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SPECIAL EDITORIAL

The Fragasso Group, Inc.

The Retirement Planning and Wealth Preservation Specialists

A Registered Investment Advisor

…For the Serious Investor

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An Editorial for the 21st Century

What's in Store for Investors?

Robert Fragasso

Where are the markets going? What role will technology and the internet play? Who will be the financial services providers of the future? We are asked questions like these every day as investors want to determine how best to position, protect and multiply their life's savings. What action can *you* take now to better assure your future? Let's explore.

We don't purport to divine the future. No one can. However, we believe some trends seem apparent and understanding them could prove profitable. Because we are talking about our view of the future in an attempt to assist you with the possibilities, we must clearly label this as an editorial. It is conjecture on our part, albeit based on over 27 years of experience directly in this business, framed within 44 years as an investor and overlain on an avid study of and interest in economic history. While it is an opinion based on history, the past is no guarantee of the future. However, what better indicator do we have?

We'll use a question and answer format here, employing a synopsis of many of the questions we hear daily from many of you.

Where are the markets going?

No one knows. However, markets have inevitably followed economic fundamentals. Those appear sound in the United States and in most parts of the developed world. Businesses are profitable, interest rates are historically low, governments are stable and there are no major military conflicts. Most importantly, business is innovative, creating new products, services and ways of delivering better value to customers at cheaper pricing levels. While investment markets will inevitably fluctuate based on short-term happenings, they do follow fundamentals.

What about interest rates?

Most economists expect interest rates to rise some. But, no credible experts are predicting major interest rate increases. The economy has absorbed rate raises during 1999 without disruption. It took an oil embargo in the mid-1970s and run away inflation in the late 1970s and early 1980s to cause double digit interest rates. Prior to that it took a World War and the U.S. Civil War to make interest rates spike to double digits. There does not appear to be any thing of that nature in our foreseeable future. This Federal Reserve has been masterful in handling rates and money supply. The Fed chairman, Alan Greenspan, has been re-appointed for another term.

Why are some companies' stocks so seemingly over-valued, yet still going up? (And, how can I get some of the next ones to skyrocket before they do?!)

Perception and expectation of future earnings and business potential can drive some stocks' prices to higher levels than a company's current business picture would warrant. We avoid stocks such as those. Our stock selections are driven by our analysis of earnings and cash flow. When stocks rise on the hope of future earnings or expected product successes in the future, we don't participate. It is not reasonable that one stock with $200 million of sales and $10 million of *losses* would be capitalized in the marketplace higher than another company's stock that is earning $50 million of profit on $1 billion of sales. But, those types of unreasonable valuations do exist – based solely on a jazzy business name or expectations into the future. We believe controlling a client's risk while striving for reasonable returns, based on true profitability, is a sound course and a much more reliable path to wealth accumulation. We may lose a few clients who are blinded by the illusion of quick and obscene profits, but we can't let that dissuade us from our obligation to protect hard earned capital while seeking historically reasonable – and more consistent – returns.

Does that mean that you will only buy stodgy old companies for me?

Absolutely not! Remember, it's profit and cash flow that drive stock prices. Stodgy and old don't coexist with consistently good profitability. We actively seek out companies that we believe will drive the economy into the future. We want technology stocks and we want the medically related companies that will make the breakthroughs to cure disease and lengthen life. Those are among many areas of research that we are proactively pursuing on your behalf. In addition, we will place solidly profitable companies in your portfolio that do traditional things well. That's especially true when those companies have enacted better, faster, cheaper and more customer-oriented ways of delivering their products and services.

There seem to be many types of investment firms. How can I make sense of them? Which will be the survivors?

A question near and dear to our hearts here at the Fragasso Group! We are editorializing here, but we do believe we have a handle on that question and have spent lots of time with it. We have complete latitude in fashioning our firm and in associating with whatever providers of services and products that may be available and in the best interests of our clients, and our own future profitability. We have no proprietary products. With that as a philosophical platform, let's consider the answer.

Prior to 1975, all investment firms enjoyed protected pricing, just as airlines did before deregulation. On May 1, 1975 (still referred to as "May Day! May Day!") brokerage commissions became unfixed and pricing competition was fostered on our industry. That was great for the client and bad for an industry whose only reason for existing was a monopoly on the execution of securities transactions. If you want more of a history on this, call our receptionist, Diana Schroeder at 1(800) 900-4492 for a copy of a *Pittsburgh Business Times* article we did on this subject.

As a result of deregulation and the evolution it caused, our industry is now stratified, we believe, into three types of firms. The first is the traditional brokerage firm whose sole reason for existing is the execution of transactions on a one-by-one basis for a commission. In doing so, that type of firm is willing to give a research report and an opinion on the company whose securities are being considered. The source of communications for the client is a commission salesperson who will not be paid unless a security is bought or sold. Also, this type of firm typically has a very heavy investment in the manufacturing of their own investment products – mutual funds, insurance products and inventories of bonds. An analogy may be drawn here to the phenomenon of General Motors Corp., which is the last auto maker still offering two keys with their vehicles, one for the ignition and one for the trunk. Ever wonder why? Well, they own the key manufacturing plant. And, it's unionized. GM's cars made outside the U.S. offer one key that does both functions. Firms that invest heavily in their own products must continue to sell those products, often to the exclusion of other, more competitive products.

Now it gets more interesting. The second type of investment firm is an outgrowth of the first. It is a one-stop-shopping firm that purports to offer securities, banking, insurance and even legal and accounting. One such national firm has been on a buying binge of accounting firms and expects to use that as a lever to market its investment products and services! Another merged an investment firm with a bank and an insurance company and hopes to cross sell to each firm's customers. This is not new. A relaxing of the Depression-era laws that prevented overt association of banks and brokerage firms is recent. But the "super market" approach to financial services dates back to the early 1980s attempts by American Express to compress charge cards, banking, brokerage and insurance into one relationship. The famous "socks and stocks" pairing of Dean Witter and Sears Roebuck was another example. We are not predicting disaster for these firms. Our message here is simple and direct. These mergers only make sense for the behemoths thusly created if they can cross sell proprietary products that each entity has manufactured to their customers. That's their benefit – but, not necessarily the customers' benefit!

Now, the third, and last, category of investment firm is the model we have accepted for our firm. And, that is one built on personal financial planning as a delivery platform with no proprietary products. Instead, all products from all appropriate providers are utilized, preferably on a fee basis, so that the inherent bias of commissions for transactions is eliminated. Sometimes the best thing an advisor can do for a client is to make them do nothing with their portfolio. A commission salesperson is not paid for that. A fee-based investment manager is. We deliver a thorough financial analysis and then select from among all of the appropriate stocks, bonds, mutual funds and insurance companies to populate our clients' portfolios. Also, as we maintain no securities inventories, our stock and bond selections are made from the open market rather than from the company's inventory or underwritten initial public offerings. While we believe this distinction among the various types of investment firms should be clear, it isn't always so in the minds of the public. Otherwise well informed people do not distinguish between a mutual fund, for example, that manages stocks and bonds within a narrow objective and usually within one asset sector vs. a financial planning firm. The latter creates the client's unique asset allocation model, selects the most desirable funds for each asset sector and then monitors those funds (and all other securities in the portfolio) for continued applicability to the client's objectives. When has a mutual fund ever called you to say that they are no longer appropriate to your objectives? Beyond that, a financial planning firm evaluates and advises regarding all aspects of one's finances to include tax-related securities management, cash flow management , debt structure, education funding, estate tax reduction in concert with your attorney and CPA and plotting eventual retirement security. In our opinion, securities transactions, and even investment management, will be driven even more so in the future by the need to accomplish total and integrated financial planning geared to individuals' objectives. That imaginary shelf of financial products and services exists out there with all possible choices available at the touch of a button or click of a mouse. But, what mix of choices to select? It's different for each person and family based on unique objectives. Only the most novice investor, blinded by an especially good recent market, feels they can do it all themselves. There is a reason why there is a division of labor in a sophisticated economy. People don't perform their own surgical operations, shouldn't write their own wills or replace their own auto transmissions. And, they certainly cannot duplicate decades of experience, a full time team of professionals, and tens of thousands of dollars of research and monitoring tools in trying to do it themselves.

Yes, we believe the future of the financial industry belongs to the firms who can guide their clients through the maze to successful outcomes, with a minimum of risk. It does not belong to the cheapest do-it-yourself trading price. And, it does not belong to the old-time firms who still exist only to effect a transaction. Transaction execution has become a commodity. People should not pay more than a nominal clearing charge for accomplishing that. Additionally, the mutual funds and insurance companies will continue to provide the good quality products that the planners will use with their clients in the apportions that they evaluated to be correct for each individual client. It's no coincidence that our logo is, "We Guide…You Decide." The emphasis is on "guide."

Folks will always, we believe, wish to pay for quality guidance. They will not and should not continue to pay heavily for the routine providing of administrative transactions. Another analogy presents itself. In climbing Mt. Everest, one can buy a map to the top and should not pay very much for it. However, the hiring of an experienced guide who will personally take you to the top is well worth the additional price. And, that will prove especially true when the inevitable snow storms arise while you are climbing that mountain.

This best model for an investment firm is not dependent on the investment firm's size. Rather, a large firm could be a detriment. Instead, a non-biased investment management and financial planning firm can draw from some of the most sophisticated and responsive providers in the industry. That firm is free to choose what it feels is best for its clients without needing to push proprietary products. It can joint venture with some of the best in the country and the world while protecting its ability to find even better products, services and modes of delivery as they become available. That's why we utilize Linsco/Private Ledger, the largest independent broker/dealer in the U.S. for our investment transactions. LPL encompasses over 1,600 independently owned offices and firms such as ours nationally. The resources are national, but the ownership and accountability to you is local with The Fragasso Group, Inc. We also partner with Mortgage.com for access to over 180 lenders nationally for residential mortgages and with Centerlink as a search engine for us among most of the well-rated life insurance companies in North America. We have partnered with Hilb Rogal and Hamilton for property and casualty insurance. HRH has no proprietary products and has access to most of the country's available property and casualty insurance companies rather than the more typical limitation to only one or two companies.

In our opinion, our industry will thrive on adding value by providing information, education, management and advice and guidance. We will continue to bring to our clients all of the resources that we can locate and deem appropriate in our continue efforts to protect and grow their assets. Manufacturing has learned that it cannot become moribund in rigid procedures and that it must partner with its suppliers for more flexible response to modern needs. So too the financial services industry must position itself. We believe we at the Fragasso Group have done just that.

Well, how about the part about legal and accounting? Why not make that a part of your value-added service?

Following is a letter received from one of our long time clients and reprinted with her permission. After that letter is our reply that answers the above question.

Susan Novak Hochreiter
State College, PA 16803

December 29, 1999

Bob Fragasso
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Dear Bob:

Happy New Year!! I just received your newsletter and felt it was a good time to put "in writing" a topic we have briefly discussed before: TOTAL FINANCIAL PLANNING FOR YOUR CLIENTS.

Your newsletter mentioned the importance of good representation for tax and estate planning matters. I agree; however, I wish that your office would provide these services, along with your financial planning advice.

As our financial assets change and we age, our tax and estate planning needs should be updated on a regular basis. I would appreciate the following services be added to your group: tax advice and income tax preparation, estate planning (trusts, wills, etc.), and insurance needs. You have touched upon some of these issues with long-term insurance and, recently, mortgage services.

Ideally, I would like to see your firm be responsible for looking at the "whole picture" for your clients. This would involve timely reviews which not only include the portfolio matters, but reviews of tax, insurance, and estate planning issues. And I would think that the use of a common data base for all of these items would be most beneficial for you and your clients. For example: I, as a client, would like to be apprised of tax laws which might affect my present and future estates. I would like advice as to what steps can be taken to minimize income and estate taxes. This advice, under one data base, would be something I would think most clients would be willing to pay for. Am I being unreasonable for not wanting to make separate appointments with a tax lawyer, an accountant, an insurance agent, an estate lawyer, and a financial planner?

I'd appreciate your thoughts on these matters.

Very truly yours,

Susan N. Hochreiter

Dear Susan:

And, Happy New Year to you and Larry also. Thank you for your most welcome letter and the questions raised. I say "welcome" because many of our best ideas have come from our clients. I'll try to address the questions you brought to us.

First, as you know, we do personal and corporate financial planning for our clients. And, we handle their investment management. Some attendant areas, such as long-term care and property and casualty insurance, were added as we continued our evolution away from our original national brokerage firm roots. Adding the very products and services you describe, together with losing proprietary product bias, was the major propellant in our move to independence.

We attempt to cover all of the estate and insurance considerations at our annual review meeting with clients. This contrasts to the quarterly reviews where our financial consultants work on the re-balancing of asset sectors back to the client's original asset allocation model. It is important to note that we are re-fashioning our review templates for the quarterly and annual review meetings to accomplish several important goals. The estate and insurance valuations and evaluations are a major part of that. And, lots more! You will see the benefits of that formalization at your next review meeting with your FGI financial consultant, I predict.

But, the heart of your question is a request to add legal and accounting services to our offerings to you. We believe that our role should be to make sure that you have your estate and insurance and tax work coordinated to your best benefit. But, I don't believe that we should provide you with an attorney and accountant who is on staff with us. I realize that you feel this would be of benefit and would eliminate extra meetings. And, I should tell you that other financial planning firms, local and national, are adding such expertise. But, we don't believe that's in your best interests. Here's why.

First, we could not possibly duplicate the range of expertise that should be available to you and our other clients by simply adding an attorney and a CPA to staff. While that would provide our firm with additional revenues, we feel you would be shortchanged. Consider that no one attorney or accountant, no matter how gifted or well-educated, could possess the complete range of knowledge needed. Sometimes an expert in family partnerships would be needed. Another time, it might be an expert in business buy/sell arrangements. Beyond that, an elder law expert could be necessary. Some one who has practiced extensively before the IRS may be just who is needed for another client. How about needing those skilled in business valuations, real estate or divorce proceedings? We believe that purporting a full range of necessary skills in one attorney or accountant would be detrimental to our clients. Analogously, we ask, would you have your GP physician do heart surgery? No, but, your GP MD should have an efficient system for screening in place for identifying your problems and then getting you to a qualified heart surgeon in a hurry. Two appointments necessary, but well worth it! As you correctly request of us, we should have the screening and referral systems in place to identify your estate and tax planning needs then refer you to competent professionals in the community who specialize in the areas indicated.

What is our solution? It's the same as we've always recommended. We will not disrupt the relationship that our clients have with their own legal and tax advisors. Rather, we will continue to get them back to those advisors with the items that we uncover in our financial planning work for proper attention. When a specialty is necessary, we will expect that the current attorney or accountant will bring in the appropriate additional skills from within or without his or her firm. When a client does not have an advisor, we have been proactive in getting them to one who is positioned by specialty to meet the job's requirements. With our new, tighter procedures, I believe you will see that effort intensified.

So Susan, you will need a separate appointment for your legal and tax accounting advice. And, we suggest for the above reasons, that you should want that. We will make it as easy as possible for that to occur and to be there with you and for you through that entire process.

Thanks once again for your good comments, which provoke us to re-examine our beliefs and procedures. We welcome your continued input.

Best personal regards,

Robert Fragasso