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SENIOR CONSULTANT
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INSIDE

Spencer Trask To Provide Greater Access to High Level Advice Technology

For the thousands of investment management consultants who are pioneering high level advice, there long has been frustration with the cost, complexities and inefficiencies of the technology required to provide professional investment and administrative counsel. Even with all the external market forces converging, which compel the financial services mainstream to move to high level advice, most major financial services firms are not yet at the point of creating the culture, structure and technology necessary to make high level professional investment counsel possible. These firms sense they have to move toward advice, but they have not yet made the connection between high level advice, adding value, process and technology. They do not understand it is not humanly possibly to add value for a large number of clients without process and technology. The CEOs of these firms are immersed in the commission brokerage business and are not likely to commit the resources of the entire organization to building a new financial product and services delivery platform built around high level advice. In fact, it is only when such a notion is expressed that you discover how far away the firm is from empowering you and your fellow financial advisors to provide high level professional investment and administrative counsel. So where do you and your firm go to secure the processes and technology that would empower you to deliver the highest level of professional investment and administrative counsel possible?

> THE INVESTMENT SOURCE COMPANY WILL OFFER A COMPREHENSIVE INVESTMENT PROCESS TECHNOLOGY TIED TO A VIRTUAL, REAL-TIME BALANCE SHEET AND INCOME STATEMENT, WHICH WILL BE AGGRESSIVELY PRICED TO ASSURE DEEP AND BROAD MARKET ACCEPTANCE

Until a few days ago, there was no such place, but with Spencer Trask's recent acquisition of Computer Aided Decisions, a new firm, The Investment Source Company, has been created to fill this technological vacuum. The Investment Source Company will offer a comprehensive investment process technology tied to a virtual, real-time balance sheet and income statement, which will be aggressively priced to assure deep and broad market acceptance. The technology will be built around best practices in each of the major market segments of the institutional and high net worth markets, and will be con-

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Merrill Names Stan O'Neal To Head Its Brokerage Unit, Firm Enters Phase II of Internet Revolution

E Stanley O'Neal has been appointed by Merrill Lynch to head the most visible of its four business units – its retail brokerage operation. O'Neal, 48, succeeds Launny Steffens as president of the brokerage group, a position Steffens has held since 1985 and is the favorite to succeed chairman and CEO David Komansky as the firm's president when Komansky retires in 2004 at age 65. As the brokerage industry and Merrill Lynch embark on a major strategic shift towards advice and away from trade execution, O'Neal is the perfect candidate within Merrill's deep talent pool to lead the brokerage unit through what will become a period of unprecedented change and innovation.

O'Neal is the first person to lead the Brokerage unit who has not come up the brokerage ranks, but because over the next decade literally everything a broker now knows and does will become outdated or obsolete, a different skill set is required to move the firm forward. As co-head of the firm's corporate and institutional client group with Tom Davis, O'Neal brings extensive expertise in financial engineering which is a critical skill set as the firm must streamline its cost and organization structure to reflect the realities of the new advice business environment. More recently, as the firm's chief financial officer, O'Neal worked directly with Komansky and

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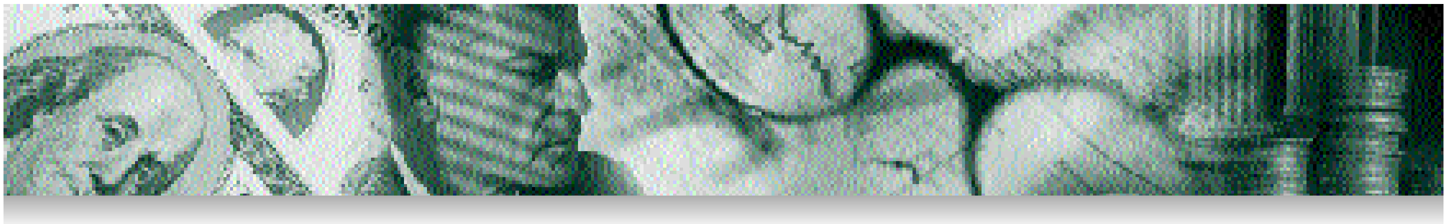

Merrill Names Stan O'Neal To Head Its Brokerage Unit, Firm Enters Phase II of Internet Revolution

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the firm's executive group to maximize the strategic use of capital to drive the global growth of the organization. O'Neal was intimately involved with all the firm's strategic initiatives and understands the economic structure and capital needs of all operating units. O'Neal is well-grounded for the challenging task of structurally and culturally re-engineering the firm around the new advice business paradigm built around on-line and off-line services.

David Komansky said he had "waited to make the management switch until much of the new changes in the retail division began to take shape, including the launch of on-line trading." The announcement of the regrouping of senior management was not totally unexpected. For weeks, rumors have swirled that Merrill was ready to shake up its senior management possibly with Komansky assuming the role of "executive CEO" where he would leave much of the day-to-day chores of running the firm to someone else, probably Jeff Peek, 52, head of the firm's Asset Management Business unit. Merrill has been without a president since Herb Allison's resignation last summer, with Komansky having doubled up in assuming the additional responsibilities of Allison. Komansky said, "I've been killing myself, doing both jobs by myself." Launny Steffens will assume the role of senior advisor, alleviating some of Komansky's workload. Komansky added, "Launny and I have been partners since the mid-1980's, and we will be even better, going forward." Komansky declined to name O'Neal as heir apparent, saying, "We now have four extremely capable people running our four major business groups and several other highly capable candidates." The other primary candidates for the top spot are Jeff Peek, 52, head of the firm's Asset Management Group; Tom Davis, 46, head of the firm's Institutional Group which O'Neal formerly co-headed with Davis; and Winthrop Smith, 50, president of Merrill's International Brokerage Group.

O'Neal inherits a brilliantly conceived, well-articulated business strategy which was crafted by Herb Allison, the firm's former president. After initial reluctance on the part of Steffens, which led to Allison's resignation, Steffens has become the leading advocate of Phase I of the firm's internet revolution. Steffens has been integral in securing the buy-in of the firm's brokers, greasing the skids for O'Neal's role of change agent in executing the second stage of the internet revolution. Steffens will continue to play an active and crucial role in the firm's transition to high level advice. He has recently assumed responsibility as chairman of the firm's Private Client Group and the role of senior executive relationship manager for wealthy clients. Steffens will also help Merrill's investment banking effort by calling upon technology company executives who are Private Client customers.

The radical new model that O'Neal will execute is the marriage of the best of on-line information and convenience with the best of face-to-face advice

Phase II of Merrill's internet revolution, which O'Neal will execute, is the culmination of months of deliberation on the direction the firm will take in the new advice business environment. In essence, the traditional brokerage business, as we know it, no longer will exist. Merrill is changing the rules for its full-service business and is not hesitant to radically change its business model because it has "every intention of winning the on-line asset game," says Steffens.

The first phase of the internet revolution was addressing how on-line services will revolutionize traditional models. But in the second phase that is now unfolding, a new question has come to the forefront: How will on-line services themselves be revolutionized by ever higher client expectations. It has become clear to Merrill that firms with a product focus rather than client focus will fail. Today only 15% of all retail trades are on-line, and only 5% of the $13 trillion in domestic investable assets are in on-line accounts; but winning the on-line asset game will not be done by viewing the internet as another distribution channel for trade execution. That is why firms built around product distribution are missing the point. Winning the on-line asset game will be based on client service with the internet being a communication tool that allows a higher level of service to be provided. The radical new model that O'Neal will execute is the marriage of the best of on-line information and convenience with the best of face-to-face advice. One dimensional on-line advice solely delivered via the internet has inherent limitations. First, the value added is limited by the understanding and capabilities of the user and the limitations of the range and depth of the solutions incorporated in software. On-line, face-to-face advice has no limitations and no excuses. In fact, with the help of the internet substantially broadening the investment and administrative considerations, rather than selling investments the Merrill broker will be empowered to provide comprehensive solutions through constructing portfolios which will accomplish the client's goals and objectives. The client can try to replicate on his own this level of professional investment counsel available to them through Merrill's financial consultants, or they may choose to simply use Merrill to execute unlimited trades for a fee. Ultimately, however, they will want results and that will take the clients to the Merrill financial consultant. Thus, Merrill's on-line services become an important tool in building a deeper and broader client relationship, incorporating the entirety of the client's assets and liabilities. By engaging the professional investment and administrative counsel of the Merrill Lynch financial consultant for an on-going fee, Merrill can assure an extremely high level of professional financial counsel to include the liability side (credit cards, mortgages, etc.) of the client's balance sheet. But if clients just want to access Merrill's proprietary research, they can get it without any strings attached. If they just want web-based trading, they can get it. If they want real-time quotes, IPO lotteries, wireless trading or automated advice on artificial intelligence, the client can get it and can get it all now. But none of these can solve the entire range of client needs. For that, the client needs a financial consultant.

In defining the needs of their clients, Merrill clients have told Merrill they want:

- to land on target with the goals and objectives that are most important to them,
- to have on-hand the right resources in process, technology, investment products, investment research and investment strategy in an uncertain and shifting environment to make good financial decisions,
- to have the insight to get out of the way of disasters coming their way,
- to be able to deal with complicated tax and estate planning issues,
- to know their decisions are wise ones,
- to enjoy the experience of managing their financial assets and liabilities,
- to have time left over to do all the other things in life that are even more fun, and
- to know they are paying a fair price for the services they are receiving.

In essence, they want to have the freedom to choose from a range of on-line and off-line services with fair and flexible pricing. They are free to access expertise when and how they want it, or are free to manage everything on their own terms. The common thread for Merrill's on-line and off-line strategy is the client's view must prevail, regardless of what end of the on-line or off-line service scale the client prefers. Thus, the challenge that Merrill and Stan O'Neal face is moving from a culture and organization structure geared to product distribution and trade execution to a new culture and structure geared toward the client and adding value. The old product distribution business model built around managing financial products along rigid product lines that was not client-focused or adaptable to change must give way to process management which is designed to add value for the client. Steffens said, "Distribution alone is not a strategy. You can build a building and tie products to your on-line networks, but that is just the first step.

THE CHALLENGE THAT MERRILL AND STAN O'NEAL FACE IS MOVING FROM A CULTURE AND ORGANIZATION STRUCTURE GEARED TO PRODUCT DISTRIBUTION AND TRADE EXECUTION TO A NEW CULTURE AND STRUCTURE GEARED TOWARD THE CLIENT AND ADDING VALUE

Clicks-and-mortar are well and good, but clients matter more. If you don't maintain laser focus on helping your clients thrive and find freedom in a complex financial world, no one is going to stay at your party very long." Indeed, most firms are designing their on-line services to showcase their strengths rather than seeing things from the client's and prospective client's perspective. They are selling product rather than addressing and managing their client's needs. "This leads to senseless feature-itis," says Steffens, "which turns clients off, rather than turning them on." It is fairly obvious from the firm's web site what it wants to accomplish. If all they talk about is financial product and not you, that tells you everything. The key to winning the internet asset game is the client, not their assets. Of course, managing a mind-boggling array of financial information in terms specifically meaningful to each client is the thesis of investment management consulting. Thus, consulting is the product and service delivery methodology that O'Neal will use in moving the firm from product management to process management, from product focus and trade execution to client focus and adding value.

O'Neal will create an open architecture service structure in bringing their digital age strategy to life. He will create the processes and technology that will serve everyone. Brokers can make stock recommendations, and financial consultants can add value through an investment process in terms specifically meaningful to each client. With half of all securities trades being executed over the internet within the next three years, even the most avid stock trader within Merrill will move their accounts on-line. As the average brokerage commission drops over 60% over the next three years, the commission broker will eventually avail themselves to a broader range of financial services and the processes that allow a much higher level of advice to be provided. This makes it possible for the broker to make the transition toward fee-based advice. For firms that do not offer options other than commission brokerage, as profit margins in commission brokerage shrink and the broker's compensation drops 80% or more, the wisdom of fee-based advice will become Merrill's drawing card. At the end of this year, when Merrill flips the switch to on-line services, its $1.5 trillion in assets will, over night, bring on-line assets of up to $2.1 trillion, or three times the $608 billion on-line today, not counting growth from other sources. This is just the beginning of the exponential growth of assets traded over the internet. Merrill will attract and keep assets by offering a broad range of services that will help clients make informed financial decisions while making Merrill central to their financial well-being.

According to Jupiter Communications Research, in this new internet revolution, clients will not have a good sense of humor when it comes to their assets. The client is in the driver's seat. Less than 40% of all financial services web sites respond to customer inquiries within 24 hours, which is not good enough for the new generation of investors coming on-line today. They have higher service expectations than those already on-line. These newer on-line users will operate on a "one strike, you're out" rule. Thus, Merrill's first-mover status must be backed up by articulate, responsible, well-versed providers of high level advice which is something that one dimensional, do-it-yourself models cannot remedy. Merrill's research has found that:

1. Clients are not only in the driver's seat but they want to know "what have you done for me lately."
2. They will demand a richer level of content and a higher level of service than is presently available from existing on-line services.
3. They will expect the freedom of simplicity and the freedom to deal with financial matters when they want, how they want, at the price they want.
4. They will want the broadest range of services in rich, collaborative environments where the most value can be added.
5. They will expect the internet to be fully absorbed in the life blood of the financial service enterprise.

Over the next three years, a more diverse, new wave of investors will come on-line with more investable assets and a greater variety of attitude toward technology. They will be affluent, more moderate traders; they are delegators, tech-weary, tech-cautious and time-crunched. Launny Steffens suggests that Merrill will win these investors by offering choices and not by forcing them into a single mold. In this transitional period, Merrill clearly wants to bring everyone along. Yet the reality of Merrill's own research and the reality of the internet suggests that within five years every Merrill broker will be providing high level, fee-based advice or they will not be in the business. Thus, O'Neal's challenge is to create very powerful, easy-to-use, comprehensive investment process technology that doesn't just empower the Merrill broker to deliver the highest level of professional investment counsel possible but technology that makes it easy for the Merrill broker to make the transition to high level, fee-based advice. By definition, Merrill can only win the internet asset game by adding more value than anyone else through the personal advice of its brokers. O'Neal must create the tools that make the highest level of advice and service possible, because by only providing an unprecedented level of professional investment counsel and value as its lowest common denominator does Merrill win the internet asset game, regardless of how demanding the client. Thus, investment management consulting becomes the financial product and service delivery methodology of the 21st century.

The key to Stan O'Neal's success is to have Merrill's brokers become early adopters and demand the processes and methodology through which they can consistently provide the highest level of professional investment counsel. This will be accomplished by creating a funding vehicle neutral (incorporating all financial vehicles and all the client's assets and liabilities) and a six-service (asset study, investment policy, strategic asset allocation, manager/investment vehicle/form of ownership search and selection/portfolio construction, performance monitor, tactical asset allocation) comprehensive investment process technology through which the highest level of financial counsel can be provided and an unprecedented level of value be added. By creating a comprehensive investment process sooner than later, O'Neal can dramatically accelerate Merrill's successful transition toward advice and decisively win the internet asset game.

THE KEY TO STAN O'NEAL'S SUCCESS IS TO HAVE MERRILL'S BROKERS BECOME EARLY ADOPTERS AND DEMAND THE PROCESSES AND METHODOLOGY THROUGH WHICH THEY CAN CONSISTENTLY PROVIDE THE HIGHEST LEVEL OF PROFESSIONAL INVESTMENT COUNSEL

When all is said and done, the vast majority of investors would prefer to be led by a professional rather than their having the burden of leading a professional. Attorneys, physicians and CPAs do not ask clients what should be prescribed nor should financial consultants. In non-discretionary commission brokerage accounts, the client bears full responsibility for account performance because without discretion, only the client determines what is bought and sold, when investments are bought and sold, and in what quantities. There is no accountability for account performance. In the new advice business model created by the internet revolution, the financial consultant is accountable for their investment recommendations and advice, and clients expect to be led by high level professional investment counsel. Investors do not want just any kind of advice or beginning advice or intermediate advice, they want and expect nothing less than the highest level of professional investment counsel. Anything less will simply not do.

As clients become more demanding, Merrill's brokers must be prepared with the processes and technology that allow them to address and manage the values and issues that are most important to each client in helping them achieve their long-term goals and objectives. Stan O'Neal will awaken Merrill to investment management consulting and its thesis of managing a mind-boggling array of investor and financial information through an investment process so it can be made specifically meaningful and relevant to the unique needs and circumstances of each investor. Indeed, nothing less will do for the investor, Merrill Lynch, the industry or Stan O'Neal. Through a well-conceived, comprehensive investment technology process, the Merrill Lynch financial consultant will be able to consistently provide the highest level of professional financial counsel at will for any investor, whether they be an individual or an institution. Merrill will not leave their brokers to their own devices, to sink or swim, in making the transition to high level advice. Thus, it is O'Neal's vision of the industry and its future, not necessarily his understanding of how things are done today that are the keys to the future of the firm.

What Stan O'Neal does in the next six months to embrace the investment process and technology of investment management consulting will determine Merrill's competitive position in the race to provide high level advice. By Merrill Lynch shifting the culture of the entire organization around high level advice, Stan O'Neal will have his hands full, but Merrill is committed to 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?

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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. ■

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