	4.70	0.90	30.50	59	5,454	–24.70
Altria Group Inc.	Large Value	Consumer Goods	4.60	2.77	9.00	60	125,413	18.38
F.N.B. Corp.	Small Value	Financial Services	4.50	0.94	10.50	106	943	12.78
Cleco Corp.	Small Value	Utilities	4.40	0.90	1.90	111	955	18.44
Trustco Bank Corp.	Small Value	Financial Services	4.40	0.60	8.00	81	1,026	9.67
Flagstar Bancorp Inc.	Small Value	Financial Services	4.40	0.90	62.20	22	1,386	10.34
First Commonwealth Financial Corp.	Small Value	Financial Services	4.20	0.64	12.20	116	1,071	12.96
WGL Holdings Inc.	Small Value	Utilities	4.20	1.29	1.30	65	1,500	16.08
Southern Co.	Large Value	Utilities	4.20	1.41	1.00	72	25,765	16.17
NSTAR	Mid Value	Utilities	4.10	2.21	2.80	63	2,888	17.13
Washington Mutual Inc.	Large Value	Financial Services	4.10	1.70	22.10	49	37,168	10.05
Black Hills Corp.	Small Value	Utilities	4.00	1.23	3.60	—	718	7.31
Energy East Corp.	Mid Value	Utilities	4.00	1.03	4.40	67	3,920	24.39
Washington Federal Inc.	Mid Value	Financial Services	3.90	0.81	6.20	49	2,089	7.15
National Fuel Gas Co.	Mid Value	Utilities	3.90	1.09	3.70	41	2,340	20.95
First Horizon National Corp.	Mid Value	Financial Services	3.80	1.60	16.10	44	5,308	1.37
AmSouth Bancorp	Mid Value	Financial Services	3.70	0.96	7.30	57	9,197	9.89
BellSouth Corp.	Large Value	Telecommunications	3.70	1.00	5.60	44	50,905	1.94
FirstMerit Corp.	Mid Value	Financial Services	3.70	1.05	7.20	111	2,401	9.40
KeyCorp	Large Value	Financial Services	3.70	1.24	4.00	53	13,784	20.15
Unitrin Inc.	Mid Core	Financial Services	3.70	1.66	3.80	54	3,117	14.15
Piedmont Natural Gas Co.	Small Value	Utilities	3.70	0.85	4.80	61	1,782	11.23
ConAgra Foods Inc.	Large Value	Consumer Goods	3.60	1.04	7.80	67	15,146	16.05
Bank of America Corp.	Large Value	Financial Services	3.60	1.65	12.90	45	189,801	21.50
Susquehanna Bancshares Inc.	Small Value	Financial Services	3.60	0.88	8.00	57	1,160	3.49
National City Corp.	Large Value	Financial Services	3.60	1.31	4.90	35	24,611	14.90
NL Industries Inc.	Small Value	Industrial Materials	3.60	0.80	42.70	19	1,070	98.64
Fifth Third Bancorp	Large Core	Financial Services	3.50	1.25	17.40	38	26,549	–17.28
FPL Group Inc.	Large Value	Utilities	3.50	2.52	4.10	53	13,873	18.73
Hudson United Bancorp	Mid Value	Financial Services	3.50	1.31	8.20	49	1,770	10.55
JPMorgan Chase & Co.	Large Value	Financial Services	3.50	1.36	5.80	70	138,972	9.97
Newell Rubbermaid Inc.	Mid Value	Consumer Goods	3.50	0.84	1.50	NMF	6,647	10.16
PNC Financial Services Group Inc.	Large Value	Financial Services	3.50	2.00	4.00	49	16,235	8.92
Comerica Inc.	Large Value	Financial Services	3.40	2.06	8.00	51	10,408	12.87
First Financial Bancorp (Ohio)	Small Value	Financial Services	3.40	0.60	2.90	66	765	13.44
Citigroup Inc.	Large Value	Financial Services	3.30	1.55	31.80	49	250,042	2.72
Citizens Banking Corp.	Small Value	Financial Services	3.30	1.14	5.20	68	1,486	8.81
Bristol-Myers Squibb Co.	Large Value	Healthcare	3.30	1.40	5.80	101	49,847	–7.27
First Merchants Corp.	Small Value	Financial Services	3.30	0.92	5.40	62	527	15.05
May Department Stores Co.	Mid Value	Consumer Services	3.30	0.97	1.90	48	8,584	4.58
U.S. Bancorp	Large Value	Financial Services	3.30	0.96	9.80	45	58,479	10.46
Albertsons Inc.	Mid Value	Consumer Services	3.20	0.76	1.40	75	8,789	8.87
BB&T Corp.	Large Value	Financial Services	3.20	1.31	12.60	50	23,227	12.86
Valley National Bancorp	Mid Value	Financial Services	3.20	0.88	6.00	57	2,730	2.81
Arthur J. Gallagher & Co.	Mid Core	Financial Services	3.10	0.93	19.10	46	3,003	3.18
Dime Community Bancshares	Small Value	Financial Services	3.10	0.53	26.00	42	668	–9.85

Active Vs. Passive: How the Two Strategies Fared in 2004

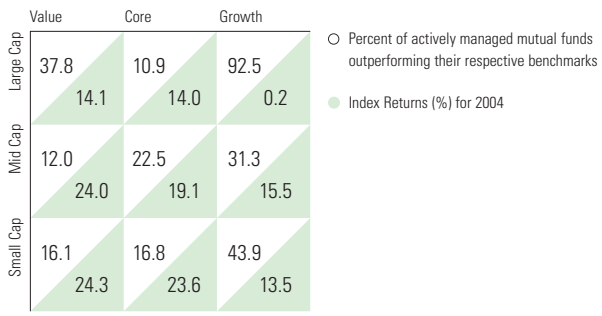
The small-cap market is inefficient whereas large caps are efficient, so we should use active management for small caps and index large caps. Is there truth in this maxim?

Russel Kinnel
Director of Fund Research

A comparison of Morningstar categories with their respective indexes would seem to contradict the theory. Consider that only 22% of small-blend funds outperformed the Morningstar® Small Core℠ Index over the five years ended December 31, 2004, while about 40% of large-blend funds beat the Morningstar® Large Core℠ Index. With respect to the Morningstar Style Box™, it's clear that the closer to small value a fund got, the tougher it was to beat its Index: 97% of large-growth, 49% of large-value, and 50% of small-growth funds beat their respective indexes, while only 23% of small-value funds beat the Morningstar® Small Value℠ Index. Does this mean the Small Value Index is super efficient and large-growth is very inefficient? Nope. These results mainly reflect a combination of two factors. Small value had the best returns over the five-year period and Large Growth had the worst. In addition, the indexes are much more style pure than the actual funds in the categories. Thus, a small-value fund that also owned stocks in the adjoining boxes, whether through appreciation or design, would have less in the hottest-performing segment of the market than the Small Value Index. Conversely, all a large-growth fund had to do to beat its index was own some stocks outside that box.

In 2004, when small value led the way but the rest of the Style Box enjoyed pretty good performance, too, this effect remained, with a variation. Nearly all large-growth funds beat the Morningstar® Large Growth℠ Index, but the other eight Style Box categories had fewer than half of their funds beat their respective benchmarks. But this time a number of categories enjoyed much smaller success rates. Small value, small blend, mid value, mid blend, and large blend each had a less-than-25% success rate.

Active Vs. Passive, 2004



It's also worth noting that these index returns are cost free. That is, they don't reflect trading costs or expenses that an investor would incur in the real-world. Thus, the data slightly overstate the real-world advantage because investments can't be made free of fees.

Still, the fact that these results reflect the opposite of conventional wisdom should give one pause when considering when passive and active strategies are most appropriate. Have actively managed small-cap funds had an easy time surpassing their benchmarks because of market inefficiency or because they had an easy benchmark to beat?

The funds' correlations with their respective indexes were fairly uniform, so it's unlikely that the results were due to the fact that some tracked the indexes more closely. All categories averaged a three-year R-squared figure between 77% and 89%. It's worth noting, though, that those figures are higher than they were when the Morningstar Style Box was changed using the same methodology of the indexes in 2002.

Morningstar® Indexes Data Overview

2004 Performance Wrap-up

Morningstar® Indexes

	Total Returns %					Best 3-Month Ret %	Worst 3-Month Ret %	Std Dev	Div Yield %	Price/ Earnings	Price/ Book	Price/ Sales
	3-Month	6-Month	1-Year	3-Year	5-Year							
Morningstar® US Market℠ Index	3.59	10.14	12.35	4.56	–1.30	22.03	–16.96	4.13	1.49	23.70	4.23	3.31
Morningstar® Large Cap℠ Index	3.48	8.71	9.54	2.12	–4.33	22.81	–16.63	4.20	1.62	23.22	4.38	3.35
Morningstar® Mid Cap℠ Index	4.14	13.68	19.66	10.69	6.70	20.25	–20.76	4.33	1.23	24.60	3.89	3.14
Morningstar® Small Cap℠ Index	3.02	14.22	20.44	12.30	9.82	25.03	–28.09	5.19	0.97	26.42	3.79	3.35
Morningstar® US Value℠ Index	3.30	9.74	16.85	9.38	7.42	18.80	–20.03	4.45	2.67	16.79	2.58	2.18
Morningstar® US Core℠ Index	3.81	10.83	15.62	5.43	2.63	22.89	–17.07	4.45	1.30	21.90	4.33	2.59
Morningstar® US Growth℠ Index	3.66	9.81	4.37	–2.21	–13.18	31.18	–33.33	7.64	0.40	33.50	5.96	5.40
Morningstar® Large Value℠ Index	3.31	8.79	14.05	6.94	4.54	18.79	–20.85	4.58	2.83	15.86	2.63	2.19
Morningstar® Large Core℠ Index	3.78	9.74	13.99	2.69	–0.67	24.02	–16.17	4.55	1.43	21.51	4.65	2.61
Morningstar® Large Growth℠ Index	3.32	**7.36**	**0.19**	**–4.35**	**–16.21**	33.60	–34.22	7.68	0.47	33.73	6.09	5.62
Morningstar® Mid Value℠ Index	3.49	11.74	**24.30**	14.98	14.74	20.68	–17.80	4.57	2.32	18.76	2.32	2.10
Morningstar® Mid Core℠ Index	**4.48**	13.89	19.05	13.07	11.96	20.83	–23.39	4.94	1.10	22.78	3.56	2.50
Morningstar® Mid Growth℠ Index	4.47	15.54	15.45	2.93	–5.33	41.08	–32.48	8.18	0.28	32.39	5.73	4.80
Morningstar® Small Value℠ Index	2.65	13.32	24.03	**19.19**	**18.95**	25.86	–20.25	4.74	2.15	21.68	2.76	2.28
Morningstar® Small Core℠ Index	**2.37**	13.82	23.61	14.79	16.38	21.97	–30.36	5.59	0.62	23.91	3.25	2.58
Morningstar® Small Growth℠ Index	4.16	**15.73**	13.48	3.02	–3.49	55.23	–35.30	9.44	0.10	34.66	5.47	5.33

Morningstar Sectors

	Total Returns %					Best 3-Month Ret %	Worst 3-Month Ret %	Std Dev	Div Yield %	Price/ Earnings	Price/ Book	Price/ Sales
	3-Month	6-Month	1-Year	3-Year	5-Year							
Information	16.61	7.33	3.62	–2.91	–15.01	21.39	–23.02	4.45	0.74	30.75	4.63	4.50
Software	**19.80**	15.26	10.68	–2.51	–16.05	52.81	–39.02	11.09	0.32	35.25	5.13	6.96
Hardware	17.30	0.08	**–3.65**	–2.12	–15.35	41.96	–35.10	11.42	0.37	28.85	5.36	4.16
Media	16.78	9.75	4.81	–1.87	–11.05	35.11	–31.95	7.60	0.40	36.22	3.54	4.59
Telecomunications	10.35	18.38	17.96	**–5.86**	**–16.47**	35.50	–25.74	7.72	2.99	22.39	3.13	2.02
Service	9.79	8.41	11.84	5.65	5.70	9.32	–12.12	2.22	1.55	22.73	3.97	3.63
Healthcare	**4.81**	**–0.07**	3.76	–0.86	3.36	21.78	–16.81	4.57	1.16	26.93	5.21	4.76
Consumer Services	16.69	11.46	17.71	8.04	3.98	31.65	–18.83	5.51	0.67	27.29	5.07	2.79
Business Services	16.70	13.86	14.95	3.22	–0.27	25.19	–22.00	5.58	0.70	26.80	5.29	2.59
Financial Services	8.72	11.49	13.99	9.84	9.50	22.93	–20.52	5.92	2.36	17.49	2.47	3.60
Manufacturing	11.92	16.16	20.15	9.39	5.63	10.79	–17.40	2.37	1.92	20.74	4.38	1.96
Consumer Goods	7.50	6.19	11.75	9.60	6.33	20.83	–18.08	4.33	2.08	20.70	6.98	2.38
Industrial Materials	13.42	18.46	18.71	7.67	2.78	17.86	–18.45	5.62	1.62	22.72	3.76	1.88
Energy	14.36	**23.52**	**32.99**	**13.88**	**10.29**	15.10	–18.45	5.64	1.62	18.27	3.18	1.81
Utilities	13.18	21.09	23.40	5.64	6.03	33.58	–20.12	5.27	3.35	18.56	2.22	1.40

Green numbers = highest returns in group
Red numbers = lowest returns in group

Price/ Cash Flow	Earnings Growth History	Book Value Growth	Sales Growth	Number of Hldgs	Turn-over %	Median Market Cap ($mil)	Top Three Sectors (% of stock)					
15.45	19.29	16.62	15.46	2,038	4.00	1,839	Financial Srvcs	21.44	Healthcare	12.42	Industrial Mat	11.94
15.36	21.12	17.43	15.64	268	1.80	19,305	Financial Srvcs	21.15	Healthcare	13.48	Industrial Mat	11.90
15.16	14.64	15.11	14.52	730	16.90	3,633	Financial Srvcs	22.64	Consumer Srvcs	12.28	Industrial Mat	10.49
17.40	12.77	12.64	16.49	1,040	27.00	979	Financial Srvcs	20.77	Industrial Mat	16.45	Consumer Srvcs	10.98
9.61	24.65	11.82	11.61	657	16.30	1,875	Financial Srvcs	40.27	Energy	14.03	Industrial Mat	9.53
13.95	11.53	19.68	12.87	720	32.20	1,711	Industrial Mat	21.51	Financial Srvcs	19.40	Healthcare	13.48
20.88	23.28	18.45	22.77	661	24.10	1,986	Hardware	20.15	Healthcare	18.77	Consumer Srvcs	18.03
9.54	29.37	12.99	12.26	92	13.90	19,828	Financial Srvcs	42.61	Energy	17.51	Telecomm	9.27
13.98	11.42	21.37	12.53	94	34.70	19,259	Industrial Mat	23.54	Healthcare	17.59	Financial Srvcs	17.17
20.64	24.47	17.82	23.41	82	25.30	19,337	Hardware	22.61	Consumer Srvcs	20.90	Healthcare	18.82
9.01	11.99	8.75	9.79	228	32.50	3,640	Financial Srvcs	34.59	Utilities	14.77	Industrial Mat	12.21
13.31	11.25	16.36	13.01	249	38.80	3,593	Financial Srvcs	26.12	Consumer Srvcs	16.10	Industrial Mat	15.53
20.95	20.77	20.10	20.63	253	38.80	3,643	Healthcare	18.85	Hardware	14.77	Business Srvcs	13.50
12.07	5.91	7.97	10.45	337	59.30	1,013	Financial Srvcs	33.78	Industrial Mat	22.48	Consumer Srvcs	7.11
15.40	13.77	11.29	15.76	377	68.40	942	Financial Srvcs	22.90	Industrial Mat	17.96	Healthcare	11.29
23.27	19.54	19.53	23.68	326	53.00	1,007	Healthcare	18.05	Business Srvcs	15.35	Hardware	14.91

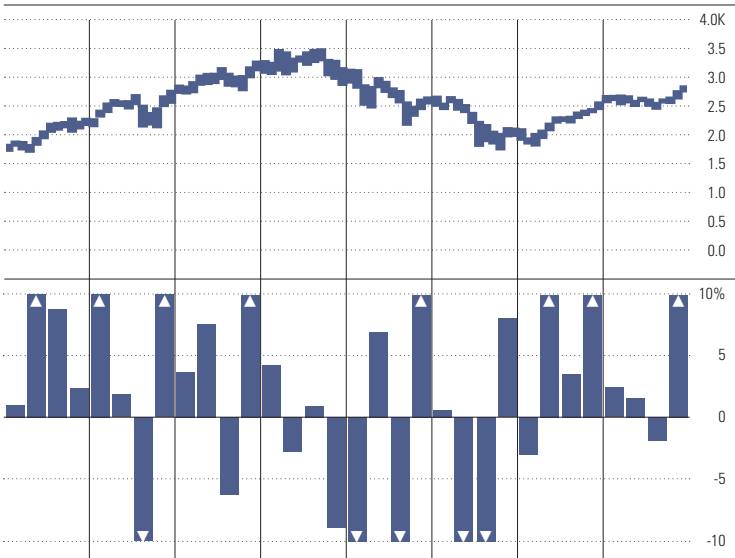
Price/ Cash Flow	Earnings Growth History	Book Value Growth	Sales Growth	Number of Hldgs	Turn-over %	Median Market Cap ($mil)	**Style (% of Stock)**			**Cap (% of Stock)**		
							Value	Core	Growth	Large Cap	Mid Cap	Small Cap
17.32	38.41	12.87	16.39	357	0.60	1,795	15.11	24.12	60.77	77.11	16.75	6.14
20.27	16.86	17.95	12.18	76	0.80	1,480	0.50	16.38	83.12	75.20	16.07	8.72
18.19	52.85	13.69	17.08	173	0.30	1,616	6.18	28.89	64.93	74.87	18.15	6.98
19.63	52.53	7.43	27.71	70	1.20	2,173	2.78	30.32	66.90	80.31	16.39	3.30
7.20	20.87	10.99	3.71	38	0.30	2,574	81.20	10.86	7.94	82.26	13.76	3.98
17.45	19.79	16.36	15.75	1040	1.00	1,805	34.53	36.28	29.20	68.36	23.41	8.23
19.06	3.24	22.91	21.92	210	1.20	1,727	11.76	41.97	46.27	76.96	16.71	6.33
16.23	21.50	17.42	16.25	223	0.40	1,976	10.38	33.14	56.48	64.49	27.02	8.50
15.81	15.32	14.15	11.97	187	1.50	1,502	14.00	45.83	40.17	47.08	36.37	16.54
14.00	28.23	12.52	12.76	420	1.30	2,003	63.38	32.24	4.38	69.96	22.71	7.32
12.46	28.53	17.83	14.35	601	0.50	2,036	45.25	42.49	12.26	70.79	21.75	7.46
14.25	18.47	23.61	10.37	145	0.70	2,509	35.62	49.58	14.79	74.79	20.23	4.99
13.46	23.85	17.81	9.54	264	3.00	1,578	26.96	64.19	8.85	70.71	18.91	10.38
10.42	62.07	15.77	27.29	110	0.90	2,183	67.91	12.24	19.85	72.82	21.90	5.28
8.30	4.58	6.27	14.87	82	3.00	2,584	93.14	6.01	0.85	54.87	37.09	8.04

Data through 12-31-04

Morningstar® US Market℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MSTAR	2,884.23	12-31-1991	2,038

The Index targets 97% market capitalization coverage of publicly trading stocks domiciled in the U.S. Stocks included in the index are free-float weighted and selected using an objective, rules-based methodology.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 2,887.94
Low 2,490.82

All-time High/Low
High 3,532.90
Low 947.74

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	4.07	–2.77	1.00	–9.02	–7.02
2001	–12.65	6.94	–15.71	11.91	–11.88
2002	0.41	–13.59	–16.96	8.04	–22.17
2003	–3.04	16.18	3.23	12.42	30.73
2004	2.30	1.56	–1.82	10.14	12.35

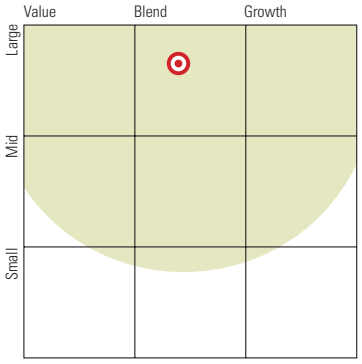
Total Returns	%	Growth of $10,000
6-Month	8.14	10,814
1-Year	12.35	11,235
3-Year Avg	4.56	11,431
5-Year Avg	–1.30	9,367
10-Year Avg	11.84	30,618
Since Inception	10.52	21,174

Risk Measures	%
Standard Deviation	4.13
Mean	0.92
Best 3-Month Return	22.03
Worst 3-Month Return	–16.96

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
2,299	2,806	3,319	3,051	2,653	2,032	2,610	2,884	Price
31.78	23.86	19.79	–7.02	–11.88	–22.17	30.73	12.35	Total Return %
2.21	1.82	1.50	1.04	1.16	1.24	2.30	1.84	Income Return %
29.57	22.04	18.29	–8.06	–13.04	–23.41	28.43	10.51	Capital Return %
27.02	33.46	37.99	31.78	30.73	24.97	26.73	23.71	Price/Earnings
5.82	8.15	10.45	7.54	5.39	4.13	4.49	4.22	Price/Book
18.00	23.61	26.17	24.32	18.25	14.22	16.81	15.40	Price/Cash Flow
3.07	4.63	7.62	5.82	3.79	2.72	3.43	3.29	Price/Sales
1.48	1.24	1.09	1.12	1.29	1.74	1.45	1.49	Dividend Yield
17.15	15.73	16.71	23.63	11.93	–0.83	18.43	25.65	Hist Earnings Growth
15.76	15.04	19.70	18.85	15.35	9.98	7.19	16.64	Book Value Growth
14.24	16.22	17.61	18.29	17.70	5.99	6.13	15.42	Sales Growth

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
General Electric	20.68	2.72
ExxonMobil	28.04	2.37
Microsoft	8.95	2.05
Citigroup	2.72	1.76
Wal-Mart Stores	0.51	1.59
Pfizer	–22.31	1.43
Bank of America	21.50	1.35
Johnson & Johnson	25.17	1.33
American International Group	–0.53	1.21
IBM	7.19	1.20
Intel	–26.56	1.06
Procter & Gamble	12.38	0.99
J.P. Morgan Chase & Co.	9.97	0.98
Cisco Systems	–20.26	0.92
Altria Group	18.38	0.89
Total Number of Holdings		2,038
% Weight in Top 15 Holdings		21.84
Turnover		4.00

Morningstar Sector Breakdown	% of Stocks
Information	20.93
Software	3.94
Hardware	9.80
Media	4.15
Telecommunications	3.05
Service	47.59
Healthcare	12.48
Consumer Services	8.93
Business Services	4.73
Financial Services	21.46
Manufacturing	31.14
Consumer Goods	8.45
Industrial Materials	12.18
Energy	7.29
Utilities	3.22

Market Cap	$Mil
Median	1,839
Max	385,883
Min	158

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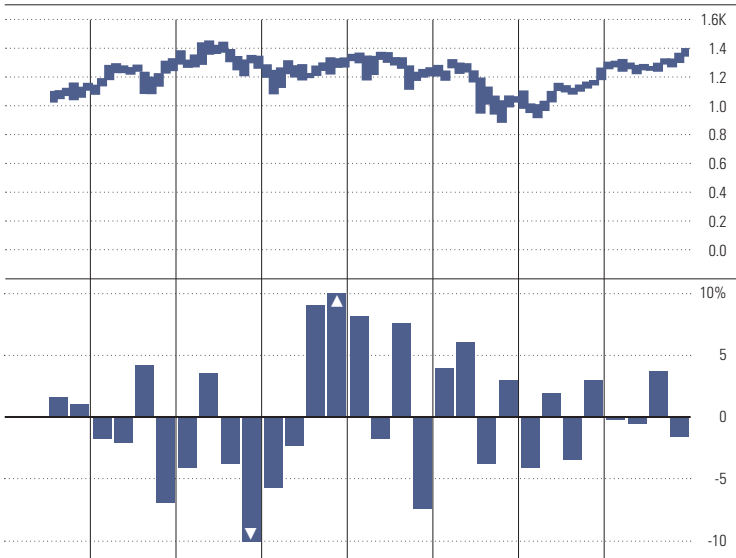
MORNINGSTAR®

Data through 12-31-04

Morningstar® Large Value℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MLVL	1,376.86	06-30-1997	92

The Index measures the performance of stocks issued by large-capitalization companies that have exhibited "value" characteristics as determined by Morningstar's proprietary index methodology. The stocks included in the Index are designated as "value" because the companies that issue them typically have relatively low valuations based on price-to-earnings, price-to-book, price-to-sales, price-to-cash flow and dividend yields. "Large-capitalization" stocks are those that form the top 70% of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 1,379.64
Low 1208.52

All-time High/Low
High 1,432.93
Low 871.05

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	–1.33	–5.68	10.01	3.20	5.66
2001	–4.50	5.50	–8.44	4.73	–3.38
2002	4.40	–7.21	–20.85	10.80	–15.05
2003	–7.18	18.16	–0.16	15.32	26.26
2004	2.18	0.96	1.62	8.79	14.05

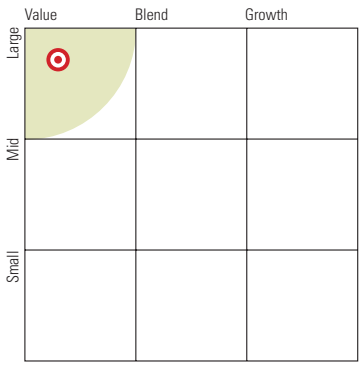
Total Returns	%	Growth of $10,000
6-Month	10.56	11,056
1-Year	14.05	11,405
3-Year Avg	6.95	12,233
5-Year Avg	4.54	12,486
10-Year Avg	—	—
Since Inception	7.23	16,880

Risk Measures	%
Standard Deviation	4.58
Mean	0.69
Best 3-Month Return	18.79
Worst 3-Month Return	–20.85

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
1,125	1,291	1,268	1,309	1,237	1,020	1,245	1,377	Price
14.03	17.85	0.57	5.66	–3.38	–15.05	26.26	14.05	Total Return %
2.5	–6.01	–19.22	12.68	8.5	7.12	–4.47	1.7	Rel US Market Index
1.51	3.10	2.38	2.38	2.16	2.51	4.19	3.44	Income Return %
12.52	14.75	–1.81	3.28	–5.54	–17.56	22.07	10.61	Capital Return %
18.98	22.07	23.30	21.50	22.83	21.33	18.38	15.86	Price/Earnings
3.34	4.22	5.20	4.75	3.33	2.38	3.08	2.63	Price/Book
10.15	14.25	13.02	13.54	10.49	7.83	10.07	9.53	Price/Cash Flow
1.78	2.15	2.43	2.13	1.67	1.33	1.74	2.19	Price/Sales
2.55	2.44	2.51	1.97	2.55	3.29	2.76	2.84	Dividend Yield
14.08	5.83	7.77	28.57	14.47	–24.86	6.94	29.37	Hist Earnings Growth
6.71	8.08	4.31	8.32	13.90	7.41	1.40	12.99	Book Value Growth
7.23	6.34	1.12	7.41	13.90	–0.45	–1.25	12.27	Sales Growth

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
ExxonMobil	28.04	9.80
Citigroup	2.72	7.28
Bank of America	21.50	5.59
J.P. Morgan Chase & Co.	9.97	4.06
Altria Group	18.38	3.66
Verizon Communications	20.25	3.28
ChevronTexaco	25.57	3.27
SBC Communications	3.74	2.49
Wachovia	16.80	2.47
Merck	–27.76	2.08
Fannie Mae	–2.33	2.01
Hewlett–Packard	–7.28	1.87
Morgan Stanley	–2.25	1.78
ConocoPhillips	35.60	1.74
US Bancorp	10.46	1.72
Total Number of Holdings		92
% Weight in Top 15 Holdings		53.12
Turnover		13.90

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	11.21	0.54
Software	0.00	0.00
Hardware	1.72	0.18
Media	0.12	0.03
Telecommunications	9.37	3.07
Service	48.69	1.02
Healthcare	4.55	0.36
Consumer Services	0.36	0.04
Business Services	1.40	0.30
Financial Services	42.38	1.97
Manufacturing	40.10	1.29
Consumer Goods	8.53	1.01
Industrial Materials	7.44	0.61
Energy	17.78	2.44
Utilities	6.36	1.98

Market Cap	$Mil
Median	19,828
Max	330,693
Min	10,408

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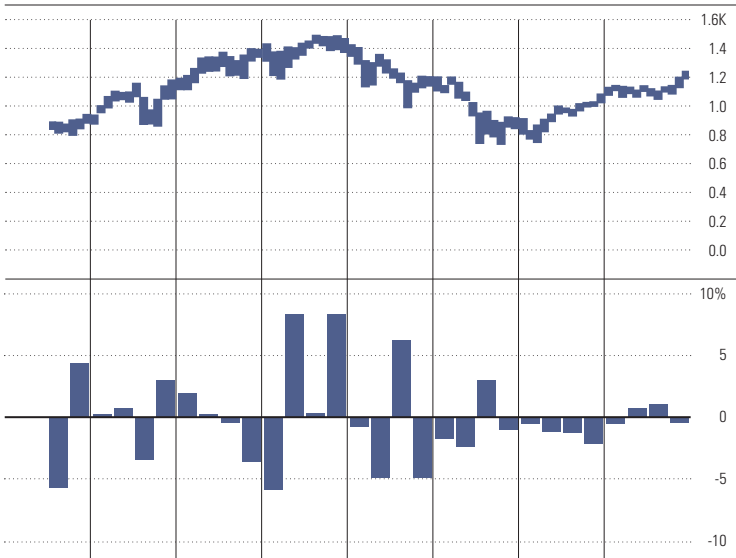
MORNINGSTAR®

Data through 12-31-04

Morningstar® Large Core℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MLCR	1,403.26	06-30-1997	94

The Index measures the performance of stocks issued by large-capitalization companies that have exhibited average "growth" and "value" characteristics as determined by Morningstar's proprietary index methodology. "Large-capitalization" stocks are those that form the top 70% of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 1,407.27
Low 1,217.06

All-time High/Low
High 1,657.8
Low 905.12

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	–1.80	5.58	1.21	–0.67	4.24
2001	–13.54	1.88	–9.44	7.38	–14.35
2002	–1.33	–16.17	–13.93	7.02	–23.82
2003	–3.59	15.05	1.95	10.29	24.71
2004	1.86	2.60	–0.61	9.74	13.99

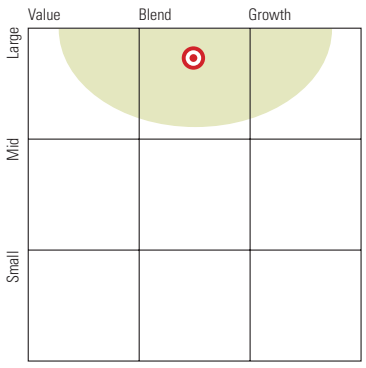
Total Returns	%	Growth of $10,000
6-Month	9.07	10,907
1-Year	13.99	11,399
3-Year Avg	2.69	10,829
5-Year Avg	–0.67	9,669
10-Year Avg	—	—
Since Inception	6.03	15,514

Risk Measures	%
Standard Deviation	4.55
Mean	0.59
Best 3-Month Return	24.02
Worst 3-Month Return	–16.17

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
1,096	1,332	1,552	1,603	1,359	1,020	1,250	1,403	Price
10.57	23.18	17.81	4.24	–14.35	–23.82	24.71	13.99	Total Return %
–0.96	–0.68	–1.98	11.26	–2.47	–1.65	–6.02	1.64	Rel US Market Index
0.98	1.65	1.27	0.96	0.87	1.16	2.16	1.70	Income Return %
9.59	21.53	16.54	3.28	–15.22	–24.98	22.55	12.29	Capital Return %
26.01	31.16	34.79	36.72	29.51	21.23	23.43	21.53	Price/Earnings
5.68	7.09	8.17	9.30	6.96	4.83	5.08	4.67	Price/Book
16.68	22.17	24.87	27.68	18.16	13.69	14.64	13.97	Price/Cash Flow
2.26	2.65	3.81	4.24	3.22	2.26	2.60	2.60	Price/Sales
1.50	1.18	1.01	0.84	1.07	1.69	1.39	1.42	Dividend Yield
19.07	12.33	6.14	13.53	13.32	3.61	17.98	21.09	Hist Earnings Growth
12.03	6.18	9.64	14.20	13.63	10.77	11.53	21.37	Book Value Growth
11.40	9.52	8.70	14.15	12.73	5.41	6.39	12.57	Sales Growth

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
General Electric	20.68	10.55
Pfizer	–22.31	5.56
Johnson & Johnson	25.17	5.15
American International Group	–0.53	4.68
IBM	7.19	4.64
Procter & Gamble	12.38	3.83
Wells Fargo	8.97	2.87
Coca-Cola	–16.11	2.79
Home Depot	21.47	2.60
PepsiCo	13.82	2.42
Abbott Laboratories	2.61	1.99
Tyco International	35.41	1.97
American Express	17.60	1.96
Oracle	3.70	1.94
Viacom B	–17.44	1.57
Total Number of Holdings		94
% Weight in Top 15 Holdings		54.52
Turnover		34.70

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	13.84	0.66
Software	1.55	0.39
Hardware	7.74	0.79
Media	3.63	0.87
Telecommunications	0.92	0.30
Service	47.20	0.99
Healthcare	18.32	1.47
Consumer Services	7.08	0.79
Business Services	5.38	1.14
Financial Services	16.43	0.77
Manufacturing	38.96	1.25
Consumer Goods	12.88	1.52
Industrial Materials	24.07	1.98
Energy	1.47	0.20
Utilities	0.55	0.17

Market Cap	$Mil
Median	19,259
Max	385,883
Min	9,356

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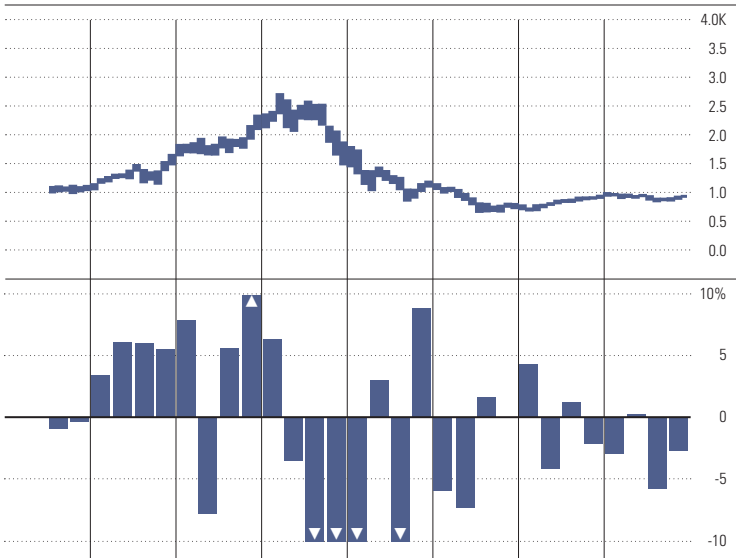
MORNINGSTAR®

Data through 12-31-04

Morningstar® Large Growth℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MLGR	943.85	06-30-1997	82

The Index measures the performance of stocks issued by large-capitalization companies that have exhibited above-average "growth" characteristics as determined by Morningstar's proprietary index methodology. The stocks included in the Index are designated as "growth" because the companies that issue them typically have higher than average historical and forecasted earnings, sales, equity, and cash-flow growth. "Large-capitalization" stocks are those that form the top 70% of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 993.26
Low 847.89

All-time High/Low
High 2,711.73
Low 666

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	10.67	–6.22	–10.13	–28.71	–33.51
2001	–25.82	9.81	–27.97	20.90	–29.07
2002	–5.48	–22.03	–15.57	7.43	–33.15
2003	1.48	12.05	4.35	10.10	30.65
2004	–0.86	1.63	–7.37	7.36	0.19

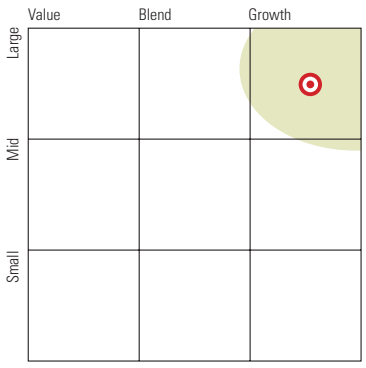
Total Returns	%	Growth of $10,000
6-Month	–0.56	9,944
1-Year	0.19	10,019
3-Year Avg	–4.35	8,751
5-Year Avg	–16.22	4,128
10-Year Avg	—	—
Since Inception	–0.30	9,777

Risk Measures	%
Standard Deviation	7.68
Mean	0.28
Best 3-Month Return	33.60
Worst 3-Month Return	–34.22

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
1,095	1,645	2,338	1,553	1,099	731	948	944	Price
9.87	51.23	42.59	–33.51	–29.07	–33.15	30.65	0.19	Total Return %
–1.66	27.37	22.8	–26.49	–17.19	–10.98	–0.08	–12.16	Rel US Mkt
0.41	0.92	0.47	0.09	0.17	0.31	0.93	0.66	Income Return %
9.46	50.31	42.12	–33.60	–29.24	–33.46	29.72	–0.47	Capital Return %
36.65	47.73	53.00	46.06	50.85	32.83	39.24	33.73	Price/Earnings
9.87	14.04	17.27	11.77	7.38	6.05	6.06	6.04	Price/Book
26.88	34.02	37.90	34.57	27.39	19.89	23.56	20.56	Price/Cash Flow
5.13	8.92	13.85	12.79	7.95	4.94	6.32	5.56	Price/Sales
0.67	0.41	0.20	0.14	0.21	0.64	0.53	0.48	Dividend Yield
19.25	26.01	34.58	36.59	6.88	10.08	31.21	29.12	Hist Earnings Growth
24.42	25.74	39.23	41.15	20.76	9.36	10.83	17.81	Book Value Growth
18.23	25.46	29.61	32.75	22.46	8.44	11.62	23.21	Sales Growth

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
Microsoft	8.95	9.77
Wal-Mart Stores	0.51	7.59
Intel	–26.56	5.05
Cisco Systems	–20.26	4.39
Dell	24.01	3.58
Time Warner	8.12	2.88
Amgen	3.82	2.73
eBay	80.07	2.59
Qualcomm	58.20	2.32
3M Company	–1.75	2.16
Eli Lilly & Company	–17.55	2.16
Medtronic	2.68	2.02
UnitedHealth Group	51.38	1.97
Genentech	16.36	1.92
Walt Disney	20.21	1.92
Total Number of Holdings		82
% Weight in Top 15 Holdings		53.06
Turnover		25.30

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	49.57	2.37
Software	12.61	3.20
Hardware	24.79	2.53
Media	12.17	2.93
Telecommunications	0.00	0.00
Service	40.72	0.86
Healthcare	18.25	1.46
Consumer Services	18.45	2.07
Business Services	2.65	0.56
Financial Services	1.38	0.06
Manufacturing	9.71	0.31
Consumer Goods	4.40	0.52
Industrial Materials	2.77	0.23
Energy	2.54	0.35
Utilities	0.00	0.00

Market Cap	$Mil
Median	19,337
Max	290,489
Min	9,520

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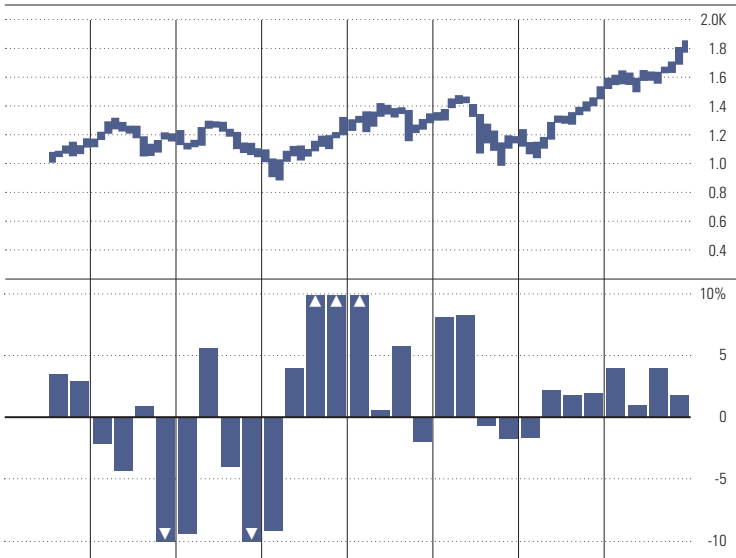
MORNINGSTAR®

Data through 12-31-04

Morningstar® Mid Value℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MMVL	1,842.91	06-30-1997	228

The Index measures the performance of stocks issued by mid-capitalization companies that have exhibited "value" characteristics as determined by Morningstar's proprietary index methodology. The stocks included in the Index are designated as "value" because they are issued by companies that typically have relatively low valuations based on price-to-earnings, price-to-book, price-to-sales, price-to-cash flow, and dividend yields. "Mid-capitalization" stocks are those that form between the 70th and 90th percentile of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 1,843.73
Low 1,496.12

All-time High/Low
High 1,843.73
Low 884.19

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	–5.16	1.27	13.97	13.82	24.59
2001	–1.31	7.50	–9.92	9.94	5.06
2002	8.61	–5.30	–17.80	6.45	–10.00
2003	–4.64	18.61	5.07	14.38	35.94
2004	6.21	2.51	2.17	11.74	24.30

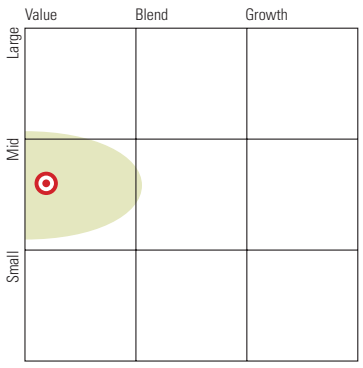
Total Returns	%	Growth of $10,000
6-Month	14.16	11,416
1-Year	24.30	12,430
3-Year Avg	14.99	15,205
5-Year Avg	14.76	19,905
10-Year Avg	—	—
Since Inception	11.87	23,193

Risk Measures	%
Standard Deviation	4.57
Mean	1.04
Best 3-Month Return	20.68
Worst 3-Month Return	–17.80

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
1,163	1,198	1,083	1,306	1,332	1,158	1,524	1,843	Price
18.12	5.85	–6.83	24.59	5.06	–10.00	35.94	24.30	Total Return %
6.59	–18.01	–26.62	31.61	16.94	12.17	5.21	11.95	Rel US Market Index
1.79	2.90	2.77	3.95	3.11	3.03	4.39	3.33	Income Return %
16.33	2.95	–9.60	20.64	1.95	–13.03	31.55	20.97	Capital Return %
20.07	19.37	18.68	16.79	17.95	18.21	18.25	18.79	Price/Earnings
2.65	2.47	2.08	2.68	1.99	1.67	2.19	2.31	Price/Book
10.88	11.41	11.00	8.98	7.88	6.53	8.26	9.03	Price/Cash Flow
1.57	1.41	1.18	1.37	1.28	1.22	1.72	2.12	Price/Sales
2.72	2.74	3.63	3.04	3.29	3.71	2.61	2.33	Dividend Yield
4.26	2.68	1.64	8.47	5.36	–8.39	14.64	14.99	Hist Earnings Growth
6.28	7.30	3.03	3.18	5.41	4.60	0.94	8.75	Book Value Growth
7.05	9.09	8.17	9.10	15.82	4.76	1.10	10.00	Sales Growth

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
Reynolds American	43.11	1.16
Cigna	42.87	1.12
Sears Roebuck	14.55	1.08
Equity Residential	29.50	1.01
PPL	26.13	1.01
Federated Department Stores	23.93	1.00
Ameren	15.09	0.97
Georgia-Pacific Group	24.12	0.97
CIT Group	29.27	0.97
UnionBanCal	14.77	0.96
Vornado Realty Trust	46.53	0.96
Phelps Dodge	30.78	0.93
Eastman Kodak	27.90	0.92
AmSouth Bancorporation	9.89	0.92
McKesson	–1.40	0.92
Total Number of Holdings		228
% Weight in Top 15 Holdings		14.89
Turnover		32.50

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	3.64	0.17
Software	0.00	0.00
Hardware	1.02	0.10
Media	1.00	0.24
Telecommunications	1.62	0.53
Service	51.70	1.09
Healthcare	4.43	0.35
Consumer Services	10.10	1.13
Business Services	3.19	0.67
Financial Services	33.98	1.58
Manufacturing	43.52	1.40
Consumer Goods	10.04	1.19
Industrial Materials	11.79	0.97
Energy	5.64	0.77
Utilities	16.05	4.98

Market Cap	$Mil
Median	3,640
Max	14,230
Min	1,703

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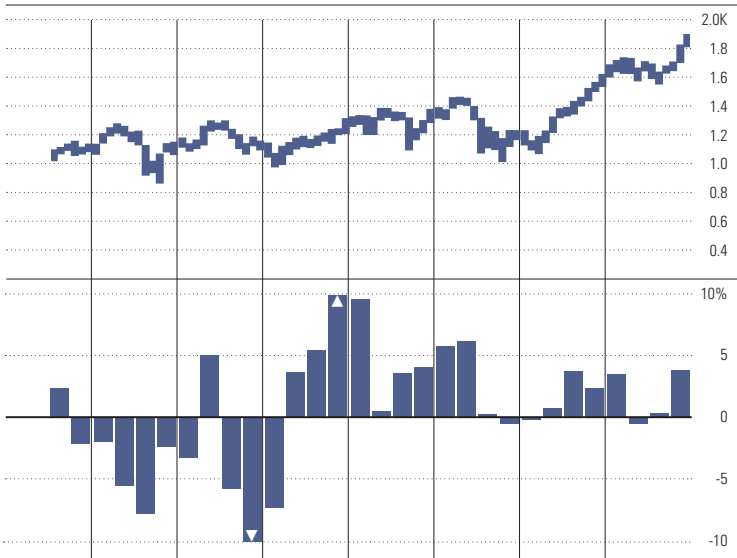
MORNINGSTAR®

Data through 12-31-04

Morningstar® Mid Core℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MMCR	1,874.58	06-30-1997	249

The Index measures the performance of stocks issued by mid-capitalization companies that have exhibited average "growth" and "value" characteristics as determined by Morningstar's proprietary index methodology. "Mid-capitalization" stocks are those that form between the 70th and 90th percentile of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 1,874.58
Low 1,538.75

All-time High/Low
High 1,874.58
Low 850.47

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	–2.55	0.66	6.51	9.85	14.77
2001	–2.94	7.34	–12.22	15.96	6.05
2002	6.09	–7.31	–16.90	7.18	–12.42
2003	–3.40	16.95	6.94	14.79	38.68
2004	5.61	0.77	–1.77	13.89	19.05

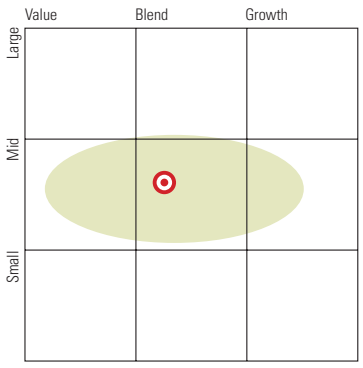
Total Returns	%	Growth of $10,000
6-Month	11.87	11,187
1-Year	19.05	11,905
3-Year Avg	13.08	14,460
5-Year Avg	11.97	17,600
10-Year Avg	—	—
Since Inception	10.14	20,634

Risk Measures	%
Standard Deviation	4.94
Mean	0.93
Best 3-Month Return	20.83
Worst 3-Month Return	–23.39

History	1997	1998	1999	2000	2001	2002	2003	12-31-04
Price	1,111	1,127	1,133	1,284	1,348	1,166	1,594	1,875
Total Return %	11.89	2.87	1.89	14.77	6.05	–12.42	38.68	19.05
Rel US Market Index	0.36	–20.99	–17.9	21.79	17.93	9.75	7.95	6.7
Income Return %	0.76	1.44	1.39	1.42	1.09	1.08	1.95	1.44
Capital Return %	11.13	1.43	0.50	13.35	4.96	–13.50	36.73	17.61
Price/Earnings	23.50	24.41	22.49	22.84	24.40	22.37	24.68	22.79
Price/Book	3.64	3.99	4.10	4.65	3.38	3.02	3.69	3.57
Price/Cash Flow	14.93	15.50	14.68	14.44	12.61	10.08	13.27	13.33
Price/Sales	2.28	2.24	2.02	2.59	2.01	1.75	2.36	2.49
Dividend Yield	1.25	1.38	1.52	0.98	0.98	1.43	1.02	1.11
Hist Earnings Growth	13.34	14.77	8.90	16.43	11.41	3.65	17.30	19.20
Book Value Growth	13.05	14.04	8.61	9.85	13.25	10.18	2.70	16.50
Sales Growth	12.84	12.90	10.18	12.19	19.82	4.77	5.76	13.12

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
North Fork Bancorporation	10.24	1.33
Computer Sciences	27.45	1.04
Royal Caribbean Cruises	58.32	1.03
Textron	32.17	1.01
MGM Mirage	93.41	0.99
Marshall & Ilsley	17.88	0.97
Rohm and Haas	6.13	0.97
DR Horton	41.36	0.92
Rockwell Automation	41.75	0.91
Parker Hannifin	28.94	0.89
Kinder Morgan	28.39	0.89
American Standard Companies	23.10	0.88
Ambac Financial Group	19.13	0.88
Kmart Holding	313.15	0.87
Synovus Financial	1.55	0.87
Total Number of Holdings		249
% Weight in Top 15 Holdings		14.45
Turnover		38.30

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	12.84	0.61
Software	1.61	0.41
Hardware	7.53	0.77
Media	3.14	0.76
Telecommunications	0.56	0.18
Service	55.11	1.16
Healthcare	5.73	0.46
Consumer Services	15.35	1.72
Business Services	7.96	1.68
Financial Services	26.07	1.21
Manufacturing	31.62	1.02
Consumer Goods	9.67	1.14
Industrial Materials	16.17	1.33
Energy	5.07	0.70
Utilities	0.71	0.22

Market Cap	$Mil
Median	3,593
Max	10,676
Min	1,359

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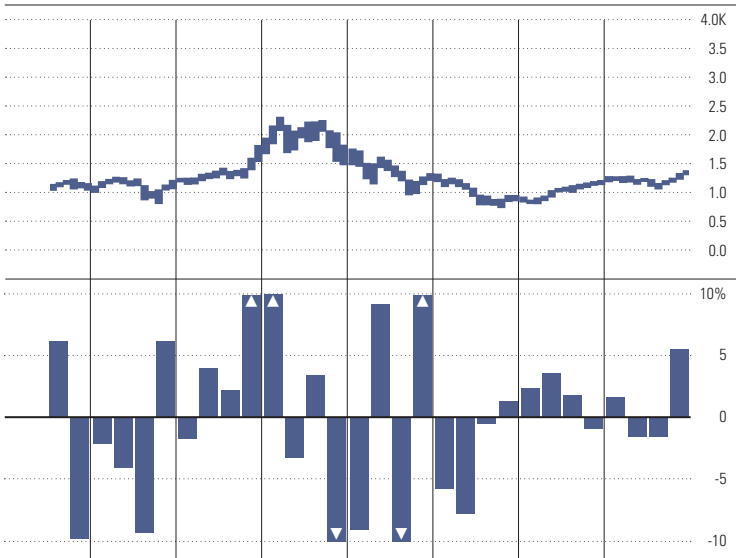
MORNINGSTAR®

Data through 12-31-04

Morningstar® Mid Growth℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MMGR	1,330.17	06-30-1997	253

The Index measures the performance of stocks issued by mid-capitalization companies that have exhibited above-average "growth" characteristics as determined by Morningstar's proprietary index methodology. The stocks included in the Index are designated as "growth" because the companies that issue them typically have higher than average historical and forecasted earnings, sales, equity, and cash-flow growth. "Mid-capitalization" stocks are those that form between the 70th and 90th percentile of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 1,330.17
Low 1,029.46

All-time High/Low
High 2,256.65
Low 706.69

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	20.60	–6.23	4.31	–24.63	–11.10
2001	–21.52	16.13	–32.48	27.42	–21.59
2002	–4.91	–21.14	–17.65	9.26	–32.54
2003	–0.25	19.71	4.88	11.80	40.02
2004	3.56	–0.01	–3.51	15.54	15.45

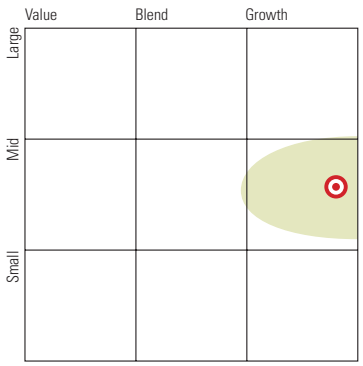
Total Returns	%	Growth of $10,000
6-Month	11.49	11,149
1-Year	15.45	11,545
3-Year Avg	2.93	10,905
5-Year Avg	–5.33	7,604
10-Year Avg	—	—
Since Inception	4.13	13,546

Risk Measures	%
Standard Deviation	8.18
Mean	0.68
Best 3-Month Return	41.08
Worst 3-Month Return	–32.48

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
1,066	1,163	1,768	1,570	1,228	827	1,156	1,330	Price
6.75	9.49	52.46	–11.10	–21.59	–32.54	40.02	15.45	Total Return %
–4.78	–14.37	32.67	–4.08	–9.71	–10.37	9.29	3.1	Rel US Market Index
0.15	0.41	0.41	0.12	0.19	0.10	0.31	0.34	Income Return %
6.60	9.08	52.05	–11.22	–21.78	–32.64	39.71	15.11	Capital Return %
34.41	38.04	46.11	42.90	39.87	33.78	35.47	32.39	Price/Earnings
5.88	8.45	12.51	8.38	6.41	4.64	5.63	5.69	Price/Book
24.60	28.91	32.44	30.38	26.03	18.44	21.77	20.78	Price/Cash Flow
4.22	6.16	12.96	9.67	6.19	3.79	4.74	4.80	Price/Sales
0.24	0.32	0.15	0.12	0.09	0.18	0.25	0.29	Dividend Yield
27.19	27.91	22.59	25.62	15.61	17.40	24.04	30.12	Hist Earnings Growth
32.39	26.50	27.14	31.64	28.38	20.19	12.45	20.10	Book Value Growth
32.26	33.40	36.95	33.08	34.64	18.26	14.60	20.18	Sales Growth

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
Network Appliance	62.52	1.15
Coach	49.40	1.03
Quest Diagnostics	31.66	0.95
Sirius Satellite Radio	141.14	0.94
Marvell Technology	87.03	0.92
XTO Energy	56.85	0.89
KLA-Tencor	–20.43	0.89
Ecolab	29.72	0.88
Hilton Hotels	33.34	0.85
VeriSign	106.13	0.83
Autodesk	209.62	0.83
L-3 Communications Holdings	43.54	0.82
Intuit	–16.74	0.82
EOG Resources	55.21	0.82
Harman International Industries	71.77	0.81
Total Number of Holdings		253
% Weight in Top 15 Holdings		13.43
Turnover		38.80

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	30.01	1.43
Software	7.88	2.00
Hardware	15.53	1.58
Media	4.08	0.98
Telecommunications	2.52	0.83
Service	49.93	1.05
Healthcare	19.06	1.53
Consumer Services	11.18	1.25
Business Services	12.96	2.74
Financial Services	6.72	0.31
Manufacturing	18.40	0.59
Consumer Goods	3.23	0.38
Industrial Materials	3.63	0.30
Energy	11.21	1.54
Utilities	0.33	0.10

Market Cap	$Mil
Median	3,643
Max	12,167
Min	1,414

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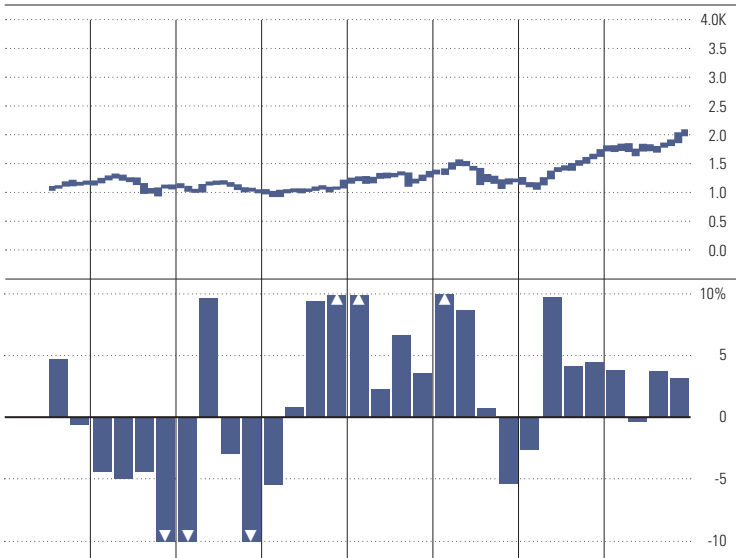
MORNINGSTAR®

Data through 12-31-04

Morningstar® Small Value℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MSVL	2,026.73	06-30-1997	337

The Index measures the performance of stocks issued by small-capitalization companies that have exhibited "value" characteristics as determined by Morningstar's proprietary index methodology. The stocks included in the Index are designated as "value" because the companies that issue them typically have relatively low valuations based on price-to-earnings, price-to-book, price-to-sales, price-to-cash flow, and dividend yields. "Small-capitalization" stocks are those that form between the 90th and 97th percentile of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 2,033.45
Low 1,599.69

All-time High/Low
High 2,033.45
Low 877.29

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	–1.33	–2.22	10.30	11.49	18.65
2001	3.09	9.28	–8.95	15.60	18.58
2002	12.75	–5.04	–16.49	2.62	–8.24
2003	–5.82	25.86	7.38	16.96	48.87
2004	6.21	1.30	1.73	13.32	24.03

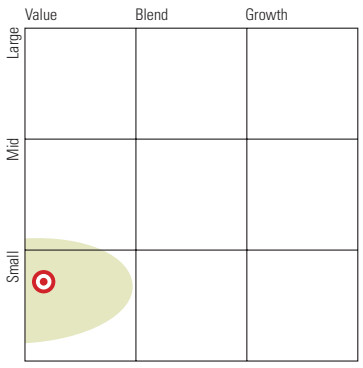
Total Returns	%	Growth of $10,000
6-Month	15.27	11,527
1-Year	24.03	12,403
3-Year Avg	19.21	16,941
5-Year Avg	18.97	23,833
10-Year Avg	—	—
Since Inception	13.09	25,158

Risk Measures	%
Standard Deviation	4.74
Mean	1.14
Best 3-Month Return	25.86
Worst 3-Month Return	–20.25

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
1,143	1,074	992	1,137	1,303	1,158	1,675	2,027	Price
15.65	–3.67	–5.19	18.65	18.58	–8.24	48.87	24.03	Total Return %
4.12	–27.53	–24.98	25.67	30.46	13.93	18.14	11.68	Rel US Market Index
1.38	2.30	2.45	4.07	3.99	2.86	4.24	3.04	Income Return %
14.27	–5.97	–7.64	14.58	14.59	–11.10	44.63	20.99	Capital Return %
17.90	18.10	17.46	15.45	20.30	18.23	21.71	21.72	Price/Earnings
2.35	2.13	1.85	1.81	2.25	1.52	2.27	2.78	Price/Book
11.65	11.13	9.82	8.36	8.41	6.44	9.96	12.04	Price/Cash Flow
1.68	1.52	1.34	1.26	1.28	1.16	1.87	2.29	Price/Sales
2.12	2.57	3.46	3.64	3.22	3.72	2.32	2.18	Dividend Yield
13.46	14.55	–1.14	10.58	2.09	–3.54	6.28	11.73	Hist Earnings Growth
11.13	12.50	4.08	1.47	1.58	1.52	–0.33	7.98	Book Value Growth
9.38	10.91	14.10	11.99	9.22	7.05	0.16	10.16	Sales Growth

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
Goodyear Tire & Rubber	86.51	0.72
Dillard's	64.46	0.60
Calpine	–18.09	0.59
Atmos Energy	18.15	0.59
Allegheny Technologies	66.41	0.57
Commerce Group MA	58.71	0.56
CMS Energy	22.65	0.56
Beazer Homes USA	50.26	0.55
AGCO	8.69	0.55
Corn Products International	57.18	0.55
Healthcare Realty Trust	21.93	0.54
Sybase	–3.06	0.54
Ciena	–49.09	0.53
Southern Union	36.84	0.52
Crescent Real Estate Equities	16.81	0.51
Total Number of Holdings		337
% Weight in Top 15 Holdings		8.47
Turnover		59.30

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	6.18	0.30
Software	0.88	0.22
Hardware	2.56	0.26
Media	1.45	0.35
Telecommunications	1.29	0.42
Service	49.94	1.05
Healthcare	2.39	0.19
Consumer Services	8.68	0.97
Business Services	5.62	1.19
Financial Services	33.26	1.55
Manufacturing	42.33	1.36
Consumer Goods	6.88	0.81
Industrial Materials	21.10	1.73
Energy	3.94	0.54
Utilities	10.42	3.24

Market Cap	$Mil
Median	1,013
Max	2,571
Min	158

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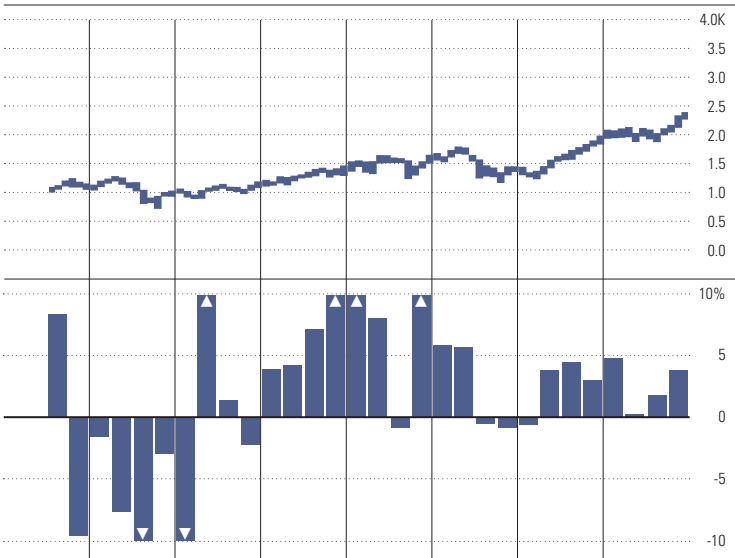
MORNINGSTAR®

Data through 12-31-04

Morningstar® Small Core℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MSCR	2,350.53	06-30-1997	377

The Index measures the performance of stocks issued by small-capitalization companies that have exhibited average "growth" and "value" characteristics as determined by Morningstar's proprietary index methodology. "Small-capitalization" stocks are those that form between the 90th and 97th percentile of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 2,355.72
Low 1,869.65

All-time High/Low
High 2,355.72
Low 713.99

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	7.93	1.66	8.20	3.78	23.21
2001	–1.44	14.96	–17.08	21.97	14.60
2002	6.21	–7.87	–17.49	6.33	–14.16
2003	–4.54	19.99	7.73	15.56	42.59
2004	7.19	1.69	–0.36	13.82	23.61

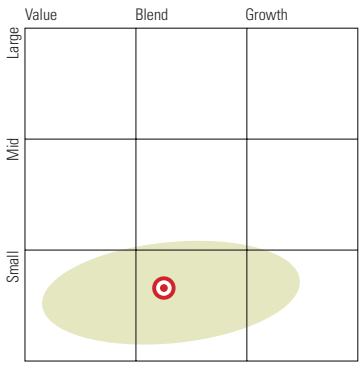
Total Returns	%	Growth of $10,000
6-Month	13.41	11,341
1-Year	23.61	12,361
3-Year Avg	14.80	15,130
5-Year Avg	16.40	21,368
10-Year Avg	—	—
Since Inception	13.06	25,108

Risk Measures	%
Standard Deviation	5.59
Mean	1.19
Best 3-Month Return	21.97
Worst 3-Month Return	–30.36

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
1,085	996	1,154	1,409	1,604	1,362	1,918	2,351	Price
8.92	–7.55	16.74	23.21	14.60	–14.16	42.59	23.61	Total Return %
–2.61	–31.41	–3.05	30.23	26.48	8.01	11.86	11.26	Rel US Market Index
0.44	0.67	0.83	1.14	0.75	0.91	1.78	1.04	Income Return %
8.48	–8.22	15.91	22.07	13.85	–15.07	40.81	22.57	Capital Return %
24.37	22.27	23.71	19.23	22.01	20.90	24.56	23.86	Price/Earnings
3.65	3.16	4.42	3.09	2.65	2.52	3.08	3.24	Price/Book
16.10	15.69	17.27	12.75	13.08	9.25	13.73	15.42	Price/Cash Flow
2.87	1.96	3.33	2.82	2.42	1.85	2.53	2.58	Price/Sales
0.74	0.66	0.65	0.75	0.73	1.26	0.80	0.61	Dividend Yield
16.05	20.54	8.80	15.08	14.20	–3.29	19.05	15.74	Hist Earnings Growth
19.30	20.85	8.13	12.18	11.70	12.94	5.07	11.48	Book Value Growth
21.70	21.95	12.62	16.00	18.15	6.52	7.46	15.76	Sales Growth

Portfolio Analysis

Ownership Zone™



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The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
Joy Global	67.83	0.59
Briggs & Stratton	25.62	0.57
Thor Industries	32.34	0.56
Kerzner International	54.13	0.56
Instinet Group LLC	17.09	0.53
Affiliated Managers Group	46.01	0.53
Toro	76.07	0.52
Fremont General	50.48	0.52
AptarGroup	36.72	0.51
Amerigroup	77.40	0.50
Meridian Gold	29.84	0.50
Steel Dynamics	65.85	0.50
Atmel	–34.78	0.50
R. H. Donnelley	48.22	0.49
Thomas & Betts	34.34	0.48
Total Number of Holdings		377
% Weight in Top 15 Holdings		7.86
Turnover		68.40

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	15.23	0.73
Software	2.37	0.60
Hardware	9.88	1.01
Media	1.23	0.30
Telecommunications	1.75	0.57
Service	53.63	1.13
Healthcare	11.82	0.95
Consumer Services	8.84	0.99
Business Services	11.05	2.34
Financial Services	21.93	1.02
Manufacturing	30.01	0.96
Consumer Goods	6.32	0.75
Industrial Materials	18.33	1.50
Energy	5.36	0.74
Utilities	0.00	0.00

Market Cap	$Mil
Median	942
Max	2,233
Min	287

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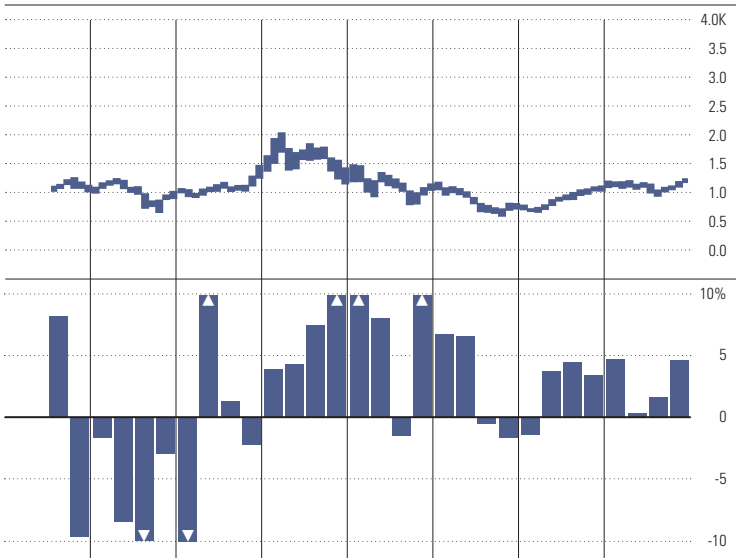
MORNINGSTAR®

Data through 12-31-04

Morningstar® Small Growth℠ Index

Ticker	Last Price	Index Inception Date	Number of Holdings
$MSGR	1,184.30	06-30-1997	326

The Index measures the performance of stocks issued by small-capitalization companies that have exhibited above-average "growth" characteristics as determined by Morningstar's proprietary index methodology.
The stocks included in the Index are designated as "growth" because the companies that issue them typically have higher than average historical and forecasted earnings, sales, equity, and cash-flow growth. "Small-capitalization" stocks are those that form between the 90th and 97th percentile of the market capitalization of the stocks eligible to be included in the Morningstar® US Market℠ Index.



Monthly Price Volatility
Monthly Price High/Low

52-Week High/Low
High 1,190.36
Low 903.98

All-time High/Low
High 1,985.74
Low 555.6

Index Performance vs. US Market Index
Quarterly Index Return
+/– US Market Index
– US Market Baseline

Performance

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Total
2000	19.40	–0.85	–5.27	–21.62	–12.10
2001	–18.87	20.25	–35.30	37.96	–12.92
2002	–6.17	–21.14	–23.67	11.77	–36.87
2003	–2.41	25.51	9.90	13.40	52.65
2004	6.19	1.09	–8.65	15.73	13.48

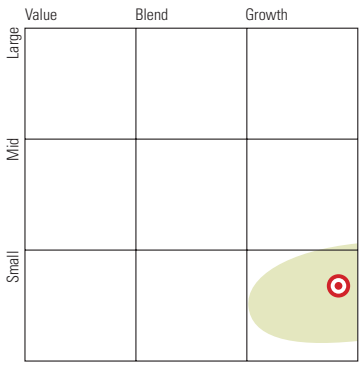
Total Returns	%	Growth of $10,000
6-Month	5.71	10,571
1-Year	13.48	11,348
3-Year Avg	3.02	10,934
5-Year Avg	–3.50	8,368
10-Year Avg	—	—
Since Inception	2.40	11,947

Risk Measures	%
Standard Deviation	9.44
Mean	0.64
Best 3-Month Return	55.23
Worst 3-Month Return	–35.30

1997	1998	1999	2000	2001	2002	2003	12-31-04	History
1,039	969	1,421	1,248	1,087	686	1,045	1,184	Price
4.02	–6.55	46.80	–12.10	–12.92	–36.87	52.65	13.48	Total Return %
–7.51	–30.41	27.01	–5.08	–1.04	–14.7	21.92	1.13	Rel US Market Index
0.13	0.14	0.18	0.07	0.04	0.04	0.17	0.18	Income Return %
3.89	–6.69	46.62	–12.17	–12.96	–36.91	52.48	13.30	Capital Return %
37.49	36.91	43.16	30.63	35.43	30.55	37.70	34.67	Price/Earnings
6.14	5.99	10.23	5.66	4.24	3.94	5.42	5.47	Price/Book
27.58	28.12	30.19	26.42	23.85	18.24	23.45	23.27	Price/Cash Flow
6.20	5.40	9.74	7.60	6.03	4.36	5.72	5.14	Price/Sales
0.13	0.15	0.06	0.04	0.06	0.11	0.13	0.10	Dividend Yield
32.71	28.69	11.17	33.45	19.06	9.43	21.25	30.49	Hist Earnings Growth
37.75	26.14	14.83	29.39	25.37	17.29	7.20	19.54	Book Value Growth
42.26	38.75	30.15	38.47	38.96	14.17	13.96	24.29	Sales Growth

Portfolio Analysis

Ownership Zone™



The fund centroid represents weighted average of domestic stock holdings.

The Ownership Zone represents 75% of fund's domestic stock holding.

Top 15 Holdings	1-Yr Return %	% Assets
Penn National Gaming	161.89	0.73
Copart	58.55	0.70
Scientific Games	40.48	0.62
Tempur Pedic International	36.77	0.62
Avocent	11.20	0.59
CACI International A	40.13	0.59
Avid Technology	28.65	0.58
Choice Hotels International	67.45	0.58
Cerner	40.48	0.56
Mine Safety Appliances	93.47	0.56
Southwestern Energy	112.09	0.55
Silicon Laboratories	–18.41	0.54
Quicksilver Resources	127.74	0.54
Hyperion Solutions	54.68	0.54
FactSet Research Systems	53.88	0.54
Total Number of Holdings		326
% Weight in Top 15 Holdings		8.85
Turnover		53.00

Morningstar Sector Breakdown	% of Stocks	Rel to US Mkt Index
Information	31.35	1.50
Software	11.44	2.90
Hardware	15.52	1.58
Media	3.13	0.75
Telecommunications	1.26	0.41
Service	49.19	1.03
Healthcare	18.46	1.48
Consumer Services	12.37	1.39
Business Services	15.07	3.19
Financial Services	3.29	0.15
Manufacturing	17.46	0.56
Consumer Goods	2.95	0.35
Industrial Materials	8.09	0.66
Energy	6.05	0.83
Utilities	0.38	0.12

Market Cap	$Mil
Median	1,007
Max	2,355
Min	310

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MORNINGSTAR®

Morningstar Market Barometer℠: Three Year Review

2004

Investors grappled with uncertainty for most of the year, but the U.S. stock market closed out 2004 with a decent showing after all. Thanks to a 10.1% gain in the fourth quarter, the US Market℠ Index finished the year up 12.4%. Growth stocks lagged behind their value counterparts by a huge margin. The US Growth℠ Index gained 4.4%, compared with a 16.9% run-up for the US Value℠ Index. There was also a gaping span in returns for the capitalization indexes. The Morningstar® Large Cap℠ Index gained 9.5% for the year, compared with a 20.4% gain for the Small Cap℠ Index. The Large Growth℠ Index just barely finished the year in positive territory. It was especially plagued by losses in blue-chip growth stocks, such as Pfizer, Intel, Cisco Systems, and Coca-Cola. Among the Morningstar sectors, Energy and Utilities were among the biggest winners for the year, while Hardware and big pharmaceutical stocks offset some of the market's gains.

2003

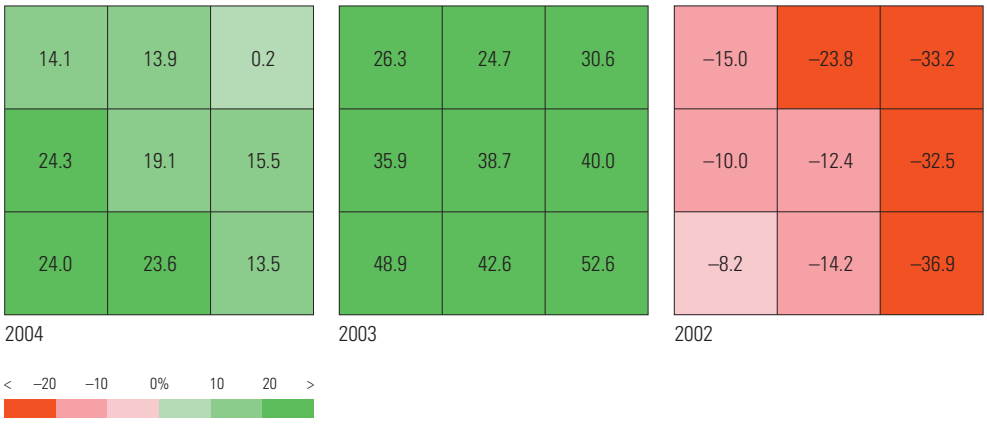
It was one of the best-performing markets in recent memory, almost across the board. The US Market Index gained 30.73% for the year—a marked reversal of fortune from the widespread losses of 2002. The end of major fighting in Iraq, a 45-year low in interest rates, and the new tax-stimulus package helped set the stage for a powerful rebound. Small stocks fared far better than large-cap issues, and growth did better than value. Every one of Morningstar's nine style indexes finished the year with sizeable gains. The best performer for the year was the Small Growth℠ Index, which gained 53% for the year. The worst performer, the Large Core℠ Index, gained a comparably mundane 24.7%. The Hardware sector was by far the best performer among the 12 Morningstar sectors, gaining a whopping 66% for the year.

2002

This was an ugly year for the markets, as the US Market Index dropped 22.2% for the year. The widespread nature of this year's downturn was striking, as neither style nor size sheltered investors from the storm. The Morningstar Market Barometer was a sea of red. The market's sources of weakness were numerous and varied—investors wary of high valuations, the war on terrorism, signs of anemic economic growth, and a wave of corporate scandals (Enron, WorldCom, and Tyco, to a name a few). However, two noteworthy trends emerged. First, value stocks fared better than their pricier growth counterparts—a shift that began with the collapse of the tech bubble in 2000. Second, small and mid-size stocks, which had been largely neglected during the bull market, were finding favor with investors. The two trends converged to assist the Small Value℠ Index in being the best performer for the year with a modest loss of 8.2%. The three Growth Indexes trailed the rest of the market with losses greater than 32% for the year.

Morningstar Market Barometer

The Morningstar Market Barometer provides an at-a-glance view of the markets, allowing instant analysis of performance trends. The performance of each Morningstar Index is depicted in varying shades of red and green that clearly reveal the magnitude of the market movements while placing them in context of the overall market. The indexes are based on the same methodology as the Morningstar Style Box™.



Appendices

Morningstar® Indexes Methodology

The Morningstar Index family consists of 16 indexes that track the U.S. market by capitalization and investment style to create an integrated system. The indexes were built using a comprehensive and non-overlapping approach, based on the methodology of the Morningstar Style Box™.

Transparent Methodology
Morningstar Indexes are entirely rules-based, governed by transparent, objective, and clearly published rules for security selection and exclusion, rebalancing, and adjustments for corporate actions.

Broad Market Coverage
The Morningstar® US Market℠ Index represents 97% of the U.S. market.

Index Eligibility
Index constituents are drawn from the available pool of liquid, U.S. domiciled stocks that trade on one of the three major exchanges. The following security types are excluded: American Depository Receipts; bulletin board stocks; convertible notes, warrants and rights; limited partnerships.

Liquidity Requirement
Securities that have more than 10 non-trading days in the prior quarter or that have average daily trading volume over the preceding six months that falls in the bottom quartile are excluded.

Constituent Weighting
Index constituents are weighted according to their free-float of shares outstanding. The free-float is defined as a company's outstanding shares adjusted for block ownership to reflect only shares available for investment.
The types of block ownership that are considered during float adjustment are cross ownership, government ownership, private ownership, and restricted shares.

Stability Buffers
To help ensure that index turnover reflects significant events, stocks are reclassified in terms of style or capitalization only if they move sufficiently beyond the break point between styles (value-core or core-growth break points) or capitalization (large-mid or mid-small). The range in which a stock's movement is permitted without impacting the classification is called the buffer zone. Short-term movements of stocks into or within the buffer zones do not result in index turnover.

Rebalancing & Reconstitution
Morningstar rebalances constituent shares and weights of its indexes quarterly in March, June, September, and December. Immediate rebalancing occurs if two constituents merge or a company's free-float changes by 10% or more. The indexes are reconstituted (stocks are added or removed from the indexes) twice annually in June and December.

Morningstar Index Construction Process
The index construction begins by defining the "investable portion" of the U.S. equity market.

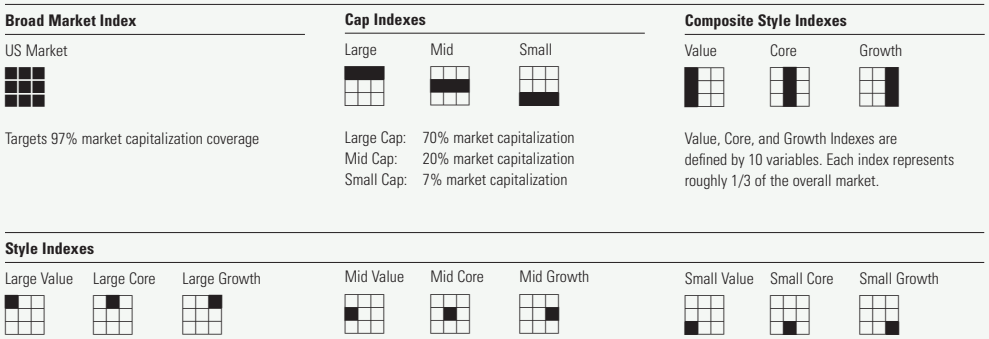
Next, liquidity screens are applied to create the Morningstar US Market Index, which targets 97% of the total capitalization of the U.S. market.

The Morningstar US Market Index is divided into three market cap indexes by defining each as a percentage of the market capitalization of the investable universe.

Flexible Cap Bands
Market cap break points are based on the percentage of the overall market, rather than a fixed number of stocks or targeted dollar amounts, a flexible approach that automatically adjusts to market expansions or contractions. The market is divided into three capitalization categories:

- Large Cap: Stocks that form the largest 70% of investable market capitalization
- Mid Cap: The next 20% of investable market capitalization (70th to 90th percentile)
- Small Cap: The next 7% of investable market capitalization (90th to 97th percentile)

Overview of the Morningstar Index Family



The nine segments of the well-known Morningstar Style Box are specified by style and market capitalization.

Determining a Stock's Style

Within each capitalization class, index constituents are assigned to one of three style orientations—value, growth, or core—based on the stock's overall style score.

A stock's style score is determined by separately measuring a stock's value and growth characteristics using related but distinct historical and forward-looking variables, each accounting for one-half of a stock's style score.

After value and growth scores are calculated, they are compared to determine whether value or growth characteristics dominate. If the value-growth scores are not sufficiently different, the stock is designated core.

Breakpoints for value, core, and growth styles are set so that the average weight of each style over time represents roughly one-third of the investable universe within the capitalization class.

Value Factors

	Weight %
Price/projected earnings	50.0
Price/book	12.5
Price/sales	12.5
Price/cash flow	12.5
Dividend yield	12.5

Growth Factors

	Weight %
Long-term projected earnings growth	50.0
Historical earnings growth	12.5
Sales growth	12.5
Cash-flow growth	12.5
Book value growth	12.5

Morningstar Index Construction Process



Morningstar® Indexes Glossary

Best/Worst 3-Month Return
The return for the 3-Month period since index inception in which the index has had its highest percentage gain or loss.

Book Value Growth
Book value growth represents the weighted average of 1-Year growth in book value or shareholders' equity for each stock in the index's portfolio.

Capital Return
This figure shows the portion of the index's total returns that was generated by realized and unrealized increases in the value of securities in the portfolio.

Centroid
Plotted in the middle of the Ownership Zone™, this represents the weighted average of all the fund's holdings.

Dividend Yield
Regular dividend per share for the current year divided by the current stock price.

Float-Adjusted Market Cap
The number of free-floating shares multiplied by current share price.

Free-Float Shares
A company's outstanding shares adjusted for non-trading blocks of 5% or more total share capitalization, to reflect shares available for investment.

Historical Earnings Growth
Historical earnings growth represents the weighted average of 1-Year growth in earnings from operations for each stock in the index's portfolio.

Income Return
This figure shows the portion of the index's total return that was derived from the reinvestment of income distributions.

Long-term Projected Earnings Growth
The projected earnings growth is an estimate of a company's expected long-term growth in earnings, derived from all polled analysts' estimates. When reported for an index, it shows the weighted average of the projected growth in earnings for each stock in the index portfolio.

Mean
The average monthly return of the index since inception.

Median Market Capitalization
The midpoint of market capitalization (price multiplied by the number of shares outstanding) of the stocks in the index's portfolio.

Morningstar Market Barometer℠
The Morningstar Market Barometer provides an at-a-glance view of the markets, allowing instant analysis of performance trends. The performance of each Morningstar Index is depicted in varying shades of red and green that clearly reveal the magnitude of the market movements while placing them in context of the overall market. The indexes are based on the same methodology as the Morningstar Style Box™.

Morningstar Sectors
Morningstar has an industry sector structure to help investors and investment professionals more easily compare and understand the sector exposures of portfolios. The sector classifications are also designed to create a more useful way to evaluate common stocks and to address the limitations of conventional sector analysis. Morningstar divides the economy into three "Super Sectors"—the Information Economy, the Service Economy, and the Manufacturing Economy—each of which contains four sectors.

Software Sector
Companies engaged in the design and marketing of computer operating systems and applications.

Hardware Sector
Manufacturers of computer equipment, communication equipment, semiconductors, and components.

Media Sector
Companies that own and operate broadcast networks and those that create content or provide it to other media companies.

Telecommunications Sector
Companies that provide communication services using fixed-line networks or those that provide wireless access and services.

Healthcare Sector
Includes biotechnology, pharmaceuticals, research services, HMOs, home health, hospitals, assisted living, and medical equipment and supplies.

Consumer Services Sector
Includes retail stores, personal services, homebuilders, home supply, travel and entertainment companies, and educational providers.

Business Services Sector
Includes advertising, printing, publishing, business support, consultants, employment, engineering and construction, security services, waste management, distributors, and transportation.

Financial Services Sector
Includes banks, finance companies, money management firms, savings and loans, securities brokers, and insurance companies.

Consumer Goods Sector
Companies that manufacture or provide food, beverages, household and personal products, apparel, shoes, textiles, autos and auto parts, consumer electronics, luxury goods, packaging, and tobacco.

Industrial Materials Sector
Includes aerospace and defense firms, and companies that provide or manufacture chemicals, machinery, building materials, and commodities.

Energy Sector
Companies that produce or refine oil and gas, oilfield services and equipment companies, and pipeline operators.

Utilities Sector
Electric, gas, and water utilities.

Super Sectors
Sectors are consolidated into three Super Sectors: Information Economy, Service Economy, and Manufacturing Economy.

Ownership Zone
Derived by plotting each stock in the index's portfolio within the proprietary Morningstar Style Box. The shaded area represents 75% of the index's assets.

Price/Book Ratio
The current stock price divided by its book value per share for the most recent year-end.

Price/Cash Flow Ratio
The current stock price divided by its cash flow per share for the most recent year-end.

Price/Sales Ratio
The current stock price divided by sales per share for the most recent year-end.

Price/Projected Earnings Ratio
The current stock price divided by the median EPS estimate for the current year. EPS estimates are provided by IBES.

Relative (+/–) US Market Index Return
Represents the amount by which an index exceeded or trailed the Morningstar® US Market℠ Index.

Sales Growth
Sales growth shows the weighted average of the sales-growth rates for each stock in the index's portfolio.

Standard Deviation
A statistical measurement of dispersion about an average, which depicts how widely the monthly returns varied over the trailing 5-Year period. A high standard deviation indicates that the predicted range of performance is wide, implying greater volatility.

Total Return
Expressed in percentage terms, return is determined each period by taking the change in price, reinvesting all income and capital gains distributions during that period, and dividing by the starting price.

Turnover Ratio
This is a measure of the index's trading activity, which is computed by taking the lesser of purchases or sales and dividing by the average monthly market cap for all securities in the index portfolio.

Client Spotlight

Barclays Global Investors Launches iShares® Using Morningstar® Indexes



J. S. Parsons
Managing Director, sales force leader for the U.S. Intermediary Business and European exchange-traded funds for Barclays Global Investors

In 2004, Barclays Global Investors (BGI) launched its iShares exchange-traded funds (ETFs) using nine Morningstar Indexes. ETFs are index funds that are bought and sold like common stocks on securities exchanges. The iShares fund family offers 97 different ETFs, making it one of the more extensive fund families where ETFs are concerned.

J. S. Parsons, BGI managing director and head of sales, said BGI chose Morningstar Indexes because of Morningstar's strong brand and its unique approach to constructing value-growth indexes based on the Morningstar Style Box™.

"The Morningstar brand really resonates with the advisor community," Parsons said. "Plus, unlike most other style indexes, Morningstar creates a core category—stocks that are identified as neither pure value or pure growth. The resulting value and growth indexes are more distinct and pure in style. This allows investors to efficiently reposition their portfolios to meet their investment strategy."

Parsons added that Morningstar Indexes offer a new approach to the value-growth split. iShares ETFs are currently available for the following Morningstar Indexes: Large Value, Large Core, Large Growth, Mid Value, Mid Core, Mid Growth, Small Value, Small Core, and Small Growth.

"An advisor who is building his or her business, say with five to 10 years of experience, has to rely on providing clients a certain quality of product available in the marketplace," Parsons said. "Morningstar Indexes give advisors an advantage in the marketplace. The nine indexes, which are constructed without any gaps or without any overlap of securities, serve as portfolio building blocks that offer a flexible basis for portfolio construction. They align closely with what advisors are trying to accomplish, particularly when they are using the Morningstar Style Box."

The investment style of each individual security in the Morningstar Indexes is determined by a comprehensive 10-factor methodology that separately measures both the value and growth characteristics of each security, using historical and forward-looking elements.

"One of the things I like about Morningstar Indexes is that when you look at value, these products are pure value play, because the core stocks are removed", Parsons explained. "If your strategy is looking to add a specific style exposure—value or growth—these indexes help you accomplish that with precision and you will have comfort that you will have the right style exposure with respect to that. If you are trying to manage a core-satellite strategy, then having a pure style for core would match up with your active manager."

Parsons added that BGI's iShares tools have "excellent tax-efficiency, cost-effectiveness, and focus. In addition to the usual tax benefits of an ETF structure, the buffering technique used by Morningstar dampens the stock turnover, reducing the transaction costs incurred by the fund. In a low-return environment, any savings you can squeeze out helps." For example, Parsons reported that iShares had zero capital gains in 2004, thanks in part to appropriately managing tax status.

Parsons also sees a role for these funds in the institutional space. "As the funds grow they may increasingly be used by investment managers for equitizing their cash positions, and gaining highly liquid exposure to different sections of the market through a single transaction," he said.

The iShares ETFs are not sponsored, endorsed, sold, or promoted by Morningstar, and Morningstar makes no representation regarding the advisability of investing in iShares.

Learn More About Morningstar Indexes

Phone

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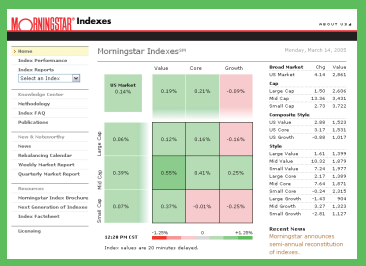
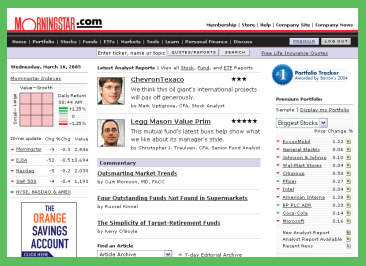
Visit The Morningstar Index Web site at http://indexes.morningstar.com



View the Indexes on Morningstar's Web site for investors at www.morningstar.com



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Morningstar Index Yearbook: 2004
Volume 1

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