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Market Update

The last three months have been all about oil prices. A barrel of light crude had been rising for years before peaking in July at almost \$80. As oil prices fell 25% from the top, stock and bond markets have stayed buoyant. Stock prices have steadily crept up since the middle of July and are close to new highs. With the fear of inflation caused by higher energy prices subsiding, interest rates have started falling again.

The markets have also acted well in response to the Federal Reserve's decision in August to stop raising the Federal Funds rate. Previous to that meeting, the Fed raised the Fed Funds rate 0.25% in each of its last 17 meetings. For now, the Fed feels they have applied enough pressure to slow the growth of the economy without completely stalling it.

Corporations have had a long winning streak, as earnings

have risen in the double digits for the past four years. This success has helped raise earnings and lower price-earnings ratios, making stocks look attractive. Have higher interest rates, commodity prices, and labor costs started to chip away at company margins and profits? We will learn as earnings are reported in October. The July reporting season was fairly controversial. Overall, corporate earnings remained on a tear, rising 16%. But when companies projected a softer business environment, their stocks were punished. For example, 3M and UPS reported positive earnings, but the stocks lost 9% after they told analysts to use the lower end of previous guidance in earnings expectations for the remainder of the year.

Next to prices at the pump, falling housing prices are making their share of the headlines. The real story in housing, however, is whether con-

2006 YTD Returns

DOW	10.86%
S&P 500	8.53%
NASDAQ	2.41%
Russell 2000	8.69%
Mid Cap 400	3.12%
MSCI EAFE	14.9%
Lehman US Agg.	3.06%
Lehman Muni.	3.69%
10 Year Treasury Yield	4.65%

sumers holding adjustable rate mortgages will be able to make higher payments as interest rates have increased. This burden, along with higher credit card minimum payments mandated by the government could push some homeowners over the edge. Low unemployment, rising wages and lower energy costs may help consumer confidence to see us through this bump in the road.

The Importance of Referrals

Referrals are incredibly important in building a successful investment management company for affluent clients for one simple reason – affluent investors prefer to find their advisors through referrals from other satisfied clients and trusted professionals. Referrals from our clients and allied professionals have driven the success of FSAG. Referrals allow us to allocate more time to solving our clients' financial challenges and managing their portfolios and less time to marketing.

We understand it is sometimes difficult to think of people who you believe may benefit from our services. We have given the issue considerable thought and have come up with specific questions which focus on the categories of people who we have had success working with in the past. We would appreciate it if you would review the questions and if you think of anyone who may fit one or more of these categories, please let us know.

Who do you know that: Is close to retirement? Is likely

to consider selling their business? Is most dissatisfied with the performance of their investments? Needs to diversify their investments?

If you find our services to be valuable, please share your experience with others who may benefit as well. The partners at FSAG are never too busy to bring our important work to others you care about.



Separately Managed Accounts: Accounts Customized for You



“Assets under management in separately managed accounts grew by 17.7% in 2005 to \$678.1 billion ... the continued growth puts the industry in line to reach \$1.5 trillion by 2011.”

**Money Management
Institute
February 14, 2006**



Mutual funds have been, and continue to be, a good solution for many investors seeking professional money management. But when you buy shares of a mutual fund, your assets are pooled with the assets of other fund holders. For investors seeking a more personal touch, recent advances in technology and changing advisor business models have facilitated the growth of separately managed accounts (SMAs) as an alternative to mutual funds.

What is an SMA?

An SMA is a personal investment account that is customized and managed for you by a professional money manager. As a personal account, your assets are not commingled with those of other investors. Historically a tool for institutional investors and high-net-worth individuals, SMAs are now available to a wider group of investors. It was once common for SMA programs to require a minimum of \$1 million in investable assets, but today you can find separately managed accounts with minimums as low as \$50,000. SMAs' lower minimums, along with a growing appreciation of their unique features, have led to their increasing popularity.

How SMAs trump mutual funds on taxes

Mutual funds have an inherent lack of tax efficiency. When you buy shares of a mutual fund, you automatically get a share of its embedded tax liabilities. By law, mutual funds are required to pay out realized capital gains

to all fund holders, regardless of how long they've held their shares. The lack of tax efficiency can certainly be a greater problem for actively managed, higher turnover mutual funds than it is for indexed mutual funds. So if you buy shares in a mutual fund right before a distribution date, you may receive a distribution and have to pay capital gains taxes even though you may have held the fund for only a short amount of time. And, a fund can have a capital gains distribution even when the fund's net asset value is declining, as the fund may have unrealized capital losses but realized capital gains. By contrast, with SMAs, each security held in the account has an individual cost basis, which allows you to make specific tax motivated moves. For example, you can generally request that your manager sell a position with an unrealized loss in order to offset capital gains. Those capital gains may be from trades made for the account, or capital gains on other assets, such as a gain from real estate.

How SMAs compare with mutual funds on trading costs and fee structures

Unlike traditional brokerage accounts, SMA fee structures are asset-based instead of commission-based. The SMA fee structure typically covers the investment management fee, trading costs, custody, reporting, and financial planning services. One thing to consider when comparing mutual fund expenses against SMA fees is the

"invisible" trading costs incurred by mutual funds. Mutual fund expense ratios cover fund management fees, administrative costs, and other operating expenses. However, they don't cover trading costs, which include brokerage commissions. Although these trading costs can vary significantly by mutual fund, estimates of these costs range anywhere from .5% to 1%. To get an "apples to apples" expense comparison, you need to determine the total amount of fees, including trading costs, for both investment vehicles.

How SMAs can be customized for your specific situation

Another important feature of SMAs is their ability to allow you to exclude certain securities, like the stock of the company you work for. You can also set sector guidelines, such as excluding a sector you might disapprove of (e.g., tobacco or casino stocks). This flexibility allows you to better tailor your asset allocation for your own unique circumstances and desires--key considerations for many investors with concentrated stock positions.

The bottom line

For investors who place a priority on control and tax efficiency, and have the necessary capital, an SMA program may make a lot of sense. Your financial professional can help you crunch the numbers, look at your overall financial picture, and determine if an SMA might be right for you.

Switching 529 Plans

If you're one of the millions of parents or grandparents who have invested money in a 529 plan (at least one industry research group estimates that assets in 529 plans could hit \$100 billion by the end of 2006), the arrival of a new academic year may be a good time to see how your plan stacks up against the competition. Mediocre investment returns, higher than average fees, limited investment options and flexibility--these are some of the things that might have you thinking you could do better with another plan. If you discover that your 529 plan's performance has been sub par, what options do you have?

Roll over funds to a new 529 plan

Perhaps your most drastic option is to do a "same beneficiary rollover" to a different 529 plan. Under federal law, you can roll over the funds in

your existing 529 plan to a different 529 plan (either a college savings plan or a pre-paid tuition plan) once every 12 months without having to change the beneficiary and without triggering a penalty. Of course, you'll need to research other plans and then choose one, which may take some time. Before investing, be sure to consider the investment objectives, risk, charges, and expenses associated with each 529 plan, all of which can be found in the plan's official statement. Once you decide on a plan, the rollover process is fairly straightforward. Call your existing plan to see what steps are required; your new plan should have a system in place to accept rollover funds. You must complete the rollover within 60 days of receiving a distribution to avoid paying a penalty. If you want to roll over your account more than once in a

12-month period, you'll need to change the beneficiary to another qualifying family member to avoid paying a penalty (you can change the beneficiary back to the original person later).

You can change plans, but should you?

Just because you can change 529 plans doesn't necessarily mean you should. If the new plan has roughly the same mix of investment choices and similar fees, you might ask yourself if you'd be better off staying put and simply changing your current investment allocations. This is especially true if you have invested in your own state's 529 plan and the availability of any state tax breaks depends on you remaining in that plan. Most 529 plans will let you change the way your future contributions are invested. So, for example, if you originally

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What Happens if I Delay Collecting Social Security?

You'll get a bigger check every month if you delay collecting your Social Security retirement benefit. How much bigger depends on which year you reach full retirement age, and how long you postpone collecting benefits. For every month you delay collecting benefits (measured from the time you reach full retirement age to the time you begin taking retirement benefits or reach age 70), you'll automatically receive a delayed retirement credit. This credit will increase your benefit by a certain percentage:

- If you were born in 1939 or 1940, your benefit will increase by 7/12 of 1% for each month, or 7% for each year you delay retirement.
- If you were born in 1941 or 1942, your benefit will increase by 5/8 of 1% for each month, or 7.5% for each year you delay retirement.
- If you were born in 1943 or later, your benefit will increase by 2/3 of 1% for each month, or 8% for each year you delay retirement.

Here's an example. Let's say you were born in 1943 and

are eligible for a \$1,000 monthly benefit when you reach your full retirement age of 66, but you decide to delay collecting Social Security retirement benefits until you turn 70. Because you've delayed your benefit for 48 months, your monthly benefit will be 32% higher at age 70 (4 years x 8%), or \$1,320.

However, delaying retirement isn't right for everyone, so make your decision carefully after reviewing your retirement income needs.



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Stocks in the News: L-3 Communications Holdings, Inc. (LLL)

L-3 Communications is another one of those companies that flies under the radar. Nearly 80% of its business goes to the U.S. Government. It provides the military, homeland security and intelligence agencies a broad range of products. The company has 70 business units divided into four main segments. It is primarily known as a specialist in secure communications, surveillance and training. L-3 sells the hardware, provides upgrades in software, and trains individuals how to run the equipment in simulated environments. These products allow troops and agents the ability to intercept and analyze communications and turn that information around to other command centers in real time.

The company was formed in 1997 by Frank Lanza, Robert LaPenta and a Lehman Brothers private equity fund (3 L's, Lanza, LaPenta and Lehman). Lanza and LaPenta worked for the defense electronic unit of Loral Corp. in 1996 when it was sold to Lockheed Martin. The 3 L's then purchased 10 business units that Lockheed did not want to create L-3 Communications. The company went public in May, 1998. Since then Frank Lanza has headed up the firm, growing the company internally and by acquiring complimentary

companies. Since 2004 alone, L-3 has purchased over 30 companies.

Two recent incidents have hurt the stock. On June 6 of this year, CEO Frank Lanza died. His leadership will be missed, but with 11 chief operating officers leading the 70 business units, this decentralized management structure should help maintain continuity until a new CEO is named. Then in July, the company announced it was taking a write off related to its treatment of stock options on the income statement. This was done as a result of the company's internal reviews, and not an SEC investigation, although the stock reacted like it was. It seems the error was a function of sloppy accounting and not some clandestine effort for executives to pocket large sums of additional compensation.

This company is now one of the most respected and advanced technological defense companies in the world. While other defense companies may worry about declining spending or jet orders, its products and services are in a niche of the military that is expanding. From a financial perspective, L-3's broad array of offerings is an advantage, since it does not have to worry that losing

Key Statistics: LLL

Price	\$78.00
EPS	\$4.95
Estimated EPS	\$5.60
P/E Ratio	15.75x
PEG Ratio	1.21x
Dividend	\$0.74
Market Cap	\$9.7B
52 Week High	\$89.00
52 Week Low	\$67.00
Beta	0.90
Expected Annual Growth Rate	13.0%
ROE	11.3%

one project will sink the company. In fact, in 2005, L-3's largest contract was only 4.5% of revenue and its top 5 contracts only accounted for 15% of sales. Last quarter, the company boosted earnings guidance and expects its internal growth rate (not including acquisitions) to be a solid 9%. That is excellent no matter what kind of company you are. Finally, with the company trading at 13.7 times next year's earnings and a long term growth rate of 13%, this is one of the cheapest, fastest growing companies in the defense sector.

Switching 529 Plans

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picked a conservative investment portfolio, most plans will let you choose a different one (or more than one) for your future contributions. Also, some plans may let you move existing funds from one investment portfolio to another, similar to a 401(k). However, both moves depend on the individual rules of your plan; this flexibility isn't mandated by federal law.

Other options

Many 529 college savings investors may wonder whether they should continue putting money into their accounts if their investment returns have been lackluster. If you'd like to have more control over your college investments, you might want to consider a Coverdell education savings account or an UGMA/UTMA custodial account, both of which let you

choose your underlying investments. Finally, keep in mind that any investment strategy should be reexamined periodically in light of new tax laws and changes in individual circumstances. A financial professional can help you select the right strategy and investments, and help you compare 529 plans.