

## April 2005 Commentary

### First Quarter 2005 - Market Review

Rising interest rates and gushing oil prices put a damper on the financial markets in the first quarter of 2005. The Federal Reserve ratcheted up short term rates by another 0.50% and crude oil prices jumped 32% (discussed further on the reverse page). Flagging in these headwinds, the U.S. equity markets lost ground in first quarter, with the Dow Jones Industrial Average ("DJIA") posting a 2.6% loss. The DJIA traded within a 600 point range during the quarter and briefly flirted with the 11,000 level before finishing the quarter at 10,504.

**Large Caps:** The S&P 500 Index lost 2.15% in the first three months of the year, but edged up 6.7% over the 12 months ending 3/31/2005. Over longer periods of time, the S&P 500 Index has produced losses of 3.16% per year over the last five years, but has averaged 10.8% per year over the last ten.

These returns hide one of the recent trends underlying the market: the significant performance disparity between the two investment styles known as "Growth" and "Value". While Growth and Value may really not be distinct investment styles the performance of each can differ markedly. Over the last five years the Value style (as measured by the Russell 1000 Value index) gained 5.2% per year, while the Growth style (Russell 1000 Growth index) lost 11.3% per year. A similar performance disparity can also be seen in the 1-year, 3-year and 10-year results. As the chart below shows, Value has outperformed Growth over the last ten years (averaging 12.8% and 8.2% per year, respectively). While no one knows whether Value will continue to outpace Growth, we recommend including both styles in portfolios and actively re-balancing to targeted levels.

**"Your true value depends entirely on what you are compared with." - Bob Wells**

### Performance of Large Company Growth and Value Investment Styles

Russell 1000 Growth vs. Russell 1000 Value



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**"We are ready for any unforeseen event that may or may not occur." - Dan Quayle**

**Mid & Small Caps:** Mid-sized company stocks (S&P 400 Index) lost 0.40% in the quarter. Small company stocks (Russell 2000 Index), fell 5.3% during the quarter. Mid caps have gained 6.9% per year over the last five years and 15.1% per year over the last ten years, while Small caps have posted gains of 4.0% per year over the last five years and 10.4% per year over the last ten years.

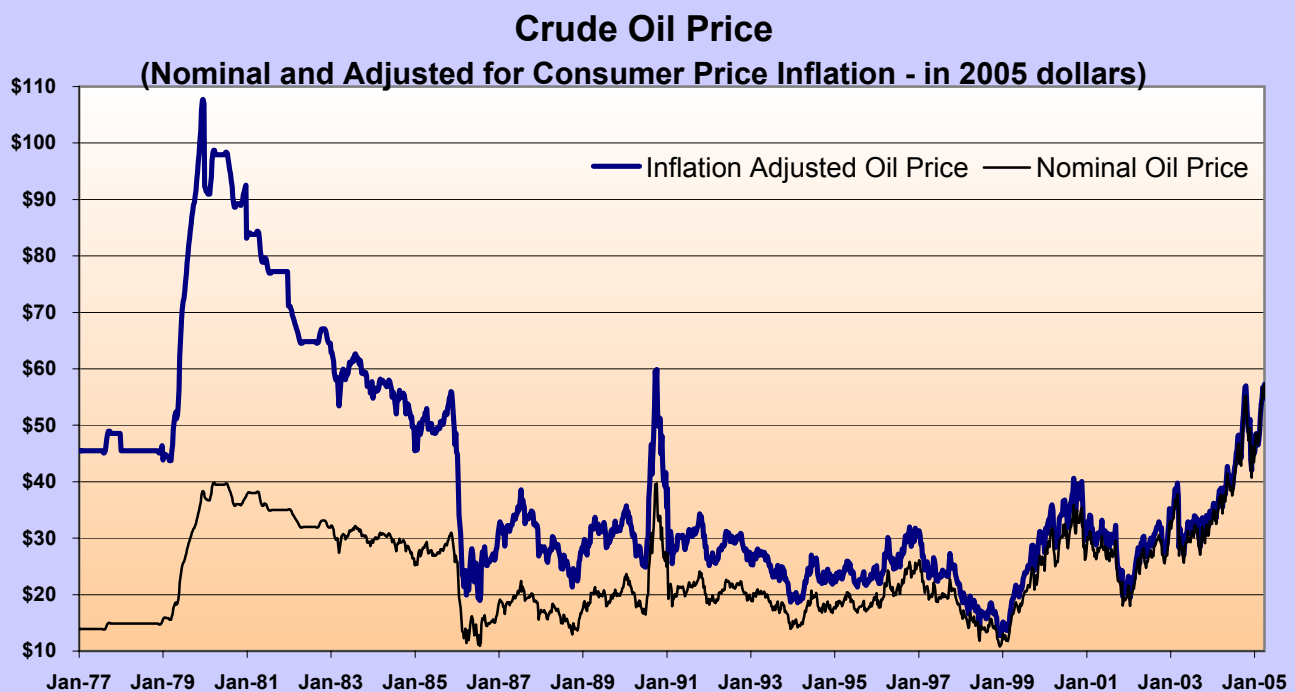
**International:** Other areas of the equity markets also struggled in the first quarter. International stocks (MSCI EAFE Index) fell 0.17% in the quarter, led by declines in Ireland (down 11.4%) and Hong Kong (down 4.2%). Natural resource concentrated economies like Australia, Canada and Norway posted positive returns during the quarter (up 1.8%, 3.6% and 4.7%, respectively). Looking at the globe as a single market, the MSCI World Index declined 1.1% during the quarter.

**Real Estate:** Real Estate Investment Trusts (REITs) also took a breather during the quarter, finishing down 7.1%, as higher interest rates put a damper on real estate appreciation. Over the last five and ten years REITs have produced stellar, and likely unsustainable, annual returns, up 19.6% and 14.0% per year respectively.

**Bonds:** The bond market also slid in the first quarter. Government and corporate bonds, as measured by the Lehman Government/Credit Index, lost 0.7% during the quarter. Over the last five years bonds have produced an annual return of 8.4% per year and 7.6% per year over the last ten years. Municipal bonds, as measured by the Lehman 1-10 Year municipal bond index, lost 0.8% in the quarter. The yield on the 10-year U.S. Treasury bond experienced a rollercoaster ride during the quarter. The 10-year yield began the year at 4.25%, fell below 4.10% in February, then rose to 4.60% in March, before finishing just under 4.50% at quarter end. Further interest rate increases are still expected in the coming months.

**Cash:** Returns on cash continue to be low, but are increasing, as U.S. T-Bills earned 0.6% over the last three months. Adjusting for inflation, returns on cash have been negative for the last three years.

**Oil:** One area that certainly has not had any problem appreciating is crude oil. Crude oil prices are now higher than ever before but, when adjusted for inflation, are just at high levels rather than extreme. Inflation adjusted oil prices traded at these levels or higher in 1991 and over a multi-year period in the early 1980s. In the past, high oil prices were often a key factor in causing recessions. Some analysts believe that as oil prices are being driven by higher global demand rather than a supply shock, higher oil prices may not cause the economy to slip into a recession. Like many, we hope that this view proves correct.



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