4Q05

THE FSAG ADVISOR

Inside this issue:

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Market Update

Close your eyes for a moment and forget about the hurricanes and high energy prices. Instead, imagine an economy that has been growing for years. Picture a place where millions of jobs have been added and the unemployment rate is only 4.9%. Think of a community where manufacturing is increasing production at a rate of 3%, capacity utilization is near 80% and productivity is running at a 5.8% pace. In fact, imagine an economy that has just finished a quarter where industrial output is at an all time high. That's right, never before has the economy produced so many goods. And on top of that, the rate of unfilled orders for goods is over 10%. What if durable goods orders were up 7.9% over the last year, with orders for industrial machinery up 8.2%, computers and electronics up 14.7%, and transportation equipment orders were up 8.9%? Wouldn't that be great!

This represents the U.S. economy today. Certainly, the devastation of Katrina and Rita will cause temporary disruptions, but it should not derail the solid recovery we have been enjoying since the tax cuts in 2003. Many predict doom and gloom, but remember, we were back on our feet quickly after a number of problems in the last two decades. We had the stock market crash in 1987, the Long Term Capital Management crisis, the Gulf War, 9/11, four hurricanes that ripped through Florida last year, and now this.

The consumer is and has been resilient. They have spent their way through many a crisis, keeping the economy going. Using declining consumer confidence numbers as evidence, some now say consumers are tapped out and will stop spending. Don't pay attention to surveys. What people say and how they act do not always move in tandem. For years, consumers have complained all the way to the cash register, never once slowing their spending habits. How can they afford to spend? Personal income has risen 5.6% the last twelve months. Sure gas prices have risen, but interestingly enough, the average household spends just 4.6% of their income on energy. Higher gas prices are no longer a shock. While gas prices may have eaten into pay raises this year, it has not crushed the family budget. Finally, rising real estate prices have caused homeowners to feel more confident as they watch their net worth grow.

The Markets
The stock and bond markets have acted stoically during this period of hurricanes and higher energy prices. The S&P 500 rose in September, which is historically the worst month of the calendar year. The energy and utility sectors have performed the best year to date. Chemical companies have had a difficult time passing on higher energy costs to their customers.

International stocks have moved up nicely. The Japanese stock market has reacted favorably to recent elections and may be waking up from a decade long slump.

Year to Date Returns
As of 9/30/05

DOW	*-0.93%*
S&P 500	*3.63%*
NASDAQ	*0.34%*
Russell 2000	*3.38%*
Mid Cap 400	*9.50%*
MSCI EAFE	*7.79%*
Lehman US Agg.	*1.81%*
Lehman Muni.	*1.64%*
10 Year Treasury Yield	*4.33%*

Ten year Treasury bond yields have managed to stay below the March highs of 4.6% despite renewed fears of inflation. The Federal Reserve continues its slow march, bumping the Federal Funds Rate to 3.75%. With the Consumer Price Index up 3.2% the last twelve months, there is still room for them to move rates higher.

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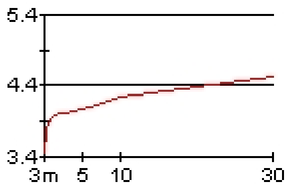
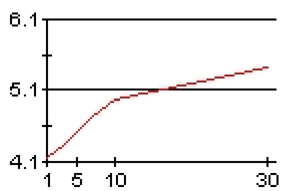
What is Meant by "Laddering Investments"?

Bond Yield Curves

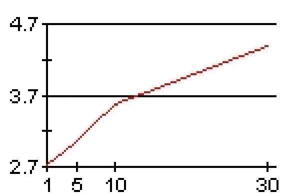
Treasury



Corporate



Municipal



Laddering, a strategy commonly used with bonds, CDs, and other fixed-income investments, is similar in many ways to the use of dollar cost averaging to purchase individual stocks and mutual fund shares. Like dollar cost averaging with stock, the basic principle of laddering is simple: You plan your fixed income purchases over time to diversify your risk. As investments mature, net receipts are reinvested within the scope of the ladder. An effective laddering strategy can help you limit overall interest rate risk and can provide you with predictable ongoing liquidity.

How laddering works

Let's say you have $100,000 that you want to invest in bonds. Since bonds with longer maturity periods typically offer a higher yield than bonds with shorter maturity periods, you might be tempted to invest the entire $100,000 in long-term bonds, let's say bonds that mature in ten years.

If you do so, however, you're tying up your investment dollars for ten years. If interest rates rise during this period, the value of your ten-year bonds will be negatively impacted, and, since you've invested your full $100,000, you'll be unable to purchase new, higher yielding bonds. If, instead, you invested the entire $100,000 in bonds that mature in just a year or two, your dollars would be available to reinvest sooner, but you'd miss out on the higher yields offered by longer-term bonds.

Laddering offers a middle ground. With laddering, you would allocate your $100,000 among bonds with varying maturity dates. For example, you might invest $20,000 in two-year bonds, $20,000 in four-year bonds, $20,000 in six-year bonds, $20,000 in eight-year bonds, and $20,000 in ten-year bonds.

When the two-year bonds mature, you could reinvest the proceeds in ten-year bonds; you could do the same when the four-year bonds mature. In time, all your bonds would have ten-year maturity dates, with 20% of the bonds maturing every two years. In the example above, you're free to reinvest a portion of your funds at prevailing rates every two years. At the same time, you're getting the higher yield provided by the ten-year bonds you're purchasing.

Benefits of laddering your investments

- Reduced interest rate risk: If rates rise, you'll be able to reinvest net proceeds from maturing investments at the higher prevailing rates. If rates drop, you can reinvest at prevailing rates, choose alternate investments, or use the proceeds for expenses.
- Greater liquidity: Because your fixed income investments mature on an ongoing basis, all of your investment dollars aren't tied up long term.
- Combines higher yield of longer-term investments with flexibility of shorter-term investments: Even though you're able to put your dollars into longer-term investments that generally have higher yields, you retain a key advantage of shorter term investments--the ability to access your funds on a regular basis.

Tradeoffs to laddering

- Opportunity cost: A portion of your laddered dollars may initially be in investments with short maturity periods. A shorter maturity period will generally mean a lower yield than a similar investment with a longer maturity period.
- Transaction costs: Consider the costs associated with reinvesting bond proceeds on a regular basis.
- Call risk: Laddering may not work with bonds that have a call provision (allowing the bond issuer to repay the bond before maturity).

The final word

If bonds, CDs, or other fixed-income investments make up a significant part of your overall portfolio, laddering is a strategy that may be worth considering.

Estate Tax Repeal - Update

The Economic Growth and Tax Relief Reconciliation Act of 2001 gradually phases out the federal estate tax until its complete repeal in 2010. Without additional legislation, however, the federal estate tax will return in 2011. Since 2001, there have been several efforts in Congress to make the estate tax repeal permanent. Most recently, the House of Representatives voted in April 2005 to do so; that bill is now being debated in the Senate. If passed by the Senate, the bill will go to President Bush who has said he will sign it into law. The question is: Will permanent repeal become law, and if so, what are the potential ramifications?

Goodbye estate tax, hello capital gains tax

Repeal does not mean that tax on wealth transfers from one generation to the next will disappear. While currently a tax is imposed on estates, after repeal, a tax will be imposed indirectly on inheritances in the form of capital gains tax. Here's a simplified explanation. Under the current tax system, property that is transferred to heirs at the owner's death typically gets a "step up" in tax basis. Generally, tax basis refers to the cost the owner paid to acquire the property, and is used to compute capital gains tax when the property is sold. For example, let's say Mr. Smith buys property for $50,000, which becomes his tax basis, and sometime later sells the property for $60,000. Mr. Smith's computed capital gain for tax purposes is $10,000. When property is transferred by gift, the recipient receives a "carry over" basis; the tax basis in the hands of the person making the gift generally becomes the recipient's tax basis. So, let's say that Mr. Smith gives the property in the above example to his son, John. Mr. Smith's $50,000 tax basis carries over to John, and when John subsequently sells the property for $60,000, John recognizes the $10,000 capital gain. However, when property is transferred because of the owner's death, the tax basis is stepped up to its current fair market value. Let's say that John receives the property through his father's will. John's tax basis is stepped up to $60,000, the property's fair market value. When John subsequently sells the property for $60,000, John recognizes no capital gain on the transaction. One of the consequences of estate tax repeal will be that the step up in tax basis will be lost. Heirs will receive a carry over basis on inherited property, and will recognize the capital gain (or loss) when the property is sold. What will this change in the tax system mean for American families? The current estate tax affects 2% of the most wealthy Americans. Capital gains tax, on the other hand, can affect anyone who owns capital assets. Therefore, unless the step up in basis remains, estate tax repeal is likely to result in creating a higher tax bill for a greater percentage of less wealthy Americans. Further, repeal will create a paperwork headache for heirs who will have to determine the decedent's tax basis in the property they've inherited.

Other pros and cons of permanent repeal

Proponents of permanent repeal regard the estate tax as morally unfair and an obstacle to family business continuity and growth. Critics call permanent repeal a boon to the mega-rich and fiscal suicide in a time of budget deficits, a Social Security and Medicare crisis, and war. The confusing reality is that there is statistical evidence both for and against the arguments presented by each side. One thing is certain, however; dealing with the uncertainties of the current state of the estate tax is a burden on Americans and their financial planning professionals who must reevaluate estate planning options every year. For many on both sides of the issue, sensible reform is a preferable alternative to the success or failure of permanent repeal.

Dealing with the uncertainties of the current state of the estate tax

The uncertainty about the long-term prospects of the estate tax is a conundrum. Whether you're willing to bet the estate tax will be permanently repealed or you believe the estate tax is here to stay, planning in advance is as essential as ever. Here are some important facts to keep in mind:

Continued on page 4

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Stocks in the News: United Technologies (UTX)

United Technologies (UTX) is probably one of the most famous companies that you have never heard of. Turn your air on this summer? Maybe you own a Carrier air conditioner. Ride an elevator or escalator today? Bet it was on an Otis. Hear a jet fly overhead? Could have been a Pratt & Whitney engine making all that noise. United Technologies owns those brands, as well as Sikorsky helicopters and Hamilton Sunstrand aerospace products. What is common among all these business units is that they participate in growing global industries that possess large market share. With George David's excellent leadership as CEO, the company has grown 16% per year over the last 10 years.

Most of United Technologies' divisions cut their teeth in the United States. Companies learned manufacturing prowess and honed their service capabilities here. This resulted in a domestically dominant and successful business unit. International markets were then added to continue the growth and there has been no stopping the company. Carrier, for example, is the leading heating, ventilating and air conditioning (HVAC) supplier in the U.S. and the world. It is now selling units in Europe where only 30% of homes have air conditioning. Asian markets are expanding rapidly as well and have helped all of United Technologies' divisions. Research and development is also important. Carrier is introducing a new air conditioner that will be 30% lighter, 20% smaller and cheaper for customers to run since it will use 40% less refrigerant.

Service contracts are a crucial addition to each elevator, airplane engine, refrigerator, and helicopter sold. These big ticket items are usually sold in long term cycles, providing for lumpy sales. Service contracts help smooth revenue streams for United Technologies and make earnings more predictable.

Some believe that exposure to the airline industry put the company at risk. This should not prove to be much of a problem. Airplane orders are actually rising world wide and may not peak until 2009. Pratt & Whitney feels that it will maintain its market share through the cycle. Hamilton Sunstrand has been successful in procuring a major role in Boeing's new 787 airplane. Once sales start, they will garner three times the normal amount of revenue they typically receive per plane, of the more than 270 that have already been ordered.

United Technologies is no high flyer, it is known for cranking out predictable performance year after year. This makes for a great stock to hold on to for the long term. Growth should continue in the low teens. The stock trades at a respectable 17 times price to earnings ratio. The company has raised its dividend each year since 1993.

Key Statistics: UTX	
Price	*$51.75*
EPS	*$2.76*
Estimated EPS	*$3.10*
P/E Ratio	*17.0x*
PEG Ratio	*1.20x*
Dividend	*$0.88*
Market Cap	*$52.8B*
52 Week High	*$54.06*
52 Week Low	*$44.24*
Beta	*0.78*
Expected Annual Growth Rate	*12.0%*
ROE	*22.0%*

Estate Tax Repeal - Update *Continued from page 3*

- Even without a federal estate tax, your state may impose a death tax of its own which you need to plan for.
- Though estate tax may be repealed, gift tax will remain. Gift tax planning is still critical to your overall estate plan.
- The estate tax phases out through 2010 by increasing exemptions and decreasing rates. Make sure your will and trusts include formula provisions that take care of these changes automatically.
- Your estate will incur other costs besides estate tax. Be sure your estate will have the cash available to pay expenses such as outstanding debts and liabilities, final medical bills, burial and funeral costs, and executor and attorney fees.
- Estate planning meets other goals besides tax avoidance. You still need to plan to take care of your surviving family members, avoid probate, distribute your estate according to your wishes, make charitable gifts, plan for incapacity, and meet many other objectives.