# 2Q06

# THE FSAG ADVISOR

## Inside this issue:



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## Market Update

Back in 2004, we believed it was more likely than not that at some time during the year interest rates were going to have to rise. It was evident in the middle of that year that our economic slump from the disastrous tech wreck earlier in the decade was over. Plenty of stimulus was injected in the economy the previous year; taxes were cut and the Federal Reserve (the Fed) cut the Federal Funds rate, the rate on loans between banks, to just 1%. With individuals having more after tax income to spend and companies able to borrow at a prime rate of only 4%, growth ensued. But good times and easy money could not last too long for fear that inflation might rear its ugly head. It became evident that it was time to start pushing a bit on the brake pedal to slow things down. As a result, in June of 2004, the Fed began to raise rates and did so in 0.25% increments in each of its last 15 meetings. The Federal Funds rate now stands at 4.75%!

This year, it is likely that short term interest rates will stop rising. This should happen when the Fed sees signs that the economy is slowing. Once the Fed raises rates, it can take as long as 18 months for the effects to begin to show results. So the first hikes in June 2004 may have only started to take a bite out of the economy at the end of last year. By the same token, it is possible that this year's two rate hikes might not impact the economy until the middle of 2007. In order to make sure the Fed does not "over do it" and sink the economy into a recession, it will need to take a breather to see what impact its actions have taken. While we did witness growth slowing in the fourth quarter of last year to an annual rate of 1.7%, most have written off that time period due to the effects of hurricane Katrina. It is yet to be seen if this is permanent.

Meanwhile, the stock market has been quite resilient in spite of higher interest rates. More times than not, stocks perform terribly when the Fed is trying to slow the economy. Instead, stocks have moved up steadily since June of 2004 and have not had a correction exceeding 10%. The first quarter of this year has been rewarding to stock owners as all indexes have turned in positive performances. Taking slightly more risk has proven to be worthwhile as small caps and international equities have outperformed large cap stocks.

**2006 YTD Returns**

| | |
|---|---|
| *DOW* | *4.25%* |
| *S&P 500* | *4.21%* |
| *NASDAQ* | *6.35%* |
| *Russell 2000* | *13.94%* |
| *Mid Cap 400* | *7.63%* |
| *MSCI EAFE* | *8.78%* |
| *Lehman US Agg.* | *-.65%* |
| *Lehman Muni.* | *.25%* |
| *10 Year Treasury Yield* | *4.85%* |

## The Merrill Lynch Rule

In April 2005, the Securities & Exchange Commission (SEC) approved the Merrill Lynch Rule, clearing the way for broker-dealers to offer fee-based accounts without registering as investment advisors.

The rule used to be titled "Certain Broker-Dealers Deemed Not to be Investment Advisors," and has been temporarily in force since 1999. The rule allows brokers to offer fee-based accounts on a nondiscretionary basis, as long as any investment advice provided is "solely incidental" to their order-taking services.

The Financial Planning Association (FPA) stated in a written response to the decision: "We believe that, at an absolute minimum, a consumer warning label is warranted given the confusion in the marketplace over who is a broker agent and who is a fiduciary investment advisor…" and "the approach taken by this rule will be a disservice to the public over

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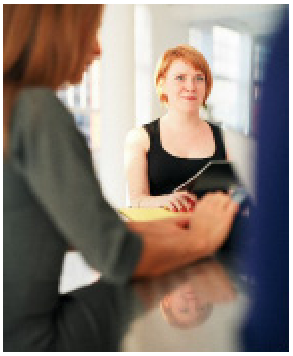
## Women and Retirement - The Importance of Planning



*"Because planning for retirement may be even more crucial for women than for men, if you haven't taken action yet, now is the time to start."*

Women face special obstacles that could prevent them from saving as much for retirement as they may need. Because women's careers are often interrupted to care for children or elderly parents, they may spend less time in the workforce and earn less money than men in the same age group. As a result, their retirement plan balances and Social Security benefits are often lower. Compounding the problem is the fact that women often start saving later, save less, and save more conservatively than men, which decreases their chances of having enough income in retirement (source: The National Center for Women and Retirement Research). Given these hurdles, it's easy to see why retirement planning can be especially vital for women. So if any of the following excuses look familiar, maybe it's time to start taking a closer look at your own retirement plan.

**I have plenty of time**

Because retirement may be many years away, it's easy to put off planning for it. The longer you wait, however, the harder it is to make up the difference. That's because the sooner you start, the more time your investments have to grow. For example, $3,000 invested annually from the age of 20 will yield approximately $700,000 after age 65 (assuming 6% annual growth, reinvestment of all interest, and no taxes). However, if you wait until you're 45 to start investing, you'd have to set aside almost $17,000 a year to accumulate the same amount. To maximize your chances of achieving a financially secure retirement:

- Realistically assess how much you'll need to save. If the figure is substantial, don't be discouraged--what's most important is that you begin saving now.
- Contribute as much as you can to tax advantaged retirement savings vehicles like 401(k)s and IRAs. But remember, even small amounts contributed regularly can add up over time.

**I'm too busy**

Perhaps you're too absorbed balancing a career with raising a family or caring for an elderly relative to give retirement much thought. But by not planning ahead, you risk shortchanging yourself and your family later on. If lack of time is your biggest obstacle to retirement, start with some simple steps:

- Get help. A financial professional can work with you to set out your retirement goals and prepare a retirement plan.
- Take advantage of automatic investing. Making contributions to an IRA is easier if you have them transferred directly from your savings account, and contributing to your 401(k) via payroll deductions will give you one less thing to think about as you tend to your more immediate concerns.

**My husband will have enough retirement income for both of us**

Are you sure? Without planning, you can't really know whether your husband's projected retirement resources will be sufficient when the time comes for you to retire, or after he's gone. Keep in mind that even though you may plan to be married forever, many women end up single at some point in their lives. In fact, according to the National Center for Health Statistics, women live seven years longer, on average, than men. The loss of a spouse can mean a significant decrease in a woman's retirement income. Consider the following ideas:

- Plan together for retirement, making sure that your retirement plan reflects your individual goals and your tolerance for risk.
- Find out what Social Security benefits you'll be entitled to, based on your husband's work record and on your own. What benefits will you receive, should you become single through death or divorce?
- Even if you aren't working outside the home or aren't covered by an employer sponsored retirement plan, continue to save for retirement. For instance, if you're married, you may be able to open and contribute to an IRA in your own name, even though you have no earned income. Because planning for retirement may be even more crucial for women than for men, if you haven't taken action yet, now is the time to start.

## Ask the Expert: What are Structured Investments?

Structured investments are commonly known as "hybrid" investments, providing a variety of risk and return profiles to meet the financial goals of an investor. These investments are an alternative to traditional asset classes providing investors with principal protection, income generation and/or the opportunity for enhanced return. The following are some of the features of structured investments:

**Principal Protection**

Investors in principal protected investments will receive at least 100% of the principal amount of their notes if they hold the notes to maturity, regardless of the performance of the underlying index. In order to achieve this protection, the investor must be willing to forgo the dividend yield or some appreciation potential, and in most cases have a time horizon of 1.5 to 5 years.

**Enhanced Return**

There is currently an investment that offers investors a unique opportunity to profit from the best of look-back performance. After 3.5 years, we look back at the historical returns of the S&P500 Index, the Europe Stock Index and the Nikkei-225 Stock Index and allocate 70% to the top performing index, 20% to the next best performing index, and 10% to the worst performing index. Investors are fully principal-protected and there is no cap to upside participation.

The stock market is up more than 60% from the bottom three years ago and many advisors suspect that equity returns will be in the low-to-high single digits for the next few years, and bond returns may even be lower. As a result, we are seeing investors and advisors reaching for more return by taking more risk. At FSAG, we believe that today it is more prudent to take less risk.

Whether investing in a note that reflects your particular market view or creating a basket of carefully selected notes, structured investments are another way FSAG can help you reach your investment goals.

At FSAG, there is no commission and we receive no additional compensation when purchasing a structured note or any other investment vehicle.

Scot Jurczyk is a Principal and Managing Director of FSAG.

*"Structured notes are an alternative to traditional asset classes providing investors with principal protection, income generation and/or the opportunity for enhanced return."*

## The Merrill Lynch Rule

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the long-term if it only formalizes two different kinds of regulation for the same advisory service."

Supporters of the rule state that it is a simple and straightforward re-pricing of brokerage services, allowing brokers the flexibility to offer a commission-based or fee-based account. Supporters also point to the substantial regulatory oversight from the National Association of Securities Dealers (NASD) that ensures brokers make suitable purchases for clients.

Opponents of the rule state that although brokers may be subject to substantial regulation, they are still not regulated with the same consumer protections as investment advisors. Under the Investment Advisor Act of 1940, advisors have a fiduciary obligation to act solely in a client's best interests or face a fiduciary breach lawsuit in a court of law. However, since brokers are only held to a "suitability standard," opponents of the rule note that brokers aren't required to act solely in the interests of their clients as fiduciaries do.

For example, brokers are not required to obtain "best execution" pricing for client trades and are allowed to sell a similar mutual fund that has higher expenses, but provides the broker with additional commissions or satisfies sales production requirements. Opponents note that under NASD regulation requirements, brokers don't always have to fully disclose some of these potential conflicts of

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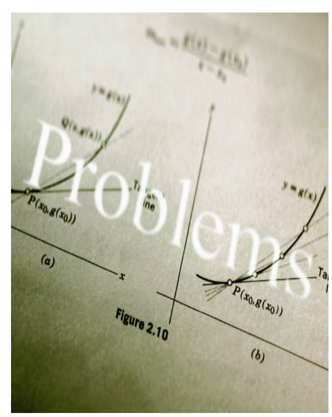

*At Financial Solutions Advisory Group, you'll find a fee-only Registered Investment Advisor (RIA) committed to putting your interests and your needs first, eliminating the commissions and self-serving incentives that get in the way of solid, successful financial planning and investment management.*

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## Stocks in the News: United Parcel Service (UPS)

| Key Statistics: UPS | |
|---|---|
| *Price* | *$79.00* |
| *EPS* | *$3.47* |
| *Estimated EPS* | *$3.93* |
| *P/E Ratio* | *19.8x* |
| *PEG Ratio* | *1.60x* |
| *Dividend* | *$1.32* |
| *Market Cap* | *$88B* |
| *52 Week High* | *$79.97* |
| *52 Week Low* | *$66.10* |
| *Beta* | *0.45* |
| *Expected Annual Growth Rate* | *12.5%* |
| *ROE* | *23.0%* |

Even though United Parcel Service (UPS) was founded in 1901, the company only recently joined the public stock markets in 1999. The Atlanta-based company was entirely employee owned until it decided to relinquish some of its shares to allow employees a more liquid way to trade their shares. Over 380,000 employees work at UPS, operating 88,000 of those brown trucks and flying 570 airplanes. Delivering packages accounts for 90% of revenue. In the United States alone, the company makes close to 15 million deliveries a day.

In a fiercely competitive market, UPS continues to find ways to grow revenues and earnings. On the revenue side of the equation, the company has been able to raise shipping rates 3% each year on a consistent basis. This year the company has already raised rates 4.5% on average with no push back from customers. Unlike a lot of companies, gasoline prices are not much of an issue since UPS is able to tack on a fuel surcharge to its bills at the end of each month. To help earnings, UPS is currently spending $2.4 billion to save $600 million annually. This money is being spent on a new "package flow technology" that will streamline the sorting process and improve routing so drivers will log 100 million fewer miles per year.

International sales should be the primary growth engine for the company going forward. In 2005, UPS shipped 25% more overseas packages than the previous year. Growth will come from not only adding hubs, mostly in Asia, but by making the hubs they run as efficient as they are here in the U.S. The hub in Germany, for example, recently expanded capacity and improved efficiency so they now ship 30 more packages per second.

A lesser known segment of the company, the Supply Chain Solutions Group, is another fast growing unit. Here UPS digs into a customer's business and provides advice on how to move goods more efficiently. Usually, UPS delivers a product from one customer to another. Here, they help clients with their own logistics: UPS may move raw goods to a factory, move product to other assemblers or between facilities, and then deliver finished products to wholesalers, retailers or end users. This helps cement client relationships and keeps them a UPS customer for a long time.

Financially, UPS is in excellent health. Their debt carries one of the few AAA credit ratings left in the market. A superior credit rating allows them to borrow at rates below their competitors. Profit margins have held steady in the mid teens. Return on equity is a generous 23%. Its $1.32 dividend is easily covered by the $4.94 of cash flow generated last year. As long as the world economy continues to plug along, UPS should hit on all cylinders.

## The Merrill Lynch Rule

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interest since from a regulatory structure they are viewed as "order takers" that simply place trades for their clients. On the other hand, registered investment advisors must disclose conflicts, file with state securities commissions and the SEC and act as fiduciaries with a legal obligation to represent their clients' interests above their own.

``There's no question that investor protections are far stronger for clients of registered investment advisors than for clients of brokers," says Mercer Bullard, a former SEC lawyer, assistant law professor at University of Mississippi and president of Fund Democracy, a pro-investor group.

Going forward, enforcement of the rule will hinge on the SEC's future interpretation of the "solely incidental" standard and their evaluation of exactly what, or how much, investment advice a broker can give before the advice is no longer merely incidental and investment advisor registration is required.