

PERSONAL BUSINESS

More rate increases may be on the way

Q: It would seem new Federal Reserve Chairman Ben Bernanke and the Fed are in a quandary. High oil and gas prices, a first-quarter spurt in economic growth and strong retail sales in April all point to budding inflationary pressures and the need to move up interest rates to cool those fears. Yet consumer confidence is down, job growth for April was weak and the figures on prices stripped of energy and food suggest inflation fears are unwarranted. Against this backdrop, what do you expect the Fed and interest rates to do over the course of the year?

A: The Federal Reserve's future policy is a tough prediction. However, the answer must be framed in terms of current economics as outlined. And that multifaceted set of economics can be synthesized down to two conflicting circumstances. First, the economy is basically sound with continued productivity growth, not linear, but pervasive as a secular movement. Second, and in juxtaposition, we are in a deficit spending situation relative to the war in Iraq and domestic demands. The first argues for an ending of interest rate boosts and the second argues for continued inflationary pressure calling for more increases.

I believe we will still have one or two more boosts in rates because of continued high government spending, but there is nothing that would indicate a rise in rates in the aggregate

stock talk

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that would take them to historically abnormal levels. And the economy can handle a normal set of rate parameters through the business cycle without causing a recession.

Q: How do you see the markets behaving the rest of the year, and is there any sector or fund segment you see doing particularly well — or particularly badly? Any specific names?

A: The markets will continue to reflect a continued robust climate for business. Large, midsize and small businesses continue to find and take advantage from new and existing business sectors and opportunities. It is hard to find a business sector that does not present solid opportunities, from the innovative to the mundane. However, there is no evidence of over-heating in the economy or in any particular sectors. The most potentially rewarding are those sectors that innovate. The areas that are most conducive to innovation center on health, communication — in all of its forms, both business-related and entertainment — and those that are productivity enhancing.

Having said that, every investor is well advised to populate their portfolio with all appropriate sectors, both the traditional and the innovative. To not do so invites the type of skewed thinking that caused the dot.com bubble of the late 1990s. There is both safety and opportunity in a diversified portfolio.

Q: If you had \$10,000 to invest, wouldn't need the money for at least 10 years and are 15 years from

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retirement, where would you put it?

A: Given at least a 3-to-5 year time horizon, most investors are well served to create a balanced portfolio using both equity and fixed income investments. The equity section provides growth of capital opportunity and the fixed income helps mitigate risk. There is a reason why that advice is enshrined in the finance textbooks. Every generation seems to have to rediscover that truth all over again, even though it is hiding in plain sight. The exact allocation to fixed income and equity will depend on the investor's objectives, time frame, risk tolerance level and family obligations along the way.

If one has \$10,000 to invest, then mutual funds should be used for the entirety of the portfolio so as to gain maximum, immediate diversification. If the amount is considerably larger, the investor should use a combination of mutual funds and individual securities as they work well together.

In all cases with all size investors, a complete range of asset sectors should be used. In no case should an investor mistakenly believe that he or she can pick only winners. Asset sector diversification helps to lower risk without lessening return potential.

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