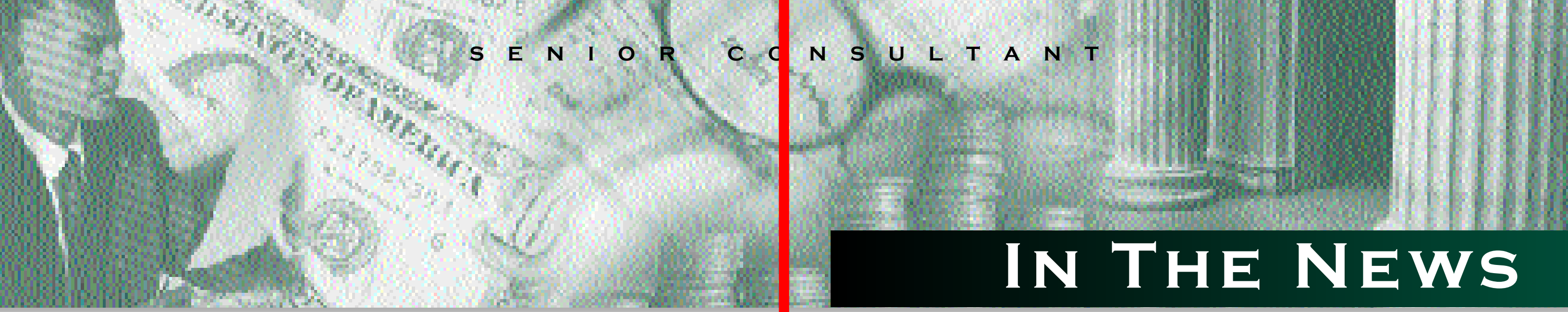

In The News

Citigroup's John Reed Retires, Sandy Weill To Unify Two Disparate Cultures Into A New Business Paradigm

After 35 years at Citigroup and its predecessor Citicorp, chairman and co-CEO John Reed has informed the board of directors that he will retire from his positions, effective at the company's annual shareholders meeting on April 18, 2000. Sandy Weill, the legendary Wall Street veteran, will assume the chairmanship of Citigroup and will become sole chief executive officer of a firm he largely created with the merger of Travelers (and its affiliate Salomon Smith Barney) with Citicorp. Mr. Weill built his reputation and career on aggressively growing the old Shearson franchise through the acquisition of brokerage firms (Haden Stone, E.F. Hutton, Lehman Brothers) and assimilating them into a highly entrepreneurial, extremely well-run financial services giant. Weill must now work his magic again in assimilating the disparate cultures of Citibank, Travelers and Salomon Smith Barney into one cohesive business enterprise that will become the new business paradigm for the most efficient and highest value delivery of all financial products and services within the industry. Weill who plans to retire himself within the next few years will develop a plan of succession with the Board, which would come up with a successor within two years. Thus, Weill has a free-hand to chart the course of Citigroup over the next three or so years which may well leave a lasting legacy in shaping the future course of the financial services industry.

By sheer force of his personality and his will, Weill has been responsible for the remarkable transformation of Shearson and Travelers. His management style of quickly assessing the economic drivers of the business, cutting to the bottomline and boldly reconstructing business units, has largely been constrained by Citigroup's awkward co-CEO structure and Reed's controversial dismissal of the highly regarded Jamie Dimon, Weill's right-hand man and heir apparent. With the retirement of Reed and the absence of a gifted senior manager like Dimon, there is a significant vision and leadership vaccuum at the top of Citigroup that Weill and the Board must fill. In the meantime, the internet revolution is underway, fast transforming the financial services industry, and Weill and Citigroup do not have the luxury of waiting for a successor to pick up the load.

The internet revolution has changed everything. The primary economic drivers of the business are no longer brokerage commissions, trade execution, financial products or even disjointed financial services, but convenient, fairly priced compre-

continued on page 25

Have We Oversold Technology and Internet Companies And Are Now At A Teachable Moment?

Is a 10% return still a reasonable long-term return expectation? Last year, the average internet IPO return was 197%. In order to make the top quintile of "America's 1,000 Most Important Companies" that account for 90% of the market value of all publicly traded stocks, a company had to generate better than a 93% return. There were 18 companies last year that chalked up returns of 1,000% or more. We are clearly in a period of unprecedented innovation, driven by technology, telecommunications and the internet. A third of last year's top performers were not trading three years earlier. The average internet company in the *Wall Street Journal* Shareholder Score Card registered average compounded annual returns of 148.8% over the past five years. There is a clear economic transformation from the old economy to the new economy underway, and we are very fortunate to witness how this is manifested in stock prices and company valuations.

Yet, for all the euphoria that is driving internet and technology stocks up, we cannot ignore the fundamental laws of economics. Nobel laureate, Peter Drucker, said, "Profit breeds competition, and excess profits breed ruinous competition." What a 197% average internet IPO return means is that the extraordinary demand for these securities in concert with the absence of liquidity has driven their prices to stratospheric levels. This same absence of liquidity also means that if there is any bad news, these stocks will take a correspondingly significant heart-stopping plunge. By definition, IPOs should be fairly priced, based on their revenues, earnings and growth prospects. Yet, if internet IPOs were up 197% on average last year, doesn't that mean they are trading at three times a fair and well-reasoned price based on all the pertinent data? Are we now beyond the realm of investing and entering a period of speculation where stock prices bear no relationship to their fundamental economic value?

This is a wonderful opportunity for internet entrepreneurs, but as is always the case, rarely does a great sales story translate into an excellent investment. Even given that the internet will transform commerce around the world, and even assuming optimistic expectations of performance, the market is, in effect, tripling (or more) a reasonable economic valuation. This is the sort of valu-

continued on page 30

Ph 804-795-1642 ■ Fax 804-795-7703

winning the internet asset game. It understands the forces at work that are driving the industry and has put the opportunity in the hands of its most capable managers. This is a momentous opportunity. Great leaders are able to perceive and rise to occasions that demand greatness. Stan O'Neal has been thrusted into that opportunity, and greatness is his to seize. As Shakespeare wrote, "There is a tide in the affairs of men which, when taken at the flood, leads on to fortune." We all hope for Stan O'Neal's good fortune, for with it comes good fortune for Merrill's brokers and clients, and the industry at-large. ■

Have We Oversold Technology and Internet Companies And Are Now At A Teachable Moment?

Continued from page 3

ation arbitrage that is dangerous because in attracting too much capital, the underlying companies have an increasingly large performance hurdle to overcome in order to sustain their value, based on even their most optimistic post-IPO pricing model. This makes for an eventual fall in price even more inevitable.

No one wants to end the party, especially when so much fun is being had by all. But is there a sound economic case to be made for chasing technology, internet and telecommunication companies to the stratosphere and beyond? Are we setting ourselves up for the market to teach us yet once again, that invaluable lesson that there is risk? Has the euphoria of 100%+ returns, even 10 times returns in one year, created unrealistic investor expectations and dulled our sense of risk? Last year, the S&P 500 was up 21%, but 93% of that gain was in just 20 stocks. We have never been in a period where stock selection and investment discipline were more important. We are at that classic inflection point where investors are attracted to the allure of extraordinary returns and are about to discover that the market conditions and circumstances that led to extraordinary performance are no longer in place and that the returns that attracted them cannot be sustained. That is why, by definition, the returns were extraordinary to begin with. This is a predictable investor behavior pattern because it is human nature. Most investors do not have a technical point of reference. Thus, to the investor, the more the investment goes up the better it gets, and the more it goes down the worse the opportunity.

Commission brokerage is all about creating unrealistic investment expectations and reacting to what sells, which means investors are more likely to buy high and sell low than buy low and sell high. The investor is attracted to the allure of the extraordinary returns only to become disappointed when the returns cannot be sustained which leads the investor to sell the investment, only to repeat the cycle again and again. The investor is thus invariably buying high and selling low, as they futilely continue to chase the promise of extraordinary returns. This is why the average rate of return in a commission brokerage account is only 6% in an environment that has generated 15%+ returns for 15 years. Investing is often counter-intuitive, and thus good sales stories rarely translate into good investments. Logic would suggest that later this year investors will be disappointed in the returns which will be realized from chasing the extraordinary popularity and the extraordinary prices of technology, telecommunication and internet stocks. This might be that teachable moment where generations of investors and financial advisors learn about risk and discover the wisdom of developing and sticking to a well-conceived, long-term investment strategy, rather than chasing short-term performance.

> **COMMISSION BROKERAGE IS ALL ABOUT CREATING UNREALISTIC INVESTMENT EXPECTATIONS AND REACTING TO WHAT SELLS, WHICH MEANS INVESTORS ARE MORE LIKELY TO BUY HIGH AND SELL LOW THAN BUY LOW AND SELL HIGH**

Momentum investing is like musical chairs. At some point, the music stops, and you don't have anywhere to go. Except in investing, you have put all your client's assets at the speculative top of the market on the premise that it will continue to go up, only to be rudely awakened. The client's expectations are high. There is no fear because the market has not sustained a downturn in the entire career of most financial advisors nor has it had a sustained downturn in the experience of most clients. Yet, what does the broker say to their clients when they are down 33% or 40%? They just have to generate 50%-66% returns next year to break even.

These are perilous times that will shape the careers of many. There is presently no concept of risk in the marketplace which has led to today's unrealistic return expectations and rampant speculation that is far outside the bounds of reasoned investment. Will trees grow to the sky or will the discipline of investment management consulting and Nobel Prize-winning investment theory prevail? This may indeed be that important teachable moment that will help shape the course of our industry. Have we entered a period where there is no reasoned explanation of what is occurring, or is this just another iteration of excessive market valuation and predictable investor behavior? Only time will tell, but if it is a case of excessive market valuation, we will know sooner than later. When the music stops, no one wants to be the last person to buy at the top of the market and get left holding the proverbial empty bag. There is an impressive case building for diversification and investment management consulting for those who may not be familiar with risk. Perhaps it is not too late for clients to have a well-conceived, long-term investment strategy developed. You can always apologize for being too conservative, but your clients and your competitors leave no room for one to be too aggressive. ■

Ph 804-795-1642 ■ Fax 804-795-7703