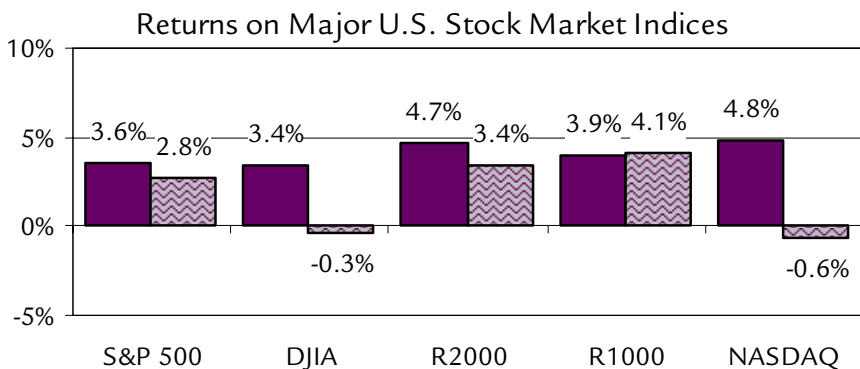


- The US equity markets had a strong quarter, resulting in positive year-to-date returns.
- Spurred by fears of energy related inflation, the Fed raised rates by 0.25% to 3.75% at their September 20th Federal Open Market Committee meeting.
- Crude oil prices rose by 10% during the 3rd quarter. The energy sector was the best performing sector of the S&P 500 Index, posting a one quarter gain of 17.7%.
- International markets, both developed and emerging, continued to outperform US markets.
- Hedge fund of funds, as represented by the HFRI Fund of Funds Index, returned over 3% during the 3rd quarter.

The third quarter has been tumultuous for individuals and markets alike. We have witnessed the devastating affects of natural disasters on personal livelihoods, morale, and even the economy. Despite generally positive market news, August was a difficult month all around. Most of the US equity indices posted negative returns during August, crude oil prices rose by approximately 10%, and Hurricane Katrina made landfall in the Gulf of Mexico on August 29th. Since that time, equity markets have recovered with the S&P 500 posting a 3.60% return for the quarter.

This outpaced the third quarter 2004 return by over 5.4%.

Although equity markets posted positive returns for the third quarter, economic news was not as optimistic. Recent inflationary fears have led the Fed to increase rates by 0.25% during



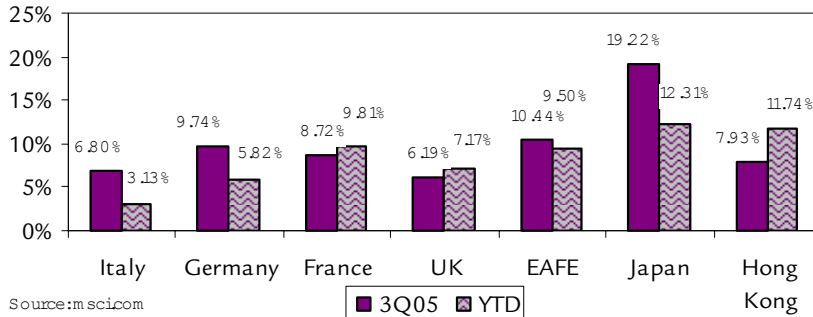
Source: Zephyr, Morningstar

■ 3rd Quarter ■ 2005 YTD

the September 20th Federal Open Market Commission meeting. In the wake of Katrina, production of oil in the Gulf of Mexico was temporarily halted causing gas shortages throughout the southeast as

Index returned 10.4% for the third quarter and the MSCI Emerging Markets Index posted an 18.1% gain. This brings the emerging markets 2005 year to date return to 25.5%. In recent years, the WaterStreet Investment Committee has recommended that clients increase allocations to international markets. We are consistently reviewing macroeconomic conditions to see how sustainable international growth, particularly in emerging markets, will be in the coming years.

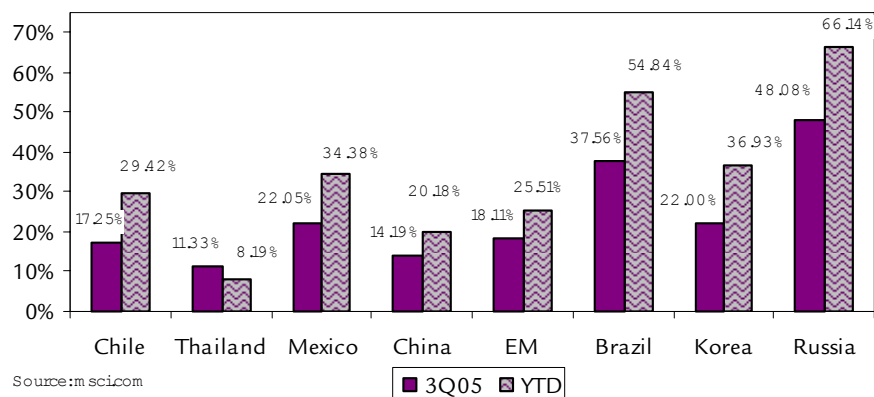
Developed Market Returns
In US Dollars



distribution pipelines were cut off. The market returns that did exist seemed to be driven by positive consumer spending. New home sales remained steady and retail sales reports stated that they have seen little, if any, decline in recent months as oil prices have steadily increased. The numbers appear to be driven primarily by high-end purchases such as digital televisions. New car sales were also high during the quarter, which helps to explain the strong loan demand reported by the financial services sector.

All investors have heard the industry buzz on the “global economy.” Many question whether this is simply a new catch phrase or really the direction the world is headed. The US current account, which calculates country’s imports and

Emerging Market Returns
In US Dollars



While US equity markets performed well during the third quarter, it is impossible not to notice the growth in international markets in recent periods. The MSCI Europe, Australia, Far East

exports of goods and services as well as net investment income, is currently running a deficit above 6% of GDP. The federal deficit, as a percentage of GDP, is approximately -4.1%. With this shortfall, it is hard to believe that the world will not see the emergence of

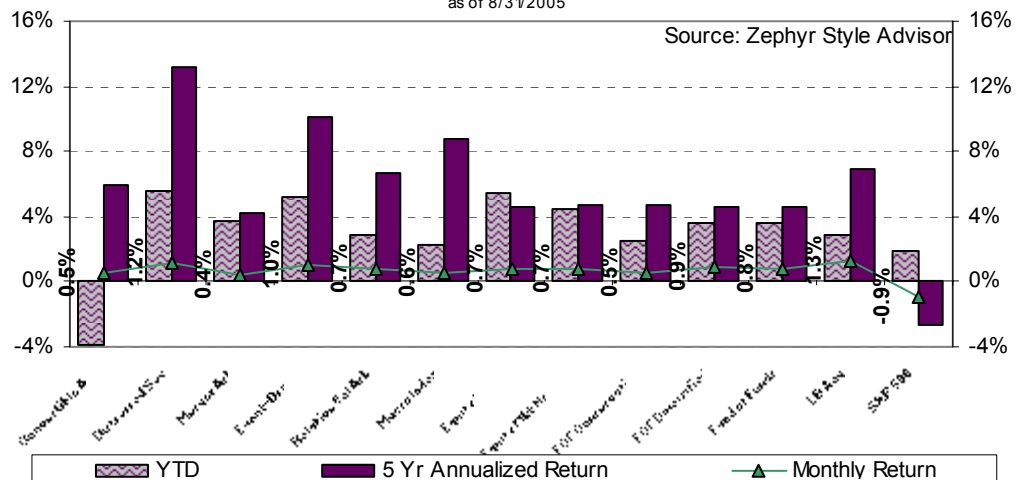
large economic players in the coming decade. The US reliance on foreign markets to sustain the economy has grown through recent years without many realizing just how vital the international role has become. The US Commerce Department has reported that the US savings rate in August was -0.7%. This means that Americans are consuming more than they earned by taking home equity loans, pulling money out of savings, carrying balances on credit cards, or sometimes all of the above in order to continue to buy goods and pay bills. The American attitude of consumerism has both a good and a bad side. On one side, with spending rates so high, the US has been able to ward off recessionary pressures caused by increased oil prices and a weak dollar. Of course, on the other side, Americans are borrowing billions of dollars from other countries. Increasingly, we are seeing countries such as China and Germany stockpiling US Treasury bills. July estimates showed that China had approximately \$711 billion of US Treasury bills and other dollar denominated reserves. Germany's current account is likely to be a surplus of close to 4% of their GDP in 2005.

China's current account surplus was 4.2% of GDP in 2004 and is expected to be even higher in 2005. This "global savings glut", as it has been penned, has certainly helped Americans

continue to spend and borrow money by creating a demand for the dollar and Treasury bills. It cannot, however, continue at this rate. At some point, Americans will no longer be able to take additional equity out of their homes or have any more capacity on their credit cards. It will be up to the rest of the world to increase their demand. That is where the global economy and the emerging markets in particular come into importance. Nations such as China and India have large portions of their population living in poverty. Currently, these citizens are finding more and more work in the growing industrial and manufacturing industries. As they become more comfortable with their income situations and needs for goods and conveniences, they will begin assuming the role of more influential consumers. Already there has been an increase in purchases of what was once considered luxury goods such as refrigerators, washers, and dryers. The sheer number of potential consumers and the rate of GDP growth in these areas leads the WaterStreet Investment Committee to believe that, for the next few years, there will be significant growth in the

Recent Hedge Fund Index Performance Update

as of 8/31/2005



international community. Investors seeking to maximize returns in their portfolios would do well to continue to invest in all areas of the world.

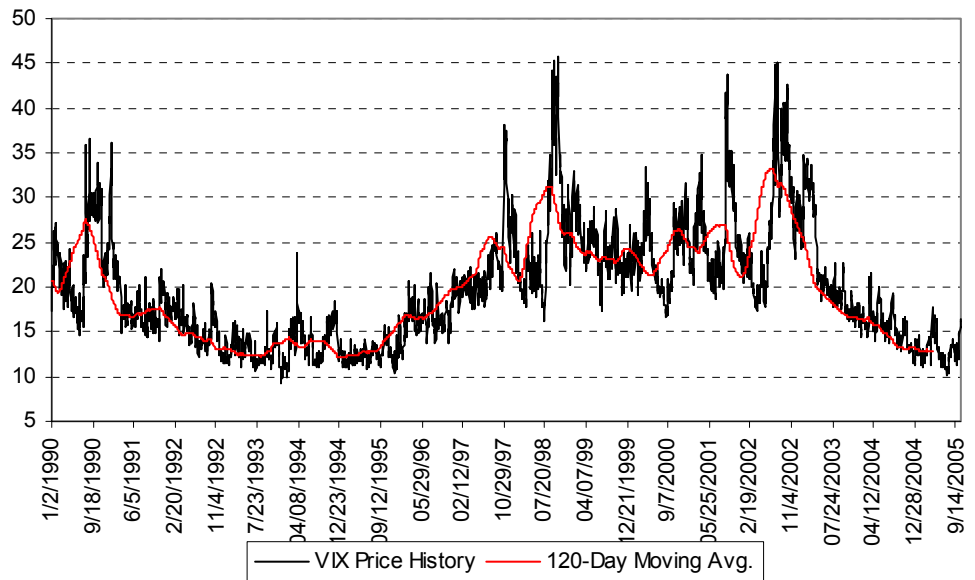
All strategies, except for Convertible Arbitrage, have performed better than the S&P500 year-to-date. There have been multiple drivers of hedge fund of funds returns over the last 8 months. This discussion will focus on some of the factors that affected convertible arbitrage, long/short equity, equity market neutral, and distressed debt.

Convertible arbitrage lost 6.5% of its value in the first 5 months of the year and remains in negative territory on a year-to-date basis. A confluence of events acted against convertible bond managers in the first 5 months of 2005. The most impacting issue revolved around the over-abundance of new issues. This over-abundance caused depressed prices, which in turn triggered liquidity-driven selling by managers due to increased redemptions by their clients. However, the strategy has rebounded well recently as technical pressures associated with investor redemptions have subsided. Convertible arbitrage manager returns were further supported by credit-spread contraction and a marginal increase in volatility.

The long/short equity and equity market neutral segments of the market

have been affected by the absence of volatility in equity prices. Implied expected volatility, as measured by the VIX (volatility measure created by the Chicago Board of Trade), has been trading at 10-year lows. This has resulted in reduced mis-pricing between securities in the market, which in turn offers fewer opportunities for directional and market neutral long/short equity managers to generate consistent notable returns.

VIX Price History
(as of 10/13/05)



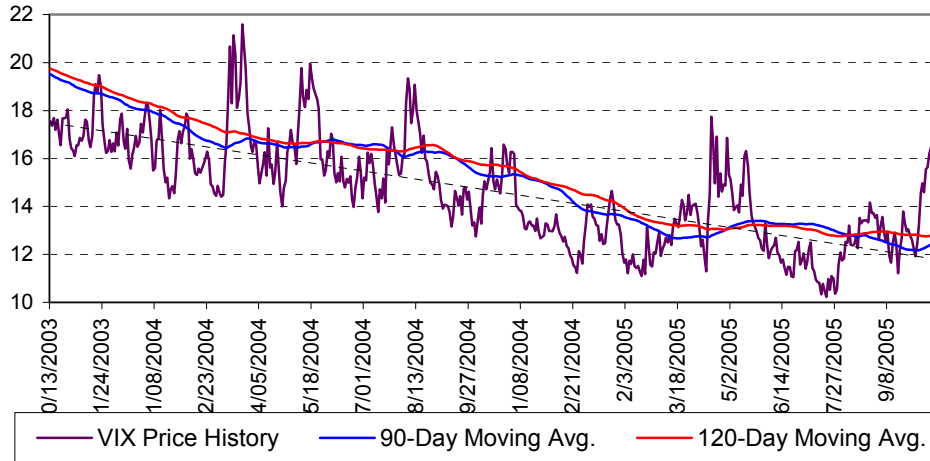
Source: Chicago Board of Options Exchange

Through the first eight months of 2005, equity market neutral strategies, as represented by the HFRI Equity Market Neutral index, have returned 4.5%. Directional long/short strategies, as represented by the HFRI Equity Hedge index, have returned slightly better at 5.5%. It is worth noting that volatility hit a 12-month low in mid-July and has since picked up to some of its highest levels for the year. Depending on a fund of funds manager's underlying strategies, this increase in volatility

could result in more attractive returns for the 4th quarter of 2005.

default within 5 years of issuance. Based on that fact, history would lead

VIX 2 Year Price History
(2005 - as of 10/13/05)



Source: Chicago Board of Options Exchange

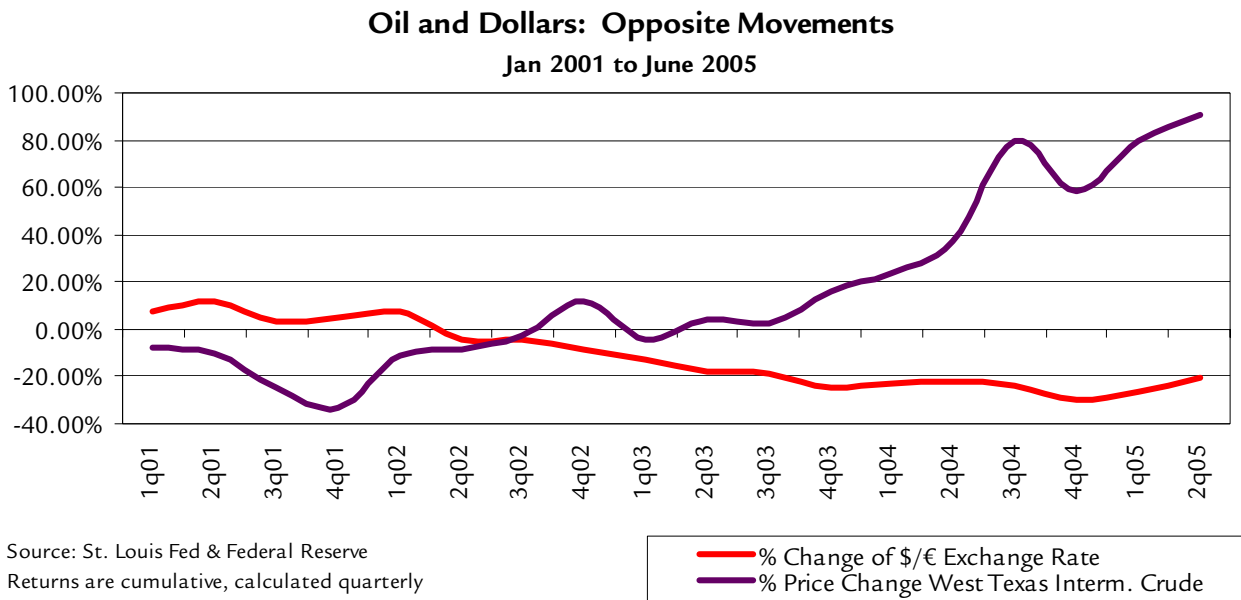
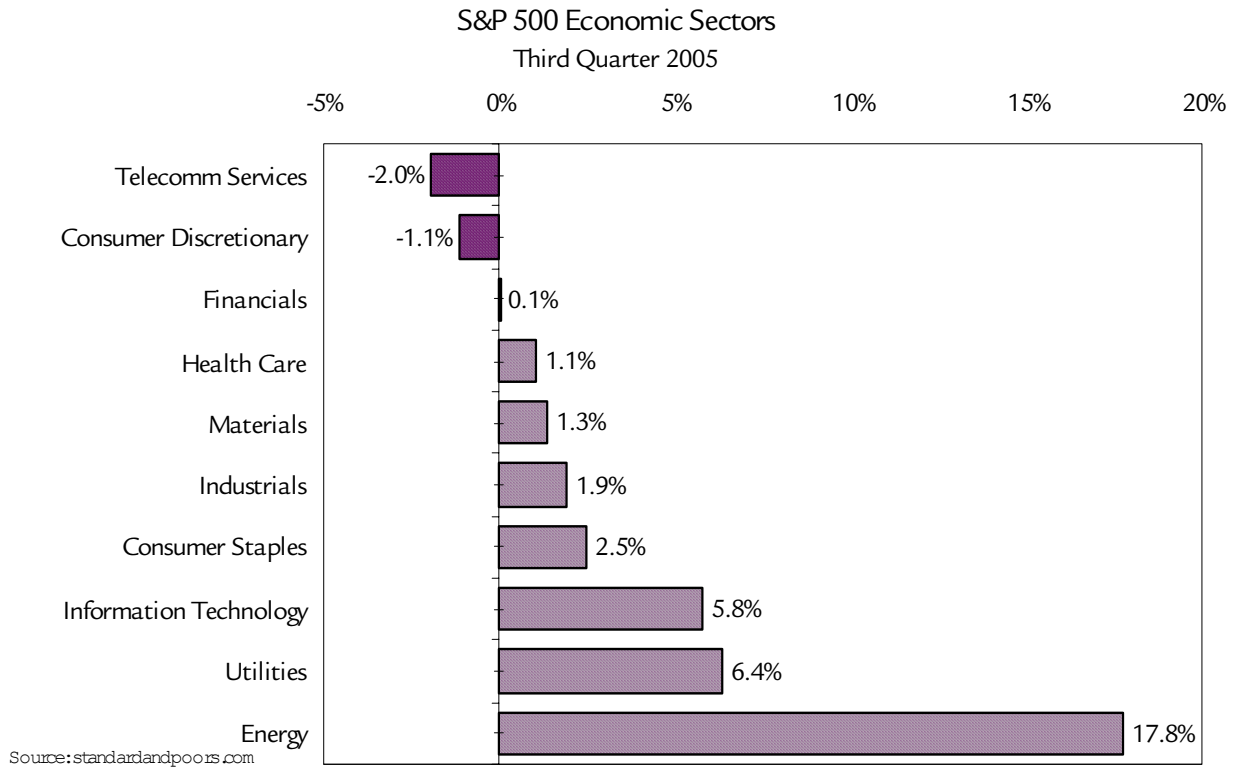
Distressed debt's incredible run over the last three years is continuing to impact many of the low-volatility hedge funds of funds in the market. Over that time frame, the strategy has annualized 19.2%. Credit spreads, as measured by Merrill Lynch High Yield Index vs. 10-year T-bills, have contracted from a record high of 11.2% to 3.8%. This rally has been fueled by an environment of historically low interest rates, extraordinarily low default levels, and significant liquidity provided by return-hungry investors. Many hedge fund managers remain skeptical that the strategy can continue its recent success and are instead trying to position their portfolios to take advantage of opportunities that widening credit spreads might provide. Already, signs of stress are beginning to surface in the distressed credit market as the quality of new high-yield debt issuance has deteriorated. Historically, 37% of all CCC-rated credit bonds, as ranked by Standard and Poors, default within the first 3 years of issuance and 50%

us to believe that a large amount of the debt issued since 2002 to companies with weak financials and poor fundamentals will either come under further stress or be defaulted on all together.

In the coming quarter,

WaterStreet believes that there are returns to be found in the hedge fund industry as well as in the equity markets. We are anticipating hedge fund managers to capture higher returns with greater equity volatility and higher interest rates.

Look for the Fed to increase rates again during the 4th quarter at the November 1st FOMC meeting. During the coming years, returns from hedge funds, given their low correlation to equity portfolios, will continue to provide clients with added and necessary diversification and will continue to be a source of returns. Both domestic and international equities should continue to produce returns as the economy has shown signs of improvement during the quarter. The WaterStreet Investment Committee continues to advocate that our clients position their portfolios to take advantage of opportunities in international markets as we believe that these markets will continue to outpace the US in the coming year.



Output, Demand, and Jobs

% change on a year ago

	GDP		The Economist poll GDP forecasts		Industrial Production		Retail Sales (volume)		Unemployment % rate		
	latest	qtr*	2005	2006	latest		latest		latest	year ago	
Australia	2.6	Q2	2.4	3.2	1.2	Q1	1.6	Q2	5.0	Aug	5.7
Austria	2.0	Q2	1.9	2.0	5.4	Jul	1.7	Jun	5.2	Aug	4.9
Belgium	1.5	Q2	1.2	1.9	-4.0	Jul	5.9	Jun	13.5	Aug†	13.2
Britain	1.5	Q2	2.0	2.2	-1.6	Jul	0.8	Aug	4.7	Jul††	4.7
Canada	2.7	Q2	2.8	3.0	0.4	Jun	5.9	Jun	6.8	Aug	7.1
Denmark	0.8	Q2	2.0	2.2	-1.6	Jul	6.1	Jul	5.7	Aug	6.4
France	1.3	Q2	1.4	1.8	-0.7	Jul	-1.2	Jul	9.9	Jul	10.0
Germany	0.6	Q2	0.9	1.3	3.0	Jul	-3.0	Jul	11.7	Sep§	10.7
Italy	0.1	Q2	-0.2	1.0	-0.9	Jul	-1.5	Jun	7.8	Mar	8.2
Japan	1.4	Q2	1.9	1.9	-2.3	Jul	3.6	Jun	4.4	Jul	4.9
Netherlands	1.3	Q2	0.5	1.6	0.1	Jul	1.2	Jun	6.6	Aug**	6.2
Spain	3.4	Q2	3.2	2.8	-3.5	Jul	0.4	Jul	9.4	Jul	10.9
Sweden	2.3	Q2	2.1	2.7	7.8	Jul	6.2	Aug	6.5	Aug†	5.5
Switzerland	1.0	Q2	0.8	1.5	3.9	Q2	1.6	Jul	3.6	Aug†	3.7
United States	3.6	Q2	3.7	3.3	3.1	Aug	7.5	Jul	4.9	Aug	5.4
Euro Area	1.1	Q2	1.3	1.7	0.5	Jul	nil	Jul	8.6	Jul	8.9

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New Series. ††Apr-Feb; claimant count rate 2.7% in May. §EU

Source: The Economist, October 1st-7th, 2005

Trade, Exchange Rates, and Budget

	Trade balance*, latest 12 mos		Current Account Balance				Exchange Rate		Budget balance % of GDP 2005‡
			\$bn		The Economist poll		trade weighted**		
			latest 12 mos		% of GDP, forecast		2000=100	year ago	
				2005	2006	June 15th			
Australia	-16.5	Jul	-43.1	Q2	-5.9	-5.5	118.3	110.6	0.9
Austria	-1.4	Jul	nil	Jul	-0.4	-0.3	103.9§	104.0	-2.0
Belgium	15.4	Jul	12.2	Mar	2.8	2.7	104.4§	104.4	-0.5
Britain	-114.3	Jul	-23.5	Q2	-2.4	-2.5	98.7	99.7	-2.9
Canada	46.5	Jul	16.3	Q2	1.4	1.2	122.7	113.6	1.2
Denmark	9.8	Jul	11.5	Jul	2.1	1.9	105.7	106.1	1.8
France	-27.8	Jul	-24.1	Jul	-0.7	-0.5	106.9§	107.0	-3.0
Germany	198.8	Jul	110.5	Jul	3.6	3.4	104.6§	104.7	-3.5
Italy	-7.0	Jul	-26.0	Jul	-1.3	-1.5	76.5§	76.6	-4.4
Japan	110.4	Jul	165.8	Jul	3.4	3.3	84.8	86.1	-6.1
Netherlands	40.0	Jul	28.3	Q2	3.7	3.6	103.9§	103.9	-2.2
Spain	-90.6	Jul	-75.2	Jun	-5.4	-5.5	77.2§	77.2	0.5
Sweden	21.4	Aug	27.9	Q2	6.7	6.2	95.3	99.7	0.8
Switzerland	7.0	Jul	40.2	Q1	11.4	11.0	106.0	106.6	-1.0
United States	-730.7	Jul	-749.7	Q2	-6.3	-6.3	86.2	86.3	-4.1
Euro Area	54.3	Jul	10.3	Jul	0.3	0.2	115.4	116.4	-2.8

*Merchandise. Australia, Britain, France, Canada, Japan, and United States imports fob, exports fob. All others cif/fob. **Bank of England except §IMF, April average. ‡OECD forecast.

Source: The Economist, October 1st-7th, 2005

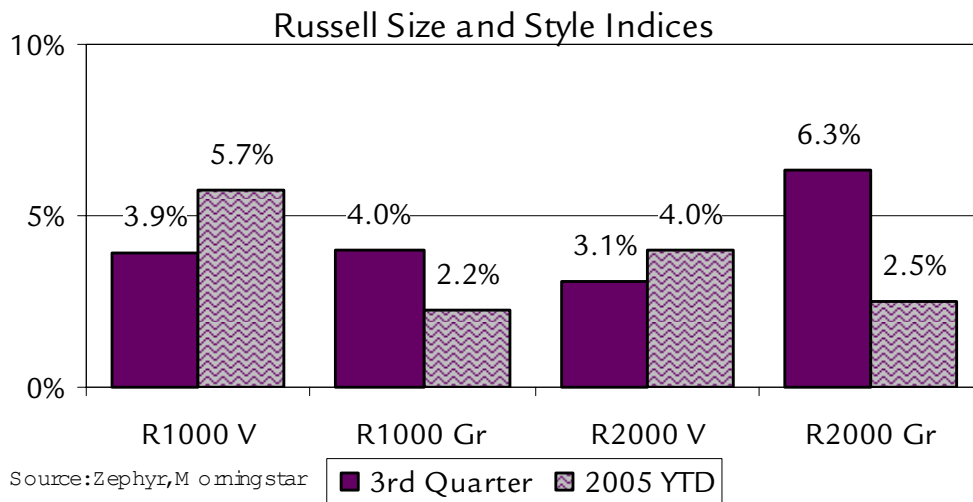
Prices and Wages

% change on a year ago

	Consumer Prices		Producer Prices		Wages/Earnings				
	latest	year ago	latest	year ago	latest	year ago			
Australia	2.5	Q2	2.5	6.9	Q2	2.8	5.8	Q2	3.0
Austria	2.0	Aug	2.3	0.9	Aug	6.3	2.3	Aug	2.0
Belgium	3.1	Aug	2.3	1.8	Jul	5.5	2.5	Jul	2.2
Britain	2.4	Aug*	1.3	3.0	Aug	2.8	4.2	Jul	3.8
Canada	2.6	Aug	1.9	-0.3	Jul	5.5	1.4	Jul	1.5
Denmark	2.2	Aug	1.2	5.0	Aug	3.1	2.9	Q2	3.1
France	1.8	Aug	2.4	2.8	Aug	2.8	2.9	Q2	2.8
Germany	2.5	Sep	1.8	1.9	Aug	4.2	1.3	Jul	0.4
Italy	2.0	Aug	2.3	3.6	Jul	3.3	2.9	Aug	2.6
Japan	-0.3	Jul	-0.1	1.7	Aug	1.7	3.7	Jul	1.7
Netherland:	1.8	Aug	1.1	5.6	Jul	5.2	0.9	Aug	1.0
Spain	3.3	Aug	3.3	4.9	Aug	4.4	3.4	Q2	3.1
Sweden	0.6	Aug	0.6	4.2	Aug	2.0	2.6	Jun	1.6
Switzerland	1.0	Aug	1.0	1.0	Aug	1.5	0.9	2004	1.4
United Stat	3.6	Aug	0.7	5.1	Aug	3.4	2.7	Aug	2.2
Euro Area	2.2	Aug	2.3	4.0	Jul	2.9	2.3	Q2	2.1

*RPI inflation rate 2.9% in May. **Feb-Apr.

Source: The Economist, October 1st-7th, 2005



International Developed Market Performance

Source: Morgan Stanley Capital International

REGIONS	In Local Currency		In US Dollars	
	3Q'05	YTD	3Q'05	YTD
EAFE	11.51%	20.90%	10.44%	9.50%
EURO	8.02%	19.74%	7.58%	6.21%
EUROPE	8.51%	20.01%	7.78%	7.79%
PACIFIC	18.49%	22.57%	16.56%	13.22%
THE WORLD INDEX	7.36%	11.30%	7.08%	6.65%
WORLD ex USA	11.56%	20.97%	10.98%	10.55%
NATIONAL INDICES				
AUSTRALIA	10.86%	21.18%	11.06%	18.05%
AUSTRIA	12.84%	36.93%	12.38%	21.46%
BELGIUM	7.62%	19.24%	7.17%	5.77%
CANADA	12.29%	22.13%	18.50%	26.09%
DENMARK	9.73%	33.04%	9.13%	17.63%
FINLAND	6.42%	28.76%	5.98%	14.21%
FRANCE	9.17%	23.80%	8.72%	9.81%
GERMANY	10.19%	19.30%	9.74%	5.82%
GREECE	9.28%	23.88%	8.83%	9.88%
HONG KONG	7.72%	11.52%	7.93%	11.74%
IRELAND	2.36%	5.11%	1.93%	-6.77%
ITALY	7.24%	16.27%	6.80%	3.13%
JAPAN	21.95%	24.22%	19.22%	12.31%
NETHERLANDS	3.58%	19.83%	3.15%	6.29%
NEW ZEALAND	6.51%	11.54%	6.15%	7.08%
NORWAY	15.36%	41.69%	15.60%	31.54%
PORTUGAL	6.18%	6.21%	5.74%	-5.80%
SINGAPORE	4.51%	13.51%	4.37%	9.69%
SINGAPORE FREE	4.51%	13.51%	4.37%	9.69%
SPAIN	11.61%	21.27%	11.15%	7.57%
SWEDEN	9.78%	26.31%	10.91%	8.59%
SWITZERLAND	10.57%	23.79%	9.87%	9.18%
UNITED KINGDOM	7.59%	16.30%	6.19%	7.17%

International Emerging Market Performance

Source: Morgan Stanley Capital International

REGIONS	In Local Currency		In US Dollars	
	3Q'05	YTD	3Q'05	YTD
EM (EMERGING MARKETS)	17.69%	26.93%	18.11%	25.51%
EM ASIA	11.87%	19.68%	9.85%	17.25%
EM EASTERN EUROPE	37.02%	58.31%	37.68%	49.49%
EM EUROPE	34.83%	53.50%	35.20%	46.70%
EM EUROPE & MIDDLE EAS	29.07%	44.24%	29.27%	37.93%
EM LATIN AMERICA	25.07%	30.58%	30.28%	45.32%
NATIONAL INDICES				
ARGENTINA	50.51%	84.04%	49.37%	87.72%
BRAZIL	29.41%	29.51%	37.56%	54.84%
CHILE	7.04%	23.13%	17.25%	29.42%
CHINA	13.96%	19.95%	14.19%	20.18%
COLOMBIA	24.82%	41.89%	26.78%	45.78%
CZECH REPUBLIC	30.13%	61.70%	31.58%	47.03%
EGYPT	12.03%	119.37%	12.66%	131.17%
HUNGARY	23.68%	58.65%	21.87%	38.48%
INDIA	17.68%	28.67%	16.38%	27.22%
INDONESIA	-1.80%	14.07%	-6.86%	2.90%
ISRAEL	13.10%	17.46%	12.74%	11.70%
JORDAN	12.89%	78.60%	12.80%	78.60%
KOREA	22.95%	37.77%	22.00%	36.93%
MALAYSIA	5.61%	3.78%	6.48%	4.63%
MEXICO	22.09%	30.00%	22.05%	34.38%
MOROCCO	13.23%	18.75%	12.94%	7.73%
PAKISTAN	8.86%	43.10%	8.76%	42.52%
PERU	32.24%	37.74%	30.25%	36.38%
PHILIPPINES	-0.02%	6.10%	-0.22%	6.26%
POLAND	24.12%	35.72%	27.69%	25.18%
RUSSIA	47.97%	66.30%	48.08%	66.14%
SOUTH AFRICA	20.95%	32.70%	26.96%	17.59%
SRI LANKA	23.67%	64.89%	22.23%	70.01%
TAIWAN	1.25%	3.34%	-3.54%	-1.32%
TAIWAN PROVISIONAL	N/A	N/A	N/A	N/A
THAILAND	10.64%	14.36%	11.33%	8.19%
TURKEY	25.03%	34.17%	24.07%	34.44%

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