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SURVIVAL GUIDE

For A Weak Economy

INSIDE

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SUPPLEMENT TO THE JANUARY 2002 INVESTMENT ADVISOR MAGAZINE

SURVIVAL GUIDE FOR A WEAK ECONOMY

Opportunity in an Uncertain World

It's not the best time to be an investment advisor. Or is it?

BY ANGELA HOLLIS FINCH

Let's face it. It's not the easiest time to be a financial advisor. The markets are up and down, but mostly down. And 401(k) statements are, well, bleak at best. Clients can be emotional and difficult, but there are ways to get through times like these. Your clients—and potential clients—need you. It may not be the easiest time to be an advisor, but it may well be the best and most gratifying. Here are some things to consider to help your clients and even get ahead of the pack in the process.

Time Heals All Wounds?

While September 11 was certainly not the beginning of this bear market (we now know that the official recession began in March), there is no question that the events of September 11 undermined consumer confidence and no discussion of the current economy is complete without mentioning it. It seems that we live in a different world than we did just a few months ago and, as a result, people have a new understanding of the importance of having their financial "ducks in a row."

Experts say that it will take time to emotionally adjust to the threat of terrorism, but countries such as Israel and Great Britain have had strong economies despite terror threats. According to therapist and *Investment Advisor* columnist Olivia Mellan, advisors need to help clients move past the primitive survival mode to rediscover one's rational thriving self. How exactly do you do this? Mellan says, "listen patiently to your client, help him explore what he needs to do to reestablish balance in his life." Mellan says that the first step may be to encourage him to volunteer or donate money, but once a sense of normalcy has returned, use that time to reinforce the planning process by reviewing long-term goals and making sure they haven't changed. Use this opportunity to review current financial health, but also to make sure your client is on track to reach future goals. For example, does your client have ample insurance coverage and a current will? How about an estate plan or business succession plan? Most of your current clients have probably already faced the "unthinkable," but this is the opportunity to win new clients who have not.

Getting Back to Your Roots

You recommend many products, but your clients need your advice now more than ever. As a financial planner, your advice is your main asset. If you've been preaching asset allocation but some clients preferred chasing growth stocks, you probably don't have to preach any longer. It's time to review goals and

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move forward with a sensible financial plan for the future.

And that's not only for current clients. There are many more potential clients who need your advice, too. The market downturn has left many do-it-yourself investors wondering where to turn next. Now is a great opportunity to gain new clients, but you have to find them first.

The Marketing Machine

Being the best-kept secret in your area is not a good business plan. A good marketing program is a lifeline. Here are some simple, cost effective suggestions that are quick and easy:

1. Prepare a client brochure. Give prospective clients something tangible that tells them more about the services you offer and the type of relationships you want to develop. Phrase in some lines that gets the client thinking about life goals. This piece should project the image of the client you want to attract. These are great for existing clients to pass along to friends, or to give a prospective client at your initial meeting.

2. If you don't have one already, develop a questionnaire—but not necessarily a financial one. You have to understand your clients' needs before you can fulfill them. For example, maybe their primary focus isn't planning for their retirement—they're interested in opening a restaurant.

3. Advertise and encourage referrals. Encourage your best clients to spread the word about you. Run ads in local papers, produce fliers, hold seminars. Try to get on local radio talk shows. Now is the time to cast a wide net. Once you get more potential clients it will be easier to keep the cream of the crop.

Keeping Them Happy

In difficult times, showing your clients that you care about them—and their investments—can have a tremendous positive impact on your practice.

1. Be visible to your clients. In response to the September 11 attacks and before, most advisors sent out a letter acknowledging client concern, and stating confidence in the U.S. economy. If you feel current conditions warrant communication, by all means, send a letter to your clients. Maybe now is a good time to send out tips on mortgage refinancing to existing and prospective clients. Use the current challenge as an opportunity to express that a sound financial plan is a must, and that you would welcome a chance to review goals.

2. Get on the phone. Particularly for your top clients, a little hand holding will offer them reassurance that you are watching out for them. If you are inundated with phone calls, try to send more letters and e-mails.

Keeping the Faith

If all else fails, ask your clients—and yourself—is there any greater economy in the world than the U.S. economy? Consider the following: According to the Web site *Fool.com*, calamity and disaster in America have customarily been followed by opportunity and reward. In the six months after the following crises, the stock market rose by double-digits:

Cuban Missile Crisis	+24
Assassination of John F. Kennedy	+15%
Nixon's Resignation	+13%
1987 Market Crash	+15%
Declaration of the Gulf War	+19%
Oklahoma City Bombing	+33%

While the current market has ventured into bull territory (at press time), history has shown that every recession has had a recovery. Using history as your guide, the most important thing you can do for your clients now is to position them for the return of the bulls.

Handling Unhappy Clients

Whether a client is upset about the market or a perceived service issue, handling the call well can make the difference between losing the client or strengthening the relationship. While most advisors pride themselves on good service skills, the long bull market may have caused those skills to get rusty. The steps below may help for the next time you get an upset client.

1. Let clients finish their initial statement without interruption. Speaking too early can make a bad situation worse.

2. Make sure you understand the issue. Rephrase the problem back to the caller and get clarification if needed.

3. Empathize. Tell them you understand why they are frustrated and that you're there to help. Your tone of voice and the speed of your speech can be used to calm clients. They need to know that you are in control of the situation. A confident, professional manner will go a long way toward reassuring them.

4. Ask clients how they would like you to resolve the situation. In most cases, their requests will not be unreasonable. At the very least it lets you know where to go next. Performance complaints can seem difficult to handle because there is no obvious "fix." Usually, clients just want to vent their frustration and be reassured that their long-term plans are still on track. A meeting to review the status of their goals can diffuse the situation.

5. If you cannot do specifically what they ask, focus on what you can do. It is important that a client not walk away empty handed.

6. Outline the solution and tell clients when they will be hearing from you. No matter what happens, never let that deadline slip. A call updating them on your progress or even just telling them that you're still working on it is much better than silence.

7. There is a limit to what you should take. Let clients know if they have crossed the line. While a stressful situation can bring out the worst in people at times, a client that repeatedly abuses you or your staff should be told that his or her behavior is unacceptable. If the behavior continues, consider terminating the relationship.

8. When the problem is solved, call the client to wrap it up. Let clients know what actions you took and anything you did to prevent a recurrence of the problem. Finally, make sure your solutions still meet their needs.

Source: John Hancock Funds 1-800-225-6020

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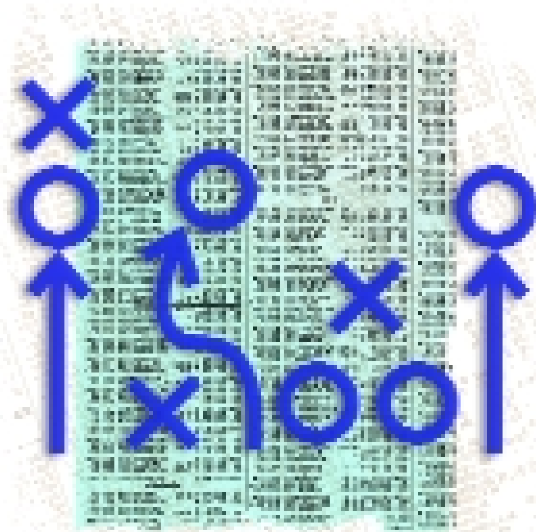
SURVIVAL GUIDE FOR A WEAK ECONOMY

Investing Strategies for Tough Times

The road to financial success will require subtle, well-measured shifts to adjust to changing times.



BY MARLA BRILL

Stay the course. Look at the long-term.

That's the mantra that many financial advisors have been repeating to their jittery clients for well over a year now. But with the economic and investment environment so drastically darker than it was when President Bush took office—and even more precarious after the September 11 terrorist attacks—even the most dedicated long-term investor may have trouble having faith in such advice.

The fact is, no matter how much investment advisors believe that sound investing is a matter of patience, prudence, and keeping an eye on long-term goals, there is no denying that things have changed. The word recession, whispered as a distant possibility just months ago, is accepted as today's reality. Paltry interest rates on certificates of deposit and money market funds, and skidding stock market returns, have piqued investor interest in bonds, just as investor interest in stocks seems to have hit rock bottom.

In September alone, investors pulled some $32 billion out of stock funds, the largest one-month outflow ever. This culminated three straight months of equity fund outflows, the longest such period since the 1990 Gulf War. And while the market has rebounded since October, a steadier course is still far from certain. Reflecting those concerns, defensive stock market sectors and strategies that couldn't draw interest two years ago now command center stage as growth stocks continue to struggle for survival.

For investors, getting ahead in tough times will probably not mean sticking to a strategy mapped out years ago when the investment climate was radically different, while ignoring immediate turbulence. Nor will it require tossing aside a long-term outlook to concentrate on short-term opportunities. Most likely, the road to success will be marked by subtle, well-measured shifts to adjust to changing times.

Bulking Up on Bonds

Just what those shifts should be, however depends largely on who you ask. With the combination of puny rates on money market securities and a plunging stock market, the relative safety of bonds has taken on added appeal, and some investors are questioning whether the added risks of equities justify their risk premium over bonds.

Even after the recent bear market, stocks remain expensive by some measures, thanks to nearly two decades of unprecedented market appreciation. According to Standard & Poor's, stocks are still trading at one and one-half times their historical price-to-earnings ratios—an indication that there is plenty of room for downward momentum.

Another argument for tough times ahead for the stock market comes from

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those well-worn Ibbotson Associates statistics, which indicate that stocks have had an average annual return of a 10.6% since 1926, while bonds have returned 5.3% a year. With stocks appreciating at an average annual rate of 21% a year between 1995 and 2000, it's not unthinkable that the next several years could bring them closer to their historic average.

Given those statistics and a weak economic environment, many investors are giving bonds more room in their portfolios these days.

"We're seeing a lot of people moving out of money market funds into short-term bond funds," says Leonard Aplet, senior vice-president and head of fixed-income research at Columbia Funds in Portland, Oregon. "With money market rates down to 2.5% and our short-term bond fund rate at 4.7%, that's not surprising." Coupled with price appreciation from falling interest rates, the Columbia Short-Term Bond Fund was up 8.7% year-to-date as of early November.

Usually, long-term bonds see the greatest price appreciation in a falling interest rate environment, but in the last year, short-term funds did almost as well. With the Federal Reserve's series of interest rate cuts, rates on shorter-term bonds fell dramatically, raising the prices of those bonds, while long-term rates inched down just a bit. As of mid-October, Morningstar reported that the average short-term bond fund was up 10.2% for the year, about 1% less than long-term bond funds.

So where is the sweet spot in the bond market these days? Municipal bonds are one good bet for taxable accounts, says Aplet, because their yields are fairly close to those of Treasury securities. "Right now, a two-year municipal bond offers about 80% of the yield of a two-year Treasury security. At the longer end of the yield curve, the yield spread is even narrower."

For taxable accounts, Aplet says, high-grade corporate bonds are "cheaper than normal and, over the long run, perform better than Treasuries." Right now, an A-rated ten-year corporate bond has a one-and one-half percent yield advantage over a Treasury issue with a similar maturity. "That's a hefty incremental return for a bond that is well within the investment grade category," he says.

With the "flight to quality" in full swing in the bond market, especially since September 11, investors have driven prices for Treasuries and top-grade corporate issues to unprecedented highs. At the same time, lower-grade fixed-income securities have underperformed their higher-quality counterparts, widening the yield spread between high-quality bonds and "junk." Historically, junk bonds have sported yields between 2.5% and 10% more than Treasury issues of similar maturity. Today, with junk bond yields upwards of 13%, the spread is tickling the higher end of that range.

But that cheapness doesn't necessarily make junk bonds a good buy now, argues well-known bond guru William Gross, head of the PIMCO Funds. "Victory generally belongs to the risk takers, but a risk taker must pick his spots and his price," he notes in a recent market commentary. "Should a risk averse investor grab for Baa and junk bond yields in an environment where corporate profits are at risk? Hardly." Instead, says Gross, investors should focus on high-quality mortgage pass-through securities, such as Ginnie Maes, as well as investment-grade municipals.

With puny money market rates and a plunging stock market, bonds have added appeal and some investors are questioning whether the added risks of equities justify their risk premium over bonds.

Stocks: Playing Defense, Picking Up Bargains

Despite the increasing appeal of bonds, few would argue that it's time to abandon stocks altogether. And while some market watchers use statistics to point to the likelihood of a prolonged market downturn, others use equally convincing figures to suggest better times ahead. Zweig Consulting, one of those in the latter camp, looked at the performance of various asset classes between 1926 and September 2001 to find out how often stocks outperform T-bills. The firm found that over a 12-month period stocks outperformed Treasury bills 68.7% of the time; over a five-year period, stocks pulled ahead over 80% of the time.

Among the more resilient sectors lately have been real estate investment trusts, or REITs. At the end of October, the NAREIT Composite Index was up 15.6% for the year.

The question is whether REITs can keep up the pace in 2002. In the process of becoming the new darlings of the stock market, they have gotten more expensive by many measures. In mid-1999, they traded at an average of 15% below their asset values. Today, their discounts are in the single-digits.

And some analysts have become more concerned about slowing growth in funds from operations (FFO), a standard industry measure that translates roughly into earnings. In a recent report, Merrill Lynch analysts predicted that 2001 would see the slowest growth in FFO since the early 1990s.

Robert Steers, chairman of Cohen & Steers Capital Management, agrees that while FFO growth is indeed weak compared to the last few years, it isn't that bad compared to

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earnings growth for the rest of the market. "For the most part, REITs will be able to report year over year gains in 2002 in the 6.5% to 7% range," he says. "Relative to other sectors, that looks terrific." With the exception of lodging REITs, which have taken an enormous hit since the September 11 attacks and are still struggling in a weak economy, Steers views the dividends of most REITs as secure because payout ratios remain low.

While smaller health care REITs dominated the market for most of 2001, Steers says that several trends, including consolidation, point to a shift in leadership to the office sector. Many larger companies are consolidating, creating industry giants that have the potential to dominate the real estate business. And of course, the destruction of the World Trade Center has created a pressing need for office space. One beneficiary of that need, says Steers, will be Vornado Realty Trust, the largest office landlord in the New York and Washington, D.C. area, and the largest holding of the Cohen & Steers Realty Shares mutual fund.

Another classic bear market play, stocks of gold and precious metals mining companies, have also done well recently. Yet investors remain spooked by the volatile nature of these stocks, as well as the run of bad performance they've had for most of the past twenty years. Over the last three-, five-, ten-, and 15-year periods, most precious metals funds have lost money.

Jean-Marie Eveillard, co-manager of the First Eagle SoGen Gold Fund, says that despite his fund's year-to-date return of 32% through early November, investors aren't pouring in. Even after the recent upsurge, which has made the fund the best performer in its sector over the last year, the fund has just $13 million in assets.

"People look at gold mining stocks as an insurance policy against a bear market, and for most of the last twenty years—almost a generation—no one has seen the benefit of having such a policy," he says. "They can't see the need for having an umbrella when it never rains."

But recent events may convince at least some investors that gold funds are worth a look. "Over the last 18 months the speculative stock market bubble has burst, the American economy has weakened, and the terrorist attacks have made investors more cautious," he says. "People are finally coming to realize that bad things can happen to the economy and the stock market. I offer no insight about what the price of gold might be a year from now. But I know that putting 2% to 4% of assets into a gold fund is a fairly cheap insurance policy."

Other money managers are finding what they consider attractive opportunities amidst the rubble of battered stocks of solid companies. "This is the kind of market where lowering an analyst's recommendation from a 'strong buy' to a 'buy' can send a stock down 20%," says John Buckingham, chief portfolio manager for Al Frank Asset Management in Laguna Beach, California. "The time to buy is when the market is having a lot of hiccups."

Lately, Buckingham has been buying some of the stocks that were hit hardest by the September terrorist attacks, including aircraft manufacturer Boeing. While the company's commercial aircraft manufacturing division has been severely impacted by the attacks, its large military division should help pick up some of the slack, he says. The same story holds true for airplane parts manufacturer Ducommun, which has both commercial and military divisions.

In the process of becoming the new darlings of the stock market, REITs have gotten more expensive by many measures.

William Nygren, manager of the Oakmark Fund, has been busy loading up stocks that were once too expensive for his value-oriented portfolio, but which have come down to pricing levels he considers attractive. Recent purchases in this "fallen angel" group include Gap, which has several well-known brands in casual apparel retailing, including Gap, Banana Republic, and Old Navy. New leadership should help make the company's clothing more appealing to a broader base of consumers, he says, and with the market downturn, the stock now sells at just ten times estimated 2003 earnings.

Another recent buy, Phillips Petroleum, now trades at less than eleven times next year's estimated earnings. Despite being a large player in the oil industry, Phillips is considered a mid-sized company. Should the industry continue to consolidate, says Nygren, it would make an attractive acquisition.

Even as a cautious mood continues to dominate the market, some investors are looking beyond traditional defensive sectors and value stocks to pockets of opportunity in companies that stand to benefit from the new security and health concerns prompted by the terrorist attacks. One such company, Acambis, produces a smallpox vaccine that could see a surge in demand as governments seek to protect their populations against the deadly disease. According to a report by Ken Trbovich, an analyst at C.E. Unterberg, Towbin, "Acambis indicated that it already had been contacted separately by no fewer than five countries regarding its ability to supply the smallpox vaccine being developed under the U.S. government contract, which gives Acambis exclusive commercial rights to the vaccine." Should anticipated demand materialize, he says, the company could begin generating revenues of $20 million to $34 million a month in 2002.

Marla Brill is a financial journalist based in Princeton, Massachusetts and is the author of Windfall: Managing Unexpected Money So It Doesn't Manage You*, recently published by Alpha Books.*

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W. P. CAREY

A Different Way To Invest in Real Estate

W. P. Carey captures the high yields and appreciation potential of sale-leaseback transactions for investors.

By now, financial advisors know that many of their clients are no longer satisfied with investments that simply mirror volatile stock market patterns. They are looking for alternatives that will provide a combination of safety, high yields, and potential for appreciation in an asset class that enhances portfolio diversification.

W. P. Carey & Co. LLC (NYSE: WPC) answers that need with investments that capture the advantages of a financing technique known as a sale-leaseback. In a typical sale-leaseback transaction, W. P. Carey acquires a property and leases it back to creditworthy tenants on a triple-net basis. This means the tenant is responsible for all insurance, maintenance, and taxes.

These sale-leaseback properties are then grouped as a portfolio and offered to investors either as a real estate investment trust (REIT) or a publicly traded limited liability company (LLC). Investors benefit from the cash flow the leases produce, as well as any appreciation from the sale of portfolio properties.

Orchestrating successful sale-leaseback transactions requires a thorough knowledge of the real estate and investment markets, as well as the ability to evaluate tenant creditworthiness. Founded in 1973 by Wm. Polk Carey, W. P. Carey has cultivated a reputation as the industry's leading provider of corporate real estate financing solutions. As the world's largest publicly traded limited liability company, the firm owns and/or manages more than 400 commercial and industrial properties throughout the United States and Europe.

Though much has changed since the firm opened its doors 28 years ago, its founder sees some parallels to that time in today's marketplace. "The year we founded the firm, the stock market lost 45% of its value," recalls Carey. "People were looking for investment alternatives that ran counter to the stock market, much as they are today." Reflecting the public's strong appetite for alternative investments, W. P. Carey recently launched Corporate Property Associates 15 Incorporated (CPA®:15), one of five private real estate investment trusts, in November 2001.

(Top L to R) Anne R. Coolidge, President of CPA®:15; Gordon F. DuGan, President of W. P. Carey & Co. LLC; (Bottom) John J. Park, Chief Financial Officer of W. P. Carey & Co. LLC and CPA®:15

Why Invest in Sale-Leaseback Transactions?

For companies, a sale-leaseback provides a way to finance an expanding business, fund acquisitions, or construct new facilities. In addition, a sale-leaselack allows companies to unlock the value of their corporate facilities, factories, warehouses, or retail stores, and eliminate illiquid and depreciated assets from their balance sheets. W. P. Carey also uses other creative financing strategies, such as build-to-suit and stock-for-property swaps, to achieve these goals.

Often, companies engaging in sale-leaseback deals are financially strong, creditworthy tenants who are simply looking for a way to tap the full value of their real estate. Portfolio properties managed by W. P. Carey & Co. LLC include many familiar names such as Wal-Mart, Federal Express, and Advanced Micro Devices.

Those investing in a portfolio of properties engaging in sale-leaseback transactions can reap a number of highly attractive benefits, including:

Competitive Total Returns. Through its ability to identify solid corporate credits and untapped real estate values, W. P. Carey has successfully provided high risk-adjusted returns to investors for many years. While past performance is no guarantee of future results, as of September 30, 2001, the publicly-traded W. P. Carey & Co. LLC had a yield of around 8%.

Investors also benefit from gains in the value of leased properties when they are eventually sold. While past performance is no guarantee of future results, distribution rates of the first nine CPA® funds reached an average of 11% before they were merged into a publicly traded company.

Attention to Preservation of Capital. W. P. Carey seeks to mitigate risk by diversifying its portfolio holdings by industry, region, and by property type. "By mixing all three layers of protection, portfolios can be created that are less susceptible to regional or industry risk," says John Park, chief financial officer.

Another layer of protection comes from the analysis conducted by members of an investment committee who each have decades of experience evaluating corporate creditworthiness. With very few exceptions, the firm's carefully underwritten sale-leaseback transactions have generally withstood the rigors of changing financial and economic times.

A Hedge Against Inflation. Each lease is the general obligation of the corporate tenant, and is typically tied to some type of inflationary factor, such as the consumer price index. This provides a base for increasing distributions, growth potential, and equity buildup. Over the years, W. P. Carey's long-term focus has provided investors with sustainable shareholder value and total returns far exceeding the net lease peer group and real estate market indices.

An Alternative to REIT Mutual Funds. In order to incorporate real estate in client portfolios, many financial advisors utilize mutual funds that invest in REITs. The problem with this approach is that many mutual funds specialize in equity REITs, which are highly susceptible to value fluctuations in the real estate market. The strong cash flows of sale-leaseback transactions, as well as a highly diversified portfolio of properties, help cushion against such fluctuations. Specifically, W. P. Carey's public and private real estate investments are cushioned from such fluctuation through the strong cash flows of sale-leaseback transactions, as well as a highly diversified portfolio of properties. Specifically, CPA®:15 and WPC are designed to produce income and long-term rising capital gains, whereas mutual funds produce taxable income and short-term capital gains distribution.

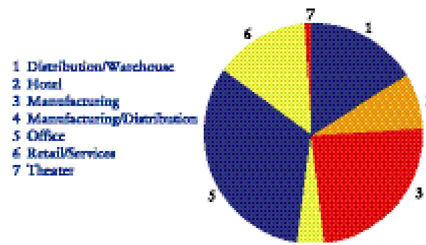
Two Ways To Invest

Both W. P. Carey & Co. LLC, the publicly-traded stock, and CPA®:15, the REIT, offer investors an opportunity to reap the unique benefits of sale-leaseback transactions. However, there are some important differences between the two.

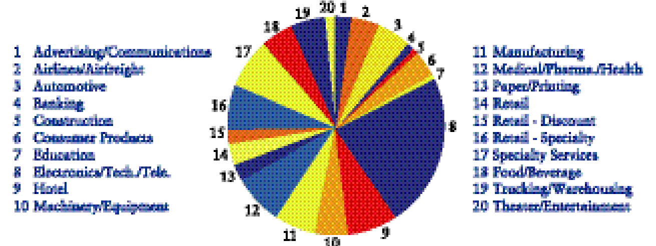
- As an untraded REIT, CPA®:15 is designed to provide investors with rising level of income and a hedge against inflation, and is particularly suitable for tax-deferred accounts. As a REIT, it is not subject to unrelated business tax income (UBTI), and may fit well in the pension and profit sharing marketplace. It is also highly suitable for retirement account investors seeking quarterly cash dividends, growth, diversification, and a hedge against inflation. There is a secondary market which investors should plan to hold these shares for the long term. Minimum investment is 250 shares ($2,500) or 200 shares ($2,000) for IRAs or Keoghs.
- As a publicly traded stock, W. P. Carey & Co. LLC carries with it both the risks and rewards of equities. Like a public REIT, its value will fluctuate with changing stock market conditions. In contrast to CPA®:15, it also derives a portion of its income from management fees. W. P. Carey & Co. LLC is particularly suitable for investors with a time horizon of less than five years, or for taxable investors who wish to take advantage of the tax benefits available under the firm's organization as a limited liability company.

Regardless of whether financial advisors choose CPA®:15 or W. P. Carey & Co. LLC, they have the assurance of knowing that their investment is backed by one of the pioneers in the field of sale-leaseback transactions.

Holdings by Property Type



Holdings by Industry



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