



Osprey Financial Group  
Coggin College of Business  
University of North Florida  
4567 St. John's Bluff Road, South  
Jacksonville, FL 32224-2675  
904.620.1676  
[www.unf.edu/ccb/ofg](http://www.unf.edu/ccb/ofg)

COGGIN COLLEGE OF BUSINESS

**UNIVERSITY OF NORTH FLORIDA**

**Fourth Quarter Report  
December 31, 2006**

## Report Highlights

**This page intentionally left blank.**

This is the fifth Fourth Quarter Report of the Osprey Financial Group. The Fund was launched on October 11, 2002 as a result of a gift from Jody and Layton Smith, long-time friends of the University of North Florida and the Coggin College of Business.

During the quarter, the Fund grew from \$734,931.90 to \$769,278.71, representing a return of 4.67%. Net of management fees, the value of the Fund increased by \$32,968.52 or 4.48%.

The Fund outperformed the benchmark by 0.36% before management fees and 0.17% after fees.

The Equity component of the Fund earned 5.90% and outperformed the benchmark by 0.49%.

The Fixed Income component of the Fund underperformed the benchmark by 0.38%.

The fund placed in the 3rd quintile (#212) among a sample of 402 professionally managed funds with similar portfolio allocation parameters. The average fund earned a return of 4.77%.



### Advisors

**John P. McAllister**  
Dean, Coggin College of Business

**George S. Prattos**  
Advisor, Morgan Stanley

**Bradley B. Ridinger**  
Advisor, Morgan Stanley

**Reinhold P. Lamb**  
Faculty Advisor

### United States

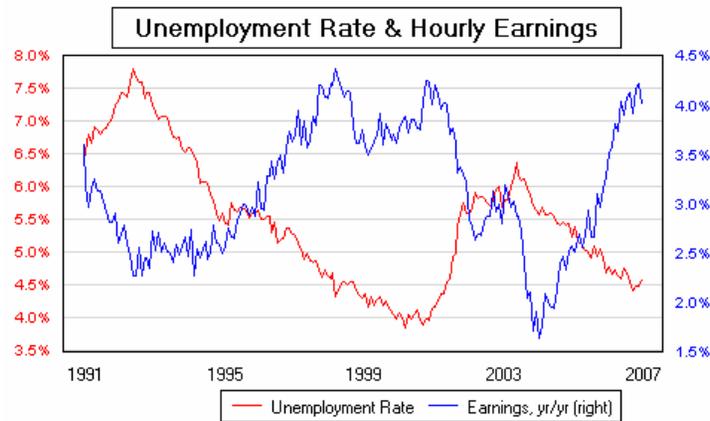
The largest economy in the world proved to be resilient in the fourth quarter of 2006 (Q4). The growth rate in the economy, along with concerns about inflation, were the topics on the minds of most. After 17 consecutive rate hikes, the Federal Reserve (Fed) had to confront these issues every 6 weeks to decide if the pace of growth was too much or inflationary pressures were too strong. The Fed decided to leave the Federal Funds rate at 5.25%, while keeping a hawkish position on inflation. While markets hit all time highs, energy prices, core inflation, the housing market, the inverted yield curve, and a new Congress controlled by Democrats, made the outlook for continued gains in the market nebulous.

From an inflationary standpoint, Q4 started with core inflation at a decade high of 2.9% of year over year in September and core PCE (Personal Consumption Expenditures Index) holding steady at 2.4% year over year; both well out of the Fed's comfort zone of 1%-2%. These numbers would improve slightly as the quarter closed at 2.6% and 2.2% respectively. The biggest question remaining was employment. The data showed unemployment at a 5-year low of 4.4% in October. While this level may be appealing to some, it is out of the inflation-neutral zone of 5%; as wages are the biggest expense to employers. The unemployment rate would close the quarter at 4.5%, showing an exceptionally strong labor market.

From a growth standpoint, Q4 would show much more strength than Q3 (a weak 2.0% GDP). Lower energy costs improved the trade deficit and helped boost personal spending 4.4% to offset some remaining weaknesses in the housing market that impaired Q3 GDP. Along with an increase in government spending, Q4 GDP came in at a much stronger 3.5%.

Combing through the mass of data, presented conflicting views about the direction of the economy. The quarter closed with the S&P 500 Index at 1,418 and the Dow Jones Industrial Average (DJIA) at 12,463, a gain of over 6.5% for both in the 3-month period. Similar questions remain going into 2007 regarding growth, inflation and future direction of interest rates. For 2007, expect economic growth to moderate and infla-

tion to come down into the Feds comfort zone as unemployment rises to neutral levels.



Source: Briefing.com

## Europe

In Q4, economic activity in the Euro area has somewhat decelerated from the very buoyant pace registered in the first half of the year. Nevertheless, growth prospects remained robust. Growth was being driven primarily by domestic demand, suggesting that the expansion has become self-sustained. The recovery in consumption was firmly established, as a strengthening labor market and improving consumer confidence formed a base for household spending. Investment spending continued to perform strongly and business confidence indicators remained upbeat, suggesting a healthy corporate sector.

## Latin America

This region continued to expand due to high commodity prices as a result of the growing global economy. The political environment throughout Latin America moved toward the left, with populist candidates elected in Bolivia, Ecuador, Nicaragua and Venezuela. On the other hand, Peru, Mexico, Chile and Colombia saw free market presidents take office. Despite political uncertainty, Latin American markets performed above average due in part to rigorous monetary and fiscal policies. Seven of the major countries' stock indices enjoyed an above average return of 23.4%. Mexico's stock market rose 22.3% to an all-time

## Osprey Financial Group, 2006-2007

### **Keith Amirault**

Sector Analyst for Energy, Material and Utilities;  
Technical Analyst

### **Russell Anderson**

Sector Analyst for Financials, Fixed Income Analyst;  
Economist for North America

### **Shannon Coles**

Sector Analyst for Consumer Staples and Healthcare;  
Economist for Asia

### **George Cook**

Sector Analyst for Information Technology and Telecommunications;  
Website and Blackboard Coordinator

### **Benjamin Franklin**

Sector Analyst for Consumer Discretionary and Industrials;  
Chief Administrator; Special Projects Coordinator

### **Ross Fredenhagen**

Sector Analyst for Information Technology and Telecommunications;  
Statistician

### **Tanya Johnson-Coomes**

Sector Analyst for Consumer Staples and Healthcare;  
Operations Manager

### **Mariya Nykyforovych**

Sector Analyst for Energy, Material and Utilities;  
Economist for Europe

### **Robert Waterman**

Sector Analyst for Financials, Fixed Income Analyst;  
Economist for North America

### **Stephen Whitley**

Sector Analyst for Consumer Discretionary and Industrials;  
Economist for Latin America

margin pressure formed a basis for our underweight exposure in the sector. Money was invested into sector ETF, XLU, and remained there for the rest of the quarter

## Portfolio Holdings

Beginning Value, September 31, 2006	\$734,931.86
Ending Value, December 31, 2006	<u>769,278.71</u>
Change in Value, Fourth Quarter 2006	34,346.95
Management Expenses	<u>1,378.43</u>
Net Change in Value, Fourth Quarter 2006	32,968.52

## Fund Composition, December 31, 2006

	<u>Shares</u>	<u>\$Price</u>	<u>\$Value</u>
<u>Equity Positions</u>			
AMERICAN EXPRESS CO AXP	250	60.67	15,167.50
CERADYNE INC-CALIF CRDN	250	56.50	14,125.00
MSCI SWEDEN INDEX FD EWD	520	32.28	16,785.60
S&P 500 INDEX FUND	120	142.00	17,040.00
MSCI EAFE INDEX FUND EFA	730	73.22	53,450.60
DJ US TELECOMM INDEX IYZ	520	29.65	15,418.00
DJ U S TECHNOLOGY INDEX IYW	1,280	54.45	69,696.00
DJ US HEALTHCARE INDEX IYH	380	66.41	25,235.80
GOLDEN DRAGON CHINA FUND PGJ	1,350	20.98	28,323.00
SPDR CONSUMER STAPLES XLP	1,650	26.12	43,098.00
SPDR CONS. DISCRETIONARY XLY	1,240	38.42	47,640.80
SPDR ENERGY XLE	855	58.63	50,128.65
SPDR FINANCIAL XLF	2,270	36.74	83,399.80
SPDR INDUSTRIAL XLI	1,540	35.01	53,915.40
SPDR UTILITIES XLU	440	36.72	<u>16,156.80</u>
Total Equity			549,580.95

### Fixed Income Positions

LEHMAN AGGREGATE BOND AGG	300	99.70	29,910.00
7-10 YR TREASURY BOND IEF	1,695	82.41	139,684.95
NUVEEN PFD & CONV INC JQC	3,190	14.11	<u>45,010.90</u>
Total Fixed Income			214,605.85

Cash 5,091.91

Total Fund Value 769,278.71

OSPREY FINANCIAL GROUP was established in 2002 and is comprised of undergraduate and graduate students selected to invest a portion of the Foundation's assets in a diversified, actively managed portfolio of equity and fixed income securities. The initial principal (\$500,000) is from a gift from Jody and Layton Smith.

high, while Brazil's stock market expanded 15.8%. Mexico experienced an average inflationary period, which allowed their Central Bank to maintain steady interest rates, thus promoting expansion. Brazil experienced GDP growth of 3.1% which led investors to anticipate future rate cuts and caused increased demand for equities. Consequently, these currencies strengthened against the U.S. dollar, sparking concern of possible future inflation. Argentina's index ended the year on a positive trend with a 22.8% return for Q4, due to increased demand for corn and soybean. Chile's, Colombia's and Peru's indices finished with returns of 30.2%, 19.9% and 24.7% respectively, due primarily to sharp increases in the price of copper and other metals.

## Asia

The Asian economy sustained its seemingly unstoppable trend upward during Q4 with many indices in China, Hong Kong, and Australia reaching all time highs. Growth in Asia remains positive with markets developing in large population centers of China and India. Japan continued to struggle on two different fronts: the business and investment side boomed, while consumers suffered with low wages and consumer spending. This led the country to keep interest rates unchanged while the central bank and government monitor the economic data closely. Thailand continued its economic downturn as the military-implemented government restricted investments in the country from overseas, consequently scaring away investors.

## Market Overview

### Equity Markets

The equity markets started Q4 on a strong note, achieving new technical levels, and breaking free from the summer's volatile trading range. In October the DJIA, S&P 500 Index, led the NASDAQ to new highs, and the DJIA successfully rallied above and held the all important 12,000 level. It is hard to quantify what effect psychological resistance had on the market, except to state that once broken it became a strong level of support for the overall market. In addition to the obvious technical factors that drove the equity markets, several key fundamental factors also contributed to the overall strength witnessed during Q4. First and foremost, a stable interest rate environment had been achieved by the new Federal Reserve Chairman Ben Bernanke. As market participants became more comfortable with his style, the uncertainty sur-

rounding the first new Chairman in nearly 20 years dissipated. Consequently, the long term outlook stabilized and funds flowed back into the market. The reinvigorated institutional money flow can be attributed to the end of the “bull run” in the energy sector. Specifically, the massive amount of capital placed in the energy market migrated to the next market poised to move. The equity markets were an attractive option as they spent the previous few months consolidating. With S&P500 earnings on the rise, investors found the fundamental justification needed to invest into equities. Furthermore, the Asian region continued to show signs of strong economic growth and created investor interest in the stocks that could benefit from the growth in India and China.

### **Fixed Income Markets**

OFG faced two major issues in Q4 as it entered the fixed income markets: the likelihood of a recession and the rare occurrence of an inverted yield curve, which was increasing in its depth of inversion. The recession issue has yet to be resolved, but it has triggered a belief that based on a weakening economy, the FOMC would likely reduce the Federal Funds rates to forestall a recession. Consequently, as the period started, we saw the benchmark 10 year Treasury at a yield of 4.75%, falling to 4.30% at the beginning of December 2006, on the anticipation of rate decreases. However, as economic data began to show strength and a reduction in inflationary pressures, the likelihood of a Federal Funds rate decrease diminished, and yields began to rise to 4.71% by the end of the quarter/year. Throughout this period, the FOMC kept rates at 5.25% and the yield curve remained inverted. The depth of the inversion during the quarter was pointing to a 30%-40% chance of recession. That depth, as measured by the spread between 2 year and 10 year yields, deepened throughout the quarter until the later part of December 2006. As economic data began to point to a soft landing, and China began to diversify their U.S. debt holdings, yields moved higher and the curve quickly reverted back to the shape it had in October 2006, albeit still inverted.

## **Portfolio Composition**

### **Asset Allocations**

At the start of the quarter, OFG believed that the allocations of 30% Fixed Income, 60% U.S. Equity and 10% International were appropriate for the current world market conditions. At the close of Q4 the continuation of the inversion of the yield curve and the depressed bond

ertheless, OFG believes there are pockets of weakness to consider, including automotive, residential construction, light construction machinery and farming equipment.

### **Information Technology**

For the IT sector, the portfolio held two ETFs (IYW, IGV) for most of the quarter. The fund sold IGV on 12/13/2006 and bought additional shares of IYW as a hedge against any adverse market moves during the winter break. The IT sector performance lagged the equity portion of the bench throughout Q4. The fund’s IT sector holding period return was up 0.52%, while the equity portion of the bench was up 6.4% for the period.

### **Materials**

In Q4, the materials sector followed the overall market higher, led by impressive economic growth in the Asian region and the steadily increasing demand for raw materials. Furthermore, the innovation by carbon fiber and various composite companies led to an increase in demand to help those companies benefit from the increased usage of their products in various industrial goods. A position in Ceradyne CRDN was entered to take advantage of this sector.

### **Telecommunications**

The Telecom sector continued to perform well from October through December of 2006 as it had done in the previous three quarters of the year. The U.S. Telecommunications Index rose 9.2% in Q4 compared to the S&P 500 Index’s increase of 6.2%. OFG had market weight exposure to the sector through the Telecom ETF (IYZ) through most of the quarter. One position in Latin American wireless carrier NII Holdings (NIHD) was briefly entered. The downturn of the oil market affected NIHD due to its reliance on various emerging economies and the funds’ Telecom exposure was shifted back to IYZ.

### **Utilities**

In planning our investment strategy, OFG had to take in to account the fact that the Utilities sector performance depends on a number of factors, including interest rates, commodity prices, and rising costs. But there are two factors that have the greatest impact on utilities: interest rates and the weather. Like most industries, producers and distributors faced rising cost pressures. Though fourth quarter fundamentals remained strong, cost headwinds remained a challenge for the sector. As a result, rising interest rates, warm winter forecasts and possible profit

factors gave investors a clear sign that the buyers were exhausted, and led to an influx of selling pressure. The hurricane season ended without any disruption of the gulf coast production or refining. When compared to the prior year, this helped the supply-side of the market breathe a sigh of relief. The conflict between Israel and Lebanon ended as a stalemate, and eased some of the geopolitical tensions that had been priced into the market during the conflict. Furthermore, the reduction in overall supply caused by the Prudhoe Bay pipeline shutdown was unable to push the market to new highs, a clear sign of exhaustion on the part of buyers. Throughout these events capital flowed out of the sector into other sectors. Positions in XLE and PBW, a clean energy ETF, were utilized to reduce the funds sector sensitivity to the price of oil.

### Financials

The financial sector is very sensitive about interest rate movements and most other macroeconomic data. Given the economic uncertainties going into Q4, the exposure to this sector was initially at market-weight. As reports continued to show a stable or strong economy, and as interest rates remained level, exposure to this sector was increased. Positions included Berkley (BER), American Express (AXP) and the sector ETF, XLF.

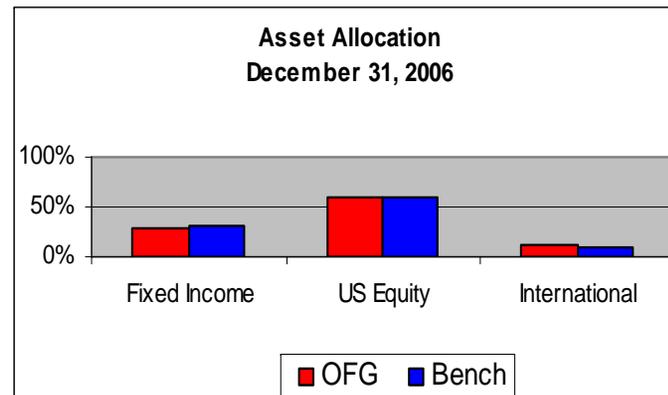
### Healthcare

News headlines spurred volatility in much of this sector, with the sector ETF, IYH, underperforming the S&P 500 Index by almost 5%. After the Democrats won the Congressional majority in the November elections, both major pharmaceutical and managed health companies dropped as the future of reimbursement rates from the Medicare program was now in question. But the Democrats did bring in a favorable political environment for alternative fuel. OFG seized this opportunity and invested in Syngenta (SYT) a biotechnology company, which specialized genetically modified corn and soybean seeds. This strategy resulted in a return of 7.55%.

### Industrials

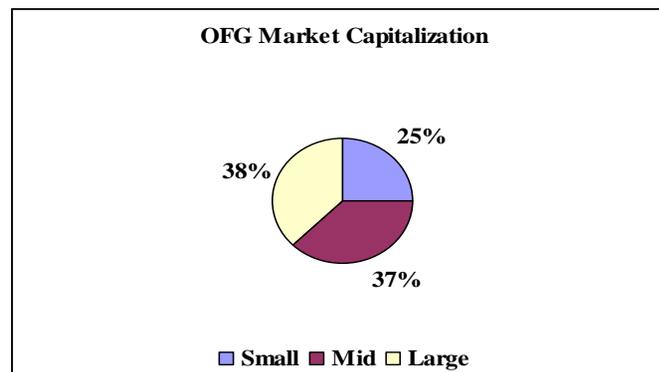
While order patterns have moderated, the trajectory of growth for the Industrial sector remains positive. Our sector tracking ETF, XLI, underperformed the S&P 500 Index by .10%. However, this was offset by a 3.39% holding period return of Armor Holding (AH) for most of November and December. Overall, the sector's fundamentals remain solid, buoyed in part by high levels in Department of Defense spending. Nev-

market, forced OFG to slightly underweight Fixed Income to 28%. To offset this move, international exposure was outweighed by 2%. OFG believed that international equities, anchored by a strong European economy, continued stability in Latin America and continued growth in China would provide enhanced returns.



### Market Capitalization

The equity portion of the fund attempted to invest in companies that showed the greatest potential for price appreciation while minimizing the risk of loss. To accomplish this goal, the Fund invested in large and mid-size companies, although most of the equity funds were invested in ETFs during this time.



### Sector Allocations

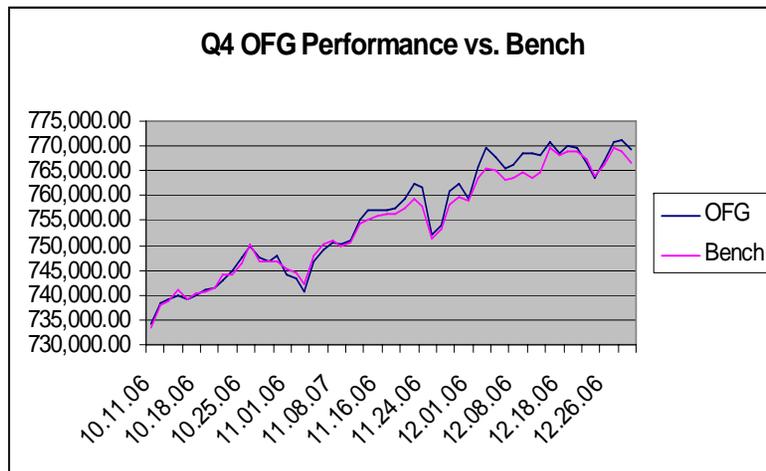
The sector with the most exposure was Financials, which was near the S&P 500 Index weight of 21.7%. With conflicting news entering the

market, the most of the fund's sector allocations were set to market weight, except for Healthcare and Utilities which were underweighted.

## Portfolio Performance

### Overall Portfolio

During Q4, the value of the Fund grew 4.67%, outperforming a weighted benchmark comprised of the S&P 500 Index (60%), the Morgan Stanley EAFE Index (10%), and the Lehman Brothers Aggregate Bond Index (30%) by 0.35%. Initial portfolio positions were entered on October 11, marking the beginning of the 2006/07 OFG foray into the market with a starting portfolio value of \$734,931.90. At the end of the quarter, the portfolio value had risen to \$769,278.71. After management fees, the value of the Fund increased by \$32,968.52 or 4.48%, and outperformed the benchmark by 0.17%.



### Monthly Performance Comparison

Decomposing the Q4 performance into monthly returns indicates that the Fund outperformed the benchmark every month during the quarter: +0.14% in October, +0.20% in November, and +0.02% in December. For the quarter, the Fund outperformed the benchmark by 0.36% before management fees and 0.17% after fees.

4.95%. OFG underperformed the benchmark by 4.15%. Below is a summary of returns for each international position during the quarter.

Ticker	Return
EFA	2.6%
EWD	9.34%
EWP	5.5%
EWV	-3.34%
EWZ	-1.3%
ILF	1.86%
PGJ	30.38%

### Sector Analysis

#### **Consumer Discretionary**

The Consumer Discretionary Index earned 9.8% in Q4 and outperformed the S&P 500 Index. GameStop Corp. (GME), a video game retailer was OFG's only Consumer Discretionary holding during the quarter. Two new gaming consoles (Playstation 3 and Nintendo's Wii) were released in December with strong forecasted sales. GME was in an ideal position as the largest video game retailer, and it was bought and sold in a little over a month for a 4.1% return. At quarter-end, OFG maintained the sector at market weight.

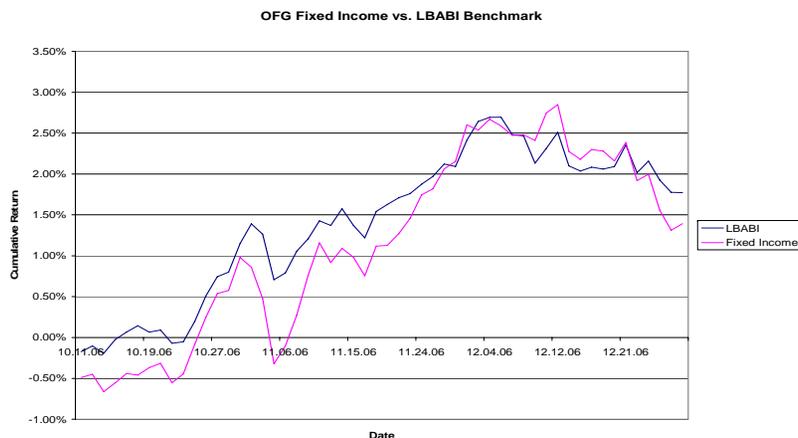
#### **Consumer Staples**

The Consumer Staples sector underperformed the S&P 500 Index, which reinforced OFG's decision to keep exposure to this sector at an underweight position. The Consumer Staples Select Sector SPDR (XLP) was the only holding and it underperformed the S&P 500 Index by 2.74%. Since this sector is defensive, OFG was ready to enter the sector quickly if the economy started into a severe downtrend. This strategy is still in place as the Fund moves forward.

#### **Energy**

As the summer of 2006 drew to a close, the multi year bull rally in energy started to show its first signs of weakness. A few key fundamental

ment was 1.39%, while the Lehman Aggregate Bond Index had a return 1.77% during that same time.

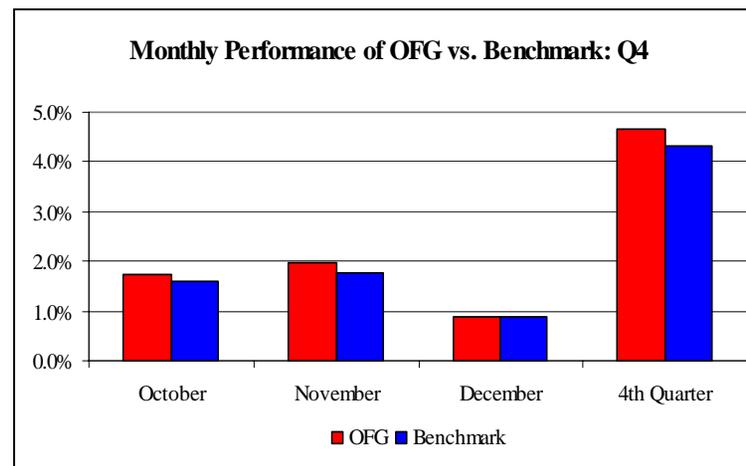


### **Performance of the International Component**

For the past few years mutual funds and exchange-traded funds that hold foreign stocks have consistently outperformed their domestic counterparts. OFG overweighed international holdings in order to earn additional returns offered by foreign markets as well as to diversify our holdings and to lower the risk. To achieve these goals, OFG invested both in emerging and developed markets. Emerging markets were represented by ETF's of China (PGJ), Brazil (EWZ), Mexico (EWW) and iShares S&P Latin America 40 Index (ILF). The European holdings (Swedish and Spanish ETF's) covered developed markets. The Fund also held positions in EFA, which tracks the international benchmark (MSCI EAFE).

The economies that are represented in the benchmark had very positive gains, and OFG tried to identify the regions within those economies that performed the strongest. Though China exceeded our expectations, terrorist attacks in Spain and an EU threat of legal action produced disappointing results. The Fund held three positions in Latin America that produced disappointing results due to a lot of oil price sensitivity.

Although the international component underperformed EAFE, it still outperformed the S&P500 Index. The EAFE produced a return of 9.1% for the quarter, while the International return of OFG's positions was



### **Portfolio Analysis**

Initially each of the three portfolio components, Fixed Income, International, and U.S. Equity, were set at market weight to the bench, (30%, 60%, 10%, respectively) as were the sector allocations across the S&P500 inside the U.S. Equity portion. The first major shift in component weightings occurred on November 7 in order to mitigate perceived risks in the U.S. bond market. In response, the Fixed Income component was underweighted to 25% of the total fund value, shifting domestic equities to 5% overweight exposure. As the Fund went into a passive management mode for the Winter Break, the Fixed Income component was moved back to market weight. This was mainly due to concerns about a possible correction in U.S. equities markets after a strong Q4 run-up. Sector allocations in the U.S. Equity component remained at initial market weights by and large throughout Q4. However, the Democrats political victories in November lowered OFG's outlook for the healthcare sector which was underweighted shortly after the elections.

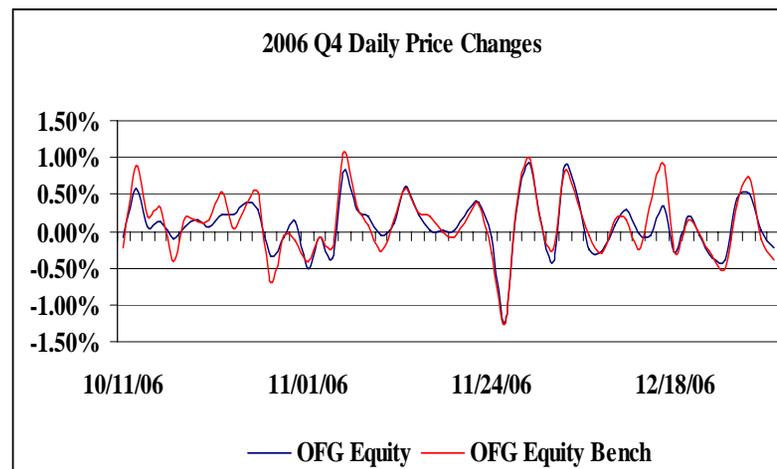
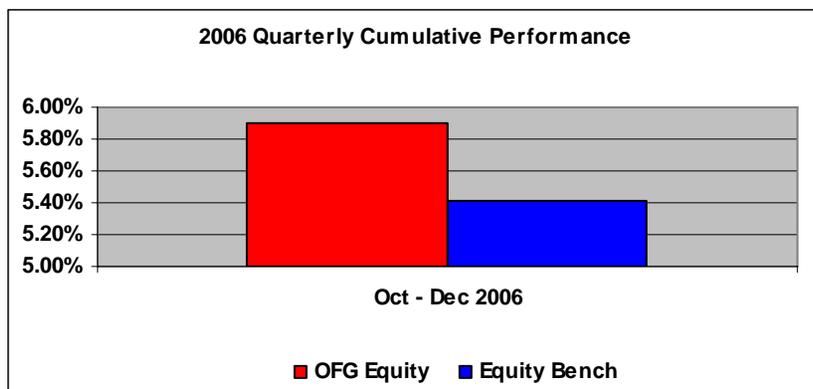
### **Performance of the Equity Component**

The dominant strategy for managing the Equity component of the Fund involved a continuous rebalancing of the ten sectors comprising the S&P 500 Index and the portion devoted to the international market according to the latest news concerning domestic and international economies. The selection of equities for the portfolio was done using fundamental and technical analysis with an emphasis on a top-down and mo-

mentum based strategy. With no rate cut apparent in the near future, the portfolio was rebalanced with greater emphasis on equities. The Equity portion of the Fund earned 5.90% for Q4 and outperformed the benchmark by 0.49%, as shown by the chart below. The weighted average of the Morgan Stanley EAFE and the S&P 500 Index returned 5.41% by comparison. The performance for the quarter was due to exceptional returns from one of the international positions (PGJ) of the portfolio, along with solid returns from the Industrials sector.

### **Analysis of Returns and Risk**

As shown in the chart below, the Equity portion of the Fund tracked the performance of the bench very closely during the quarter, showing a strong positive correlation (+0.91). There were points where the performance of the Fund lagged or exceeded the performance of the Equity portion of the bench, but this did not adversely affect the variance of the returns as the Equity portion posted a daily average standard deviation of 0.37% versus 0.44% for the Equity portion of the bench.



### **Performance of the Fixed Income Component**

During Q4, the fixed income portfolio consisted of two ETFs, Nuveen Preferred Convertible Income Fund (JQC) and iShares Lehman 7-10 Year Treasury (IEF). Most (80%) of the Fixed Income portfolio was in IEF. Overall performance was measured against the Lehman Brothers Aggregate Bond Index (LBABI) as the benchmark. Both IEF and JQC demonstrated higher volatility when compared to LBABI. Due to the overall drop in Treasury yields and the appreciation of JQC's preferred and convertible assets, the Fund saw positive performance through the beginning of November and weighted Fixed Income at 30% of the overall portfolio value. However, there were signs of a correction in the bond market in early November, and in order to protect the overall value of the Fund, OFG dropped the weight of Fixed Income to 25% on November 7, 2006. After reallocation, the fixed income component performed very well and was 43 basis points above the bench by December 11. This was short lived, however, as yields moved higher on stronger economic news and diversification by China away from U.S. debt and to European debt.

As of December 19, when the Fund moved into a more passive mode, OFG's Fixed Income was 22 basis points above the benchmark. From December 19 to December 29, higher yields continued and the performance dropped below the LBABI benchmark by 38 basis points. From October 10 to December 29, JQC had a return of 7.75% and IEF had a return of 1.32%. The overall performance of the Fixed Income compo-