3Q07

THE FSAG ADVISOR

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Market Update

The economy has gyrated madly in the early months of the year, and a fully employed labor force (the unemployment rate is down to 4.5%) has given a boost to consumer spending — which soared at a 4.4% rate in the first quarter of the year. But the housing market continues to crumble, and inventories of unsold homes are pushing up toward historical highs. The end result was 0.6% first quarter growth, which is not far from recession.

The stock market has also bounced around. If there has been a steady factor, perhaps it would be the hand of Federal Reserve Chairman Ben Bernanke. He has kept the Federal Funds rate at 5.25%, and has both talked up the housing market and kept down expectations that the central bank will be cutting rates anytime soon.

A repetitive theme among top corporate executives has been the difficulty these companies are having in recruiting and training skilled professionals. We conclude the labor market will remain tight through the balance of 2007. Consequently, we look for pressure on wages, a potential reduction in productivity, and a continued threat of inflationary pressures. We suspect that the Bernanke Fed will keep the Fed Funds rate at 5.25% through the rest of the year, and may look to hike rates up to three times next year.

Turning to the broader economy, we think that the housing market will stabilize by year-end as we look for the inventory of unsold homes to fall from the current 8.4 months to below 8 months. Lower housing prices will lead to the pick-up in demand.

We don't see any relief in sight for drivers of SUVs. Oil prices are expected to stay in the $60s, and gasoline will likely average $3 per gallon, at least through the summer. But there is a silver lining to the high gas prices. In our view, global economic growth is driving these prices higher, and this growth is creating opportunities for domestic companies with multinational operations — particularly compared to the current domestic economic growth rate below 1%.

2007 YTD Returns

Index	Return
DOW	*8.76%*
S&P 500	*6.96%*
NASDAQ	*7.78%*
Russell 2000	*6.45%*
Mid Cap 400	*11.98%*
MSCI EAFE	*10.37%*
Lehman US Agg.	*0.98%*
Lehman Muni.	*0.16%*
10 Year Treasury Yield	*5.03%*

Source: Argus Research Company

Is It Time for a New Financial Services Relationship?

How do investors know when it's time to take a fresh look at their financial services relationship? In some cases a re-evaluation is called for when the existing advisory relationship is not meeting the investor's needs.

Today's affluent investors demand a combination of the following capabilities:

- Investment performance
- Quality service
- Knowledgeable representatives and advisors
- Ability to resolve problems
- Familiarity with their specific situation

Above all, an advisory relationship must be based on trust. An extensive survey of more than 6,000 advisory clients conducted by Schwab Institutional revealed that trust was the most important factor in an advisory relationship, followed by competence, quality of advice and investment returns. Investors who do not deem their advisors trustworthy are taking their money elsewhere – in fact, one recent survey showed that high-net-worth households that felt trust was lacking in their relationship

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A Registered Investment Advisory Firm
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Is It Time for a New Financial Services Relationship? *Continued from page 1*

"Forty-six percent of wealthy households now use an independent advisory firm as their primary financial relationship because they feel they receive more objective advice."

Source: Spectrum Group, Ultra High Net Worth Perspective Series Summer, 2004.

were one-and-a-half times more likely to move at least some of their business to another advisor. Similarly, 25% of affluent investors recently surveyed by Spectrem Group moved a portion of their assets out of their financial services firms in the previous two years because of lack of trust.

Another reason to consider a new financial advisory relationship is when one's financial affairs have become so complex that the individual or the existing advisor cannot properly manage them. Triggering factors may include extraordinary income due to an asset sale, executive compensation or business liquidation; asset growth requiring complex tax and portfolio analysis; retirement concerns such as how to take required minimum distributions or arrange beneficiary designations for minimal tax impact; changes in family dynamics requiring revisions to the estate plan; or the simple realization that something may be missing from the overall financial plan or the relationship with an advisor.

When one's financial affairs become too complex for an individual to manage alone, it sometimes takes a team of advisors to address such areas as investment management, tax planning, risk management, income planning and estate planning in an integrated manner.

Here are some questions that can help you determine if it might be time for a new financial advisory relationship.

For investors who already work with a broker

- Do I feel that my broker's advice is based on a thorough understanding of my personal goals, financial situation, life stage and risk tolerance?
- Did my broker and I collaborate to create a customized investment plan that truly reflects my situation?
- Am I satisfied with the frequency and quality of the contact I currently have with my broker?
- Do I sometimes feel that my broker's recommendations for products, including ones from their own company, are not always in my best interest or may be motivated by commissions?
- Does my broker have the expertise and credentials (such as CFP, CFA, CPA, MBA or JD) to advise me about my complete financial situation, including taxes and estate planning?
- Am I confident that the plan I've developed with my broker will help me maintain my lifestyle into retirement and provide for my family after I am gone?
- Has my broker recently reviewed my beneficiary designations with me to make sure the designations on record are the individuals whom I would intend to receive proceeds?

For individuals who are investing on their own

- Is my portfolio becoming too complex or time-consuming for me to feel comfortable managing on my own?
- Do I have the tools I need to plan and optimize my portfolio to meet my near-term and long-term financial goals?
- Would I rather be spending my time on other things?
- Is my portfolio currently meeting or exceeding my performance goals?
- Does my investing plan take my entire financial picture into account, including investments, assets like real estate or a small business, and debts?
- Would I have more peace of mind if I were working with an investment professional to help me achieve my financial goals?

If you would like to read this white paper in its entirety, please visit our website at www.fsadvisorygroup.com.

Source: Schwab Institutional: Investing in More Objective Advice – A Guide to Working With an Independent Registered Investment Advisor

Inheriting a 401(k) Plan Account?

When you inherit a 401(k) plan account, the options available to you depend on a number of factors, including the terms of the 401(k) plan and your relationship to the deceased 401(k) plan participant. In general, you'll have four options: Take an immediate distribution, disclaim all or part of the assets, leave the money in the 401(k) plan (if the plan permits), or roll the funds over to an IRA.

Should you take the cash?
Obviously, if you need the funds immediately, taking a lump-sum distribution from the 401(k) plan may be your only viable alternative. But you'll have to pay ordinary income tax on the distribution (except for the amount of any after-tax contributions and qualified Roth distributions). Special tax rules may apply if the plan participant was born before January 2, 1936 - consult a tax professional for details. A lump sum might also be attractive if you're entitled to a distribution of employer stock. You may be able to pay ordinary income tax on just the participant's basis in the stock, and defer tax on the appreciation (called "net unrealized appreciation," or NUA) until you sell the stock in the future--at capital gain rates.

What's a disclaimer?
When you disclaim (i.e., refuse to accept) 401(k) assets, they pass instead to the plan participant's contingent beneficiary, or estate if there is no contingent beneficiary. In general, you must give the plan written notice of your intent to disclaim the funds within nine months after the participant's death. But be careful not to exercise control over the funds in the meantime or you may lose your ability to disclaim the funds. A disclaimer may be an attractive option if you're sure you won't need the funds, and the transfer to the contingent beneficiary makes good economic and estate planning sense.

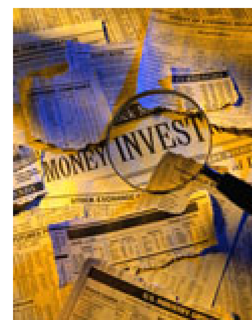
The problem with 401(k) plans
If you're like most beneficiaries, your goal will be to stretch payments out as long as possible, taking full advantage of the tax deferral offered by retirement plans. This means either leaving the assets in the 401(k) plan, or rolling them over to an IRA. For most, leaving the funds in the 401(k) plan isn't the best choice for two reasons. First, the investment alternatives available to you in a 401(k) plan are limited to the ones selected by the employer. Second, the distribution options offered by a 401(k) plan typically aren't as flexible as those available in an IRA.

Roll the funds over to an IRA
Unless the 401(k) plan offers a unique investment alternative, rolling the 401(k) assets over to an IRA will usually be your best choice. IRAs offer virtually limitless investment options. And when it comes time to take distributions from the plan, IRAs offer the most flexible payment provisions.

If you're a surviving spouse, you'll have to decide between rolling the funds over to your own IRA, or to an IRA that you establish in the participant's name, with you specified as the beneficiary (this is referred to as an "inherited IRA"). Which should you choose? In most cases, you'll be better off rolling the funds over to your own IRA. Rolling the funds over to an inherited IRA is typically appropriate only if you're not yet age 59½ and you think you'll need the funds before you reach that age. That's because distributions from an inherited IRA aren't subject to the 10% early distribution penalty tax. (In contrast, distributions from your own IRA before age 59½ are subject to the 10% penalty tax unless an exception applies.)

If you're not the surviving spouse, you don't have the option of rolling the 401(k) assets over to your own IRA. But thanks to the Pension Protection Act of 2006, you may be able to make a direct rollover of the 401(k) funds to an inherited IRA. A 401(k) plan isn't required to offer this option, so check with your plan administrator. This new rule applies to distributions you receive after 2006.

The rules governing inherited 401(k) plan accounts are complex. Your FSAG advisor can help you sort through the alternatives, and make the decision most appropriate for your individual circumstances.



"Unless the 401(k) plan offers a unique investment alternative, rolling the 401(k) assets over to an IRA will usually be your best choice."

At Financial Solutions Advisory Group, you'll find a fee-only Registered Investment Advisor (RIA) committed to putting your interests and your needs first, eliminating the commissions and self-serving incentives that get in the way of solid, successful financial planning and investment management.

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Stocks in the News: PepsiCo Inc. (PEP)

PepsiCo, based in Purchase, New York, is a leading producer of soft drinks and snack foods. The company has four operating divisions: PepsiCo Beverages North America, Frito-Lay North America (FLNA), PepsiCo International, and Quaker Foods North America. The company's brands include Pepsi, Fritos, Lay's, Mountain Dew, Sierra Mist, Aquafina, Gatorade, Quaker, and Tropicana.

PepsiCo's focus on healthier, high-margin products and global expansion will help to drive long-term growth. Senior management has been emphasizing the progress that the Frito-Lay and Quaker Oats divisions have made on health and wellness initiatives. During the first quarter, FLNA completed the switch to sunflower oil, eliminating almost 50% of the saturated fat in its products. The focus on healthier products is also a priority in the international snack and beverage portfolio. PepsiCo International CEO Mike White noted that the company plans to begin using healthier oils in some products, expand its use of oats and grains, and introduce low-salt items in new markets. PepsiCo International is also focused on expanding core brands with locally relevant flavors (for example, white mushroom-flavored Lays chips in Russia, spicy seafood Lays in Thailand, and bell pepper Lays in India). The company is confident it can deliver 2007 EPS of at least $3.30, a 10% increase from last year. Management warned that 2Q07 is likely to be the most challenging quarter of the year as the company faces difficult year-over-year comparisons. If the PEP shares sell-off during this period, we would be even more bullish on the stock.

Key Statistics: PEP	
Price	*$66.59*
EPS	*$0.66*
Estimated EPS	*$3.33*
P/E Ratio	*18.99x*
PEG Ratio	*1.81x*
Dividend	*$1.20*
Market Cap	*$108.62B*
52 Week High	*$70.00*
52 Week Low	*$59.00*
Beta	*0.64*
Expected Annual Growth Rate	*10.5%*
ROE	*35.5%*

Source: Argus Research Company

College Savings: How Does an UGMA/UTMA Compare to a 529 Plan?

Both an UGMA/UTMA custodial account and a 529 plan can be used to save for college. But after comparing a few key features, the 529 plan probably comes out ahead.

Taxes

Income in a 529 plan grows tax deferred, and withdrawals used to pay college expenses are completely tax free at the federal level (and possibly at the state level too). But any income earned by assets in a custodial account (for a child under age 18) is taxed under the "kiddie tax" rules--the first $850 is tax exempt, the next $850 is taxed at the child's rate (usually 10%), and anything over $1,700 is taxed at the parent's rate.

Investment flexibility

With a custodial account, you have complete control over the investments you decide to place in the account (assuming you're the custodian). But with a 529 plan, you're limited to the investment offerings pre-selected by the plan.

Control

Assets contributed to a custodial account are considered irrevocable gifts to your child. Second, withdrawals can only be made for your child's benefit, not yours. And once your child reaches age 21 or 25 (for UTMA accounts) or age 18 (for UGMA accounts), the custodianship ends and your child receives sole control of all assets in the account. This is a drawback for some parents who believe their child may not use the money for college. By contrast, as account owner of a 529 plan, you can change the beneficiary at any time, you control the funds all the time, and you can withdraw money for purposes besides college (though you will pay a 10% federal penalty on the earnings portion).

Financial aid

Under the federal aid formula, 529 plans are considered a parent's asset (if the parent is the account owner) while custodial accounts are considered a child's asset, a less favorable classification. This is because children must use 35% of their assets for college expenses (20% starting July 1, 2007), but parents must use only 5.6% of theirs.

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