

Morningstar Market Commentary

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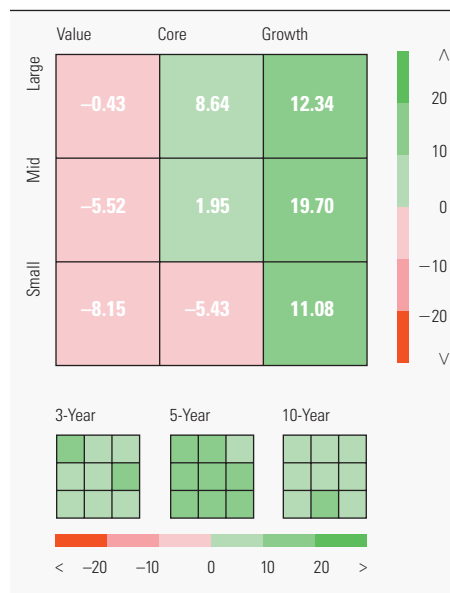
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2007 Year-End Review

1-Year Morningstar Market Barometer



Crossroads and Trend Reversals

Investors did not lack for excitement in 2007. A full-blown credit crunch, a banking crisis of sorts, interest rate cuts, a massive commodity rally, a plunging dollar, wild swings in stock and bond prices, you name it. Granted, most of the news was negative; in fact, borderline scary. Yet, the end results were far from awful. While far away from its mid-year high due to a fourth-quarter slide, the Morningstar US Market Index still finished the year up 5.9%. The Morningstar Core Bond Index rose 7.4% for the year, overcoming the credit crisis and lingering inflation fears. And commodities left all the other indexes in the dust, as captured by the Morningstar Long-Only Commodity Index's hefty 32% gain.

Why the long faces then? Well, financial markets are indeed facing some formidable headwinds. The U.S. housing market is in serious trouble, with home prices, foreclosure rates, and an overhang of unsold homes, creating an environment more unfavorable than seen in decades. This has led to sharp deflation in mortgage-backed assets, which, through the complex web of structured-debt securities, has soured the entire debt-creation process. The crisis has forced banks to realize huge losses on their balance sheets, thereby restricting their ability to extend credit. Historically, widespread malaise in the banking sector has spelled gloom for the economy and for asset prices.

Moreover, sharp rises in commodity prices has stroked inflation fears. A "stagflationary" environment has also historically proven harmful for equities, and would pose very difficult policy challenges for the U.S. Federal Reserve.

For those still willing to look at the bright side, there are some significant highlights. Corporate balance sheets are generally in fine shape, the employment scene is reasonably healthy, U.S. exports are booming due to continued strong economic growth overseas, and equity valuations are reasonable. Sound investing ideas are not impossible to sketch in this setting, especially for investors with a longer-term focus. As an example, several prominent investors from abroad have recently picked up U.S. assets on the cheap.

Overall, markets have shown some key transitions during this past year. Among the most striking is the return to favor of growth stocks after being in the shadow of value stocks for years. Considering how long overdue the return to growth has been, and the historical cyclical nature of the two styles, growth's recent run could well gather strength. Another change this past year was the return of market volatility, which is only natural, as several years of robust corporate earnings and economic growth look set to falter.

Overview

One multiyear trend that stayed vehemently intact in 2007 was the continued dominance of the manufacturing side of the economy over services and information technology. The Morningstar Manufacturing Super Sector Index gained 23%, powered by the global economy's voracious demand for energy and industrial goods. The Morningstar Information Super Sector Index rose 10.5% to finish a distant second. That performance was still vastly better than the Morningstar Services Super Sector Index's 4.4% loss for the year. The financial services sector was easily the biggest culprit in the Service Super Sector's downfall.

A Closer Look

Information Super Sector +10.5%

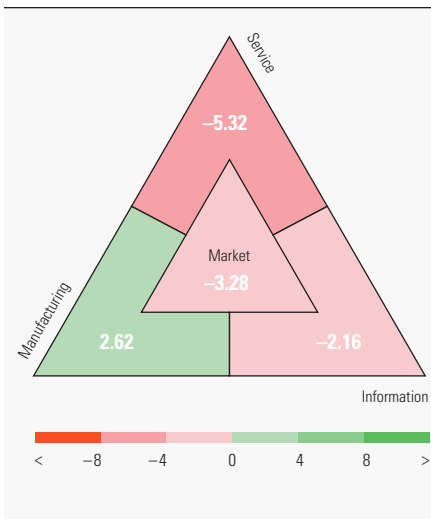
For most of the year, investors regarded technology stocks a safe haven from the turmoil affecting the larger economy, which allowed the software and hardware sectors to finish with strong gains despite some indiscriminate selling toward the end of the year. The Morningstar Software and Hardware Indexes gained 16% and 17%, respectively. Star performers included Apple, Inc., which rose a whopping 133% as its vastly popular consumer electronics products allowed it to post profit margins rarely seen in that competitive field.
















Service Super Sector -4.4%

Financial services were easily the most bad news-infested sector in 2007. Indeed, not since the technology bubble burst in 2000 has any part of the market dealt with such harsh critique. Banks, real estate trusts, insurance companies—anything remotely related to the housing sector—endured severe punishment. Overall, the Morningstar Financial Services Index (which makes up slightly more than 40% of the Morningstar Services Super Sector) lost 16% for the year.

It is true that heedless lending practices and the excessive creation of highly leveraged structured-debt securities have created a rather toxic brew

4th Quarter Morningstar Sector Delta and Return %



Sector	YTD	3-Year	5-Year
 Information	10.47	8.24	12.92
 Software	15.83	9.87	12.57
 Hardware	16.94	9.36	15.78
 Media	-12.89	-1.81	5.56
 Telecommunication	11.21	13.76	13.63
 Service	-4.36	5.63	11.11
 Healthcare	9.57	8.53	9.62
 Consumer Services	-5.23	2.35	11.24
 Business Services	13.75	14.34	16.98
 Financial Services	-15.92	2.92	10.51
 Manufacturing	22.78	17.89	20.35
 Consumer Goods	11.28	10.14	12.81
 Industrial Materials	37.23	31.41	30.53
 Energy	20.52	13.41	18.69
 Utilities	18.16	19.17	21.15

Morningstar Super Sectors

	P/E	P/B	Yield %	Earn Growth	Sales Growth
Information Super Sector	22.09	3.06	0.85	10.90	9.24
Service Super Sector	15.42	2.23	2.06	13.48	7.97
Manufacturing Super Sector	16.03	3.10	1.75	20.84	4.63

that threatens to choke the supply of credit. However, some analysts (including Morningstar equity analysts covering the sector) believe that financial services stocks are being valued with extreme prejudice at this time. For example, Morningstar analysts see excellent bargains at U.S. Bancorp (down 8% for the year) and Capital One (down 39%). Both banks did a great job of sidestepping the housing mess and have solid balance sheets to boot.

The Services Super Sector did have two noteworthy winning candidates in the healthcare and business services sectors, which rose 10% and 14%, respectively. Both sectors were seen as havens from the market gyrations caused by the credit crisis.

Manufacturing Super Sector +23%

Global economic growth continued at a brisk pace in 2007, and was again especially strong in emerging markets, setting up yet another year of superb returns for natural resources and industrial

goods suppliers. The Morningstar Energy Index soared 37% and the Morningstar Industrial Materials Index rose 21%, earning them the top two spots in 2007 among all sector indexes. The Manufacturing Super Sector also claimed the third spot, earned by the Morningstar Utility Index's 18% gain. Growth in generation capacity amid strong power demand has produced a cash-rich operating environment for electricity suppliers.

Strong energy demand, geopolitical uncertainty, and falling inventories of energy stockpiles in many countries pushed oil prices to nearly \$100 per barrel, raising incentives for greater exploration efforts. Thus, the biggest beneficiaries of the rally have been energy services companies. For example, drilling equipment manufacturer National Oilwell Varco, Inc. jumped 133% in 2007. Among industrial materials stocks, the best performers were multinationals that saw their exports boom, aided by a strong dollar. Examples include engine manufacturer Cummins, Inc., which rose 115%.

Overview

One of the most interesting and dramatic trend reversals in 2007 occurred in the style arena. Reversing one of the longest winning streaks for an investment style in recent history, growth stocks handily beat their value peers. The Morningstar US Growth Index gained nearly 14% in 2007, while the Morningstar US Value Index was down almost 2%. This impressive comeback has once again highlighted the importance of style diversification: Having adequate exposure to both styles can be a valuable risk-management technique for any portfolio. The Morningstar US Core Index finished almost exactly in the middle, with a gain of 6.4%.

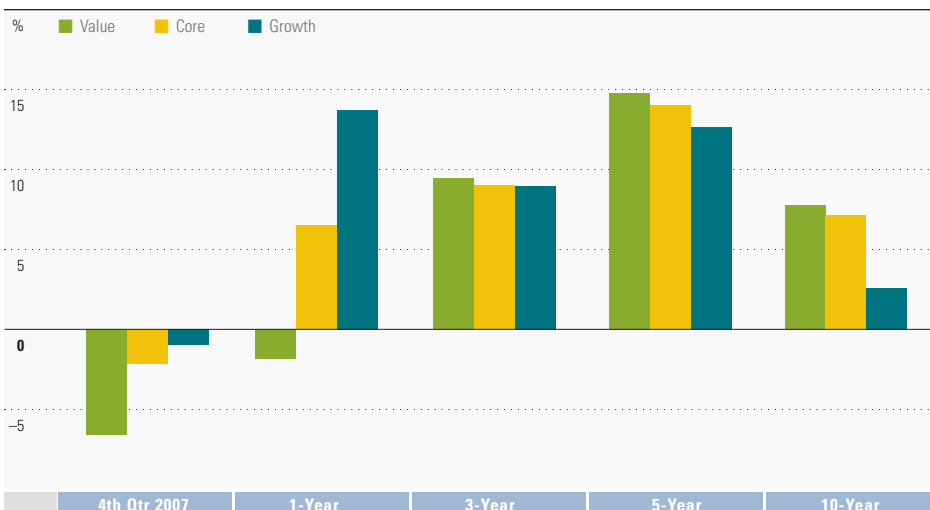
A Closer Look

Morningstar Value Index -1.9%
Financial services stocks, old-media companies, and homebuilders top the list of detractors here. Banking giant Citigroup, Inc. paid a heavy price for its subprime involvement, slumping 45% through the year. Citi had to bring a massive amount of deflated asset-backed securities onto its balance sheet, an action investors fear would tie up precious capital. Among media stocks, the example of The New York Times Company captured the plight the sector is facing. The stock dropped 25% amid a vicious cycle of declining readership and eroding ad revenues.

Pulte Homes, Inc. was a prominent example among numerous troubled homebuilders. One of the nation's largest builders, Pulte shed 68% of its value as its excess land holdings and heavy debt burden were seen as serious impediments to survival in a housing market turned brutal.

Morningstar Core Index +6.4%
Stalwart businesses with steady and ample cash flows boosted the Morningstar US Core Index, as investors regarded such companies as safe places to hide from the market turmoil. Diversified industrial conglomerate Honeywell International, Inc. was a textbook example last year,

Trailing Returns



Index Stats

	P/E	P/B	Yield %	Earn Growth	Sales Growth
Morningstar Value	12.01	1.79	3.01	14.00	2.39
Morningstar Core	17.57	2.96	1.59	15.92	8.87
Morningstar Growth	24.20	4.09	0.57	26.60	13.80

gaining 39%. Honeywell thrived on global industrial expansion, generating double-digit revenue and earnings growth.

The Morningstar US Core Index lost ground, however, with its share of troubled financial services stocks among the detractors. Merrill Lynch & Company, Inc. lost 41%, for example. The venerable financial institution's risk-control procedures were called into question after it took staggeringly bigger losses on mortgage investments than the bank initially anticipated.

Morningstar Growth Index +13.8%
Growth stocks stormed back in 2007 after years of investor neglect. Key growth hunting grounds such as technology were viewed by investors as sectors largely immune from the debt crisis, and able to power through a U.S economic slow-down. Also, some market observers have noted that true-blue growth stocks are more prized when earnings growth in the broad market slows, which is consistent with what we observed in 2007.

Examples include First Solar, Inc., a major supplier of electronic components to the solar power generation industry. First Solar had an explosive 795% rise, as investors paid tribute to the company's proprietary, dramatically cost-reducing technology. Online retailer Amazon.com, Inc. also scored a massive, triple-digit gain, soaring 135% on the back of scorching revenue growth. Amazon's status as the lone giant in a lucrative merchandise area and fast-growing retail medium has allowed it to post a series of growth surprises.

Overview

The past year saw a turning of tides in the market cap space as well. After lagging small-cap and mid-cap stocks for several years, and after closing that gap in 2006, large-cap stocks finally took the lead in 2007. The Morningstar Large Cap Index finished the year with a 6.7% gain, buoyed, among other factors, by risk-aversion that gripped markets. The Morningstar Mid Cap Index finished in the middle, rising 5.2%. The Morningstar Small Cap Index finished last with a 0.7% loss, as investors perceived small-caps as more vulnerable to an economic slowdown.

A Closer Look

Morningstar Large Cap Index +6.7%

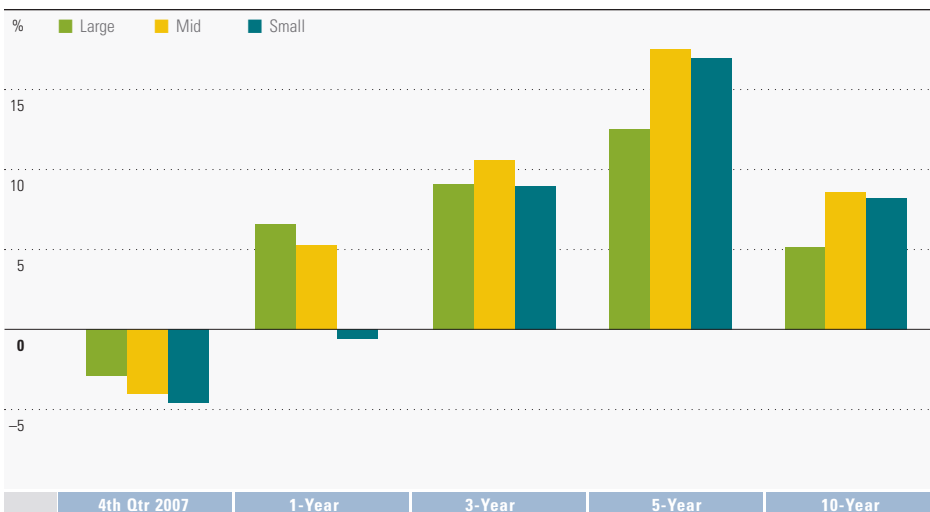
Large companies connected to commodities and industrial goods had an exceptionally strong year. Being plugged into globally strong demand for their products aided such companies, as did a weak dollar. Monsanto Company, the world's leading producer of seeds, is an interesting example: The stock climbed 114% in 2007, in part due to skyrocketing food prices.

MasterCard Incorporated also benefited from global trends, being a leading brand in the fast-growing global payments industry, with the stock soaring 119%. Google, Inc., which jumped 50% in 2007, is yet another example of a "wide moat" business able to better weather the storm. Internet advertising has vast growth potential, and Google is the undisputed leader in the field, which has translated to fantastic profits.

Morningstar Mid Cap Index +5.2%

Energy-related stocks were huge winners in the mid-cap space as well. SunPower Corporation, a provider of solar power products and services, made the most of strong demand for solar products worldwide. SunPower's revenue more than doubled over the past year, and the stock shot up

Trailing Returns



Index Stats

	P/E	P/B	Yield %	Earn Growth	Sales Growth
Morningstar Large Cap	16.57	2.83	1.81	17.69	8.14
Morningstar Mid Cap	16.76	2.36	1.35	18.98	5.97
Morningstar Small Cap	17.91	2.00	1.47	-3.25	0.05

251%. Another strong contributor was online travel agency Priceline.com, Inc. The stock climbed 163%, as investors rewarded it for posting surprisingly strong revenue growth through successful foreign acquisitions.

Morningstar Small Cap Index -0.7%

Small-caps did not fare well in the uncertain market environment. Also, the fierce merger and acquisition boom that has taken hold since 2006 slowed considerably by mid-2007 with the advent of the credit crisis, thereby taking away key support for small-caps. The worst offenders were financial services companies. Operating conditions in that sector have become very challenging due to the credit crisis, which makes smaller players exceptionally vulnerable. For example, bond insurer Security Capital Assurance Ltd. plunged 86%. As even the market leaders in that subsector came under pressure, investors lost confidence that Security Capital would be able to survive a turn in the credit cycle or secure financing at a competitive cost.

Retail stocks were another particularly weak area due to fears of a looming consumer slowdown. Consumer electronics seller Circuit City Stores, Inc. tanked 77%, having posted results disappointing enough to cast doubt on the retailer's future. Specialty women's gear retailer Chico's FAS, Inc. was also in similar trouble. Chico's compounded the threat of reduced discretionary spending by lacking compelling merchandise as well, leading to disappointing earnings and a 56% stock slide.

Media stocks were also a conspicuous detractor. A key theme in that sector has been the shift of advertising dollars to the Internet and away from traditional media such as newspapers and radio stations. Radio station operator Citadel Broadcasting Corporation and newspaper group McClatchy Company both lost 70% for the year.

Overview

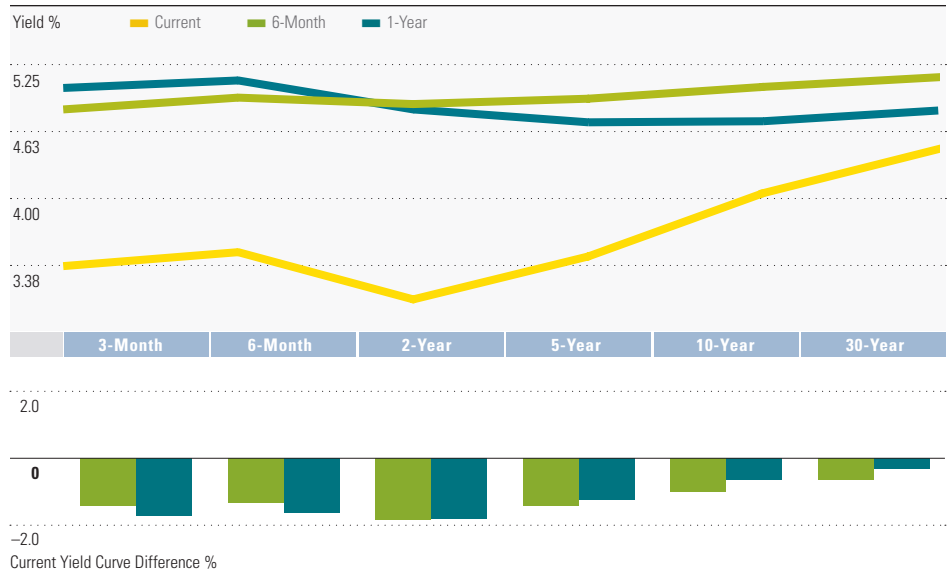
A casual observer could be forgiven for thinking that the bond market's fourth-quarter 2007 performance is simply a math error. With the Morningstar Core Bond Index (MCBI) up more than 3.3% for the period and capping the year with a 7.4% gain, it would be natural to wonder just how bad the year's numerous bond-market blunders truly were. The Morningstar US Government Bond Index had a whopping 9% gain for 2007. Investors holding inflation-indexed Treasuries, however, were some of the market's biggest winners: Morningstar's TIPS Index turned in a gaudy 11.8% return.

A Closer Look

How is it possible that a market producing most of the year's disastrous headlines, staring down the power of a declining dollar, still managed to turn in such an impressive performance? The answers are many. One factor was simply that as fears of economic weakness and the potential for recession gained traction, along with short-term interest rate cuts, investors saw less risk that inflation would take over in coming years. Prices on Treasury bonds and TIPS, for example, imply expectations of a modest 2.5% per annum CPI over the next 10 years. And despite the dollar's downward spiral (which typically scares off bond investors) and massive U.S. government spending on military operations, investors fearful of other bogeymen still found safe haven in Uncle Sam's debts. The tumble of Treasury bond yields was so pronounced that it lit TIPS on fire, despite muted inflation expectations.

The market for government agency mortgages has proven resilient largely for different reasons. Generally, rising Treasury prices—accompanied by falling yields—trigger one or more waves of mortgage refinancing. But while homeowners with good credit can still replace old mortgages with above-market rates, refinancing, prepayment, and new-issue activity in the market have been mild

Shifting Treasury Yield Curve



Morningstar Bond Indexes

	Quarter Return %	1-Year Return %	3-Year Return %	Yield to Maturity	Average Duration	Average Maturity
Broad Market Index						
Core Bond	3.32	7.42	4.70	4.73	4.25	6.60
Sector Indexes						
US Govt Bond	3.97	9.03	4.94	3.66	4.85	6.66
Corporate Bond	2.34	5.25	3.84	5.63	6.05	10.10
Mortgage bond	3.24	7.02	4.89	5.27	2.88	4.94
Term Indexes						
Short-Term Core Bond	2.52	7.31	4.31	3.69	2.09	2.36
Intermediate Core Bond	3.68	8.53	4.49	4.30	4.45	5.24
Long-Term Core Bond	4.13	7.53	4.83	5.06	9.16	15.32
Inflation Protected Secs.						
TIPS	5.12	11.77	4.94	1.54	7.89	9.55

overall in 2007, as housing turnover and prices have stalled. Ultimately, the government-backed mortgages (issued by Ginnie Mae, Fannie Mae, and Freddie Mac) that constitute the Morningstar Mortgage Bond Index are helped by that environment, as fewer prepayments translate to better price stability and appreciation when Treasury yields fall.

Still, how is it possible that the Morningstar Corporate Bond Index appears to have performed so respectably in 2007 given the severe liquidity

problems in that market? It's a matter of perspective. In aggregate, the high-quality corporate bond market is quite sensitive to changes in Treasury yields, and that market's rally has served to counter some of the otherwise nasty pain felt by corporate bonds. In fact, though, the huge gap between returns for Treasuries and comparable high-quality corporate bonds in 2007 is reported to have been among the widest in bond-market history. Based on the expected risks for investment-grade corporates, that actually implies a truly lousy showing overall.

Fund Categories and Benchmarks

The average return of active funds exceeded the return of the relevant Morningstar index in six out of nine style benchmarks. Benchmarks in struggling corners of the market are usually easier to beat because active managers can choose to be less faithful to an out-of-favor style. As expected, the worst-performing indexes, Morningstar Small Value, Morningstar Small Core, and Morningstar Mid Value, were beaten by the best proportion of managers: Almost 71%, 74%, and 89%, respectively, of the managers competing against those indexes won. Managers added value by effectively avoiding troubled sectors such as financial services, and by favoring winning sectors like energy instead.

Commodities Report

Commodities left stocks and bond investments in the dust. A combination of insatiable global demand, tight supply conditions and disruption fears, and rising uncertainty in financial markets contributed to a bumper year for commodities in 2007. The Morningstar Long-Only Commodity Index surged 32% for the year. Even the Morningstar Long/Short Commodity Index, which did not find many supportive short candidates in the strong bull market, rose 21%.

Oil prices flirted with the \$100 per barrel mark, as supplies barely kept pace with booming demand, especially from fast-industrializing emerging markets. Geopolitical uncertainties in oil-rich nations and the shifting of investors' assets into oil futures in the face of market turmoil also fueled the trend. High oil prices have led to a search for alternative, grain-based sources of fuel, which has sparked additional demand for agricultural commodities. In addition, the global demand for food also swelled. As a result, prices of rice, wheat, soybeans, and corn scaled near-record highs. These elevated costs sparked inflation fears, which, combined with a slipping dollar, led many investors to use gold as a hedge. This contributed to high gold prices not seen in almost

Active vs. Passive

	Value	Core	Growth
Large	69.27 -0.43	29.83 8.65	55.56 12.34
Mid	88.50 -5.52	63.58 1.95	30.45 19.71
Small	70.54 -8.15	74.33 -5.43	32.95 11.08

○ Percent of actively managed mutual funds outperforming their respective benchmark. Includes the oldest share class for all U.S. diversified mutual funds with at least a one-year history. As of December 31, 2007 there were 2,527 eligible funds. Morningstar classifies funds into style categories based on the average style score (using the same 10-factor methodology as underlying benchmarks) of all available portfolio holdings over a three-year period.

● Index Returns (%), 1-year, 2007

Morningstar Commodity Index Returns %

	Quarter	1-Year	3-Year	5-Year	10-Year	15-Year
Long-Only Commodity	9.75	31.73	18.17	19.34	13.13	12.60
Long/Flat Commodity	9.75	24.33	13.24	14.06	13.38	12.36
Long/Short Commodity	9.73	21.00	8.73	10.26	14.24	12.52

three decades. Overall, the performance of commodities in 2007 affirmed their case as an asset class that doesn't move in tandem with stocks and bonds.

Conclusion

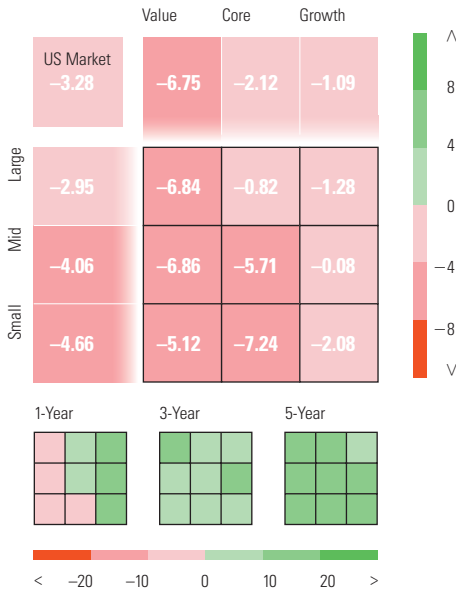
There is no denying that markets face some serious questions at the start of this new year, chief among them is whether widespread contagion is on the cards. The worry is that mortgage defaults will lead to a chain reaction of defaults among other borrowers, eventually affecting corporate debt and dragging equities down. Alternately, worst-case scenarios would be avoided if the U.S. manages to stave off recession, possibly through continued strong exports supported by a resilient global economy.

Successfully navigating a portfolio in this difficult environment will crucially depend on identifying key market trends. 2007 saw a couple of long

winning streaks come to end, namely, the demise of small-cap stocks and value stocks. Meanwhile, some other multiyear trends gathered more steam, such as the boom in commodities and the dollar in decline. We will see which of these trends bloom or go bust in 2008, but meanwhile, as the past year has amply shown, a diversified approach is best.

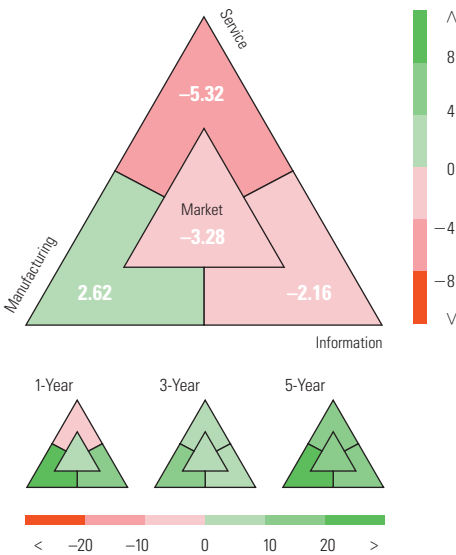
Happy investing! ■■■

4th Quarter Style Indexes



Index	Total Returns %					Price/Earnings	Price/Book	Yield%	5-Yr Earn Growth
	Quarter	1-Year	3-Year	5-Year	10-Year				
Morningstar US Market	-3.28	5.92	9.29	13.90	6.14	16.68	2.66	1.70	16.15
Large Cap	-2.95	6.69	9.05	12.53	5.10	16.57	2.83	1.81	17.69
Mid Cap	-4.06	5.23	10.68	17.55	8.68	16.76	2.36	1.35	18.98
Small Cap	-4.66	-0.66	7.14	16.95	8.13	17.91	2.00	1.47	-3.25
US Value	-6.75	-1.91	9.49	14.75	7.78	12.01	1.79	3.01	14.00
US Core	-2.12	6.44	9.03	14.03	7.14	17.57	2.96	1.59	15.92
US Growth	-1.09	13.82	8.97	12.62	2.57	24.20	4.09	0.57	26.60
Large Value	-6.84	-0.43	10.27	14.06	7.09	12.22	1.96	3.06	15.90
Large Core	-0.82	8.64	9.23	13.13	6.22	17.38	3.17	1.73	17.21
Large Growth	-1.28	12.34	7.08	9.96	0.89	23.41	4.13	0.67	27.94
Mid Value	-6.86	-5.52	7.78	16.17	9.41	10.94	1.47	2.69	14.35
Mid Core	-5.71	1.95	8.78	16.27	9.03	18.37	2.61	1.23	20.05
Mid Growth	-0.08	19.70	15.13	19.79	6.83	26.61	4.18	0.31	34.93
Small Value	-5.12	-8.15	5.04	16.43	9.70	13.14	1.30	3.37	-4.43
Small Core	-7.24	-5.43	6.80	16.51	10.88	17.70	2.07	0.92	-0.86
Small Growth	-2.08	11.08	8.94	17.50	4.03	27.53	3.51	0.33	11.85

4th Quarter Sector Indexes



Index	Total Returns %					Price/Earnings	Price/Book	Yield%	5-Yr Earn Growth
	Quarter	1-Year	3-Year	5-Year	10-Year				
Information	-2.16	10.47	8.24	12.92	3.58	22.09	3.06	0.85	10.9
Software	9.61	15.83	9.87	12.57	6.04	25.61	5.21	0.67	19.09
Hardware	-3.22	16.94	9.36	15.78	5.33	22.75	3.85	0.66	9.68
Media	-9.56	-12.89	-1.81	5.56	1.70	17.09	1.62	1.12	21.81
Telecommunication	-5.39	11.21	13.76	13.63	0.62	21.42	2.16	1.41	6.58
Service	-5.32	-4.36	5.63	11.11	9.36	15.42	2.23	2.06	13.48
Healthcare	1.26	9.57	8.53	9.62	7.11	22.65	3.74	1.30	13.28
Consumer Services	-5.74	-5.23	2.35	11.24	7.47	18.42	2.77	1.24	11.99
Business Services	2.45	13.75	14.34	16.98	5.47	20.93	3.18	0.94	10.03
Financial Services	-11.31	-15.92	2.92	10.51	6.60	11.33	1.53	3.29	14.41
Manufacturing	2.62	22.78	17.89	20.35	6.79	16.03	3.1	1.75	20.84
Consumer Goods	1.31	11.28	10.14	12.81	6.40	18.90	4.15	2.35	10.38
Industrial Materials	6.21	37.23	31.41	30.53	15.05	14.33	3.13	1.12	26.19
Energy	-1.02	20.52	13.41	18.69	7.95	16.03	3.26	1.69	25.12
Utilities	7.47	18.16	19.17	21.15	9.34	16.93	1.76	2.69	7.30

Bond Indexes

	Quarter	1-Year	3-Year	5-Year
Core Bond	3.32	7.42	4.70	4.53
US Government	3.97	9.03	4.94	4.10
Corporate	2.34	5.25	3.84	5.02
Mortgage	3.24	7.02	4.89	4.66

Commodity Indexes

	1-Year	3-Year	5-Year	10-Year	15-Year
Long-Only	31.73	18.17	19.34	13.13	12.60
Long/Flat	24.33	13.24	14.06	13.38	12.36
Long/Short	21.00	8.73	10.26	14.24	12.52

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