

## IN THE NEWS

### Have Efficient Markets Resurfaced And Are They Here To Stay?

Has our concept of efficient markets become passé or will the recent downturn restore our faith? The silver lining in the recent market correction in and of itself is that the correction is the essence of an efficient market. For the past decade or more, wise and seasoned analysts and investors such as Warren Buffett and Marty Whitman have reasoned there is little correlation between the intrinsic value of common stocks and their prices. The common complaint was the market was overpriced, but there was very little they could do about it because we have to work with what we've got.

Indeed, last year was the height of Alan Greenspan's irrational exuberance as the average internet initial public offering (IPO) zoomed up 197% from a fair and equitable offering price based on all pertinent data. For many, internet IPOs became a proxy for

how overvalued technology stocks have become. With the average internet IPO trading at three times its reasonable valuation, it became clear these stocks could drop 66% and would just then begin to be valued fairly.

The valuation of the average internet company taken public assumes a 29% earnings growth rate relative to 3% for old economy companies. Thus, in order for these stocks to maintain their post IPO prices, they are required to generate earnings growth rates of 37% a year, well into the future, just to maintain their current market value. The likelihood that even the brightest stars of the internet, e.g., Yahoo, would almost double their earnings every year for the foreseeable future is not particularly good. So, a market correction which would bring stock prices back in line with their intrinsic value would actually be wel-

comed by many industry veterans. Finally, the old-fashioned idea of efficient markets would come into play. Yet, in the recent downturn, the NASDAQ just dropped over 33% and quickly rebounded to be only 25% down from its high in March. This does not bode well for the NASDAQ because eventually there has to be some correction between earnings, value and price. The performance target, dictated by price, requires that these companies achieve three times what is reasonable and realistic. Something must give, and it is likely to be a drop in price. But this time, it needs to be an overcorrection in order for investors to see a resurrection of efficient markets and for risk to again become tangible. This will be the first opportunity for many advisors and investors to use classic investment theory in constructing portfolios, and reason will have

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### Cortez And Pastore Join Goldman Sachs To Create and Execute the Firm's Consulting Strategy

Richardo Cortez, the Prudential Securities veteran who ran sales and marketing in its investment management consulting business unit (Investment Management Services), and Peter Pastore, the Salomon Smith Barney veteran who ran Systems, Operations and Administration for its consulting business unit (Consulting Services Division) have joined Goldman Sachs. Though no specific plans have yet been set, Cortez and Pastore will help Goldman Sachs explore how it can capitalize on the industry's evolution toward fee-based advice. The focus is not just on the firm's internal needs but on how Goldman might emerge as a significant player in the new emerging advice business environment. With Goldman's sophistication, they could create for third party users a new, far more

powerful funding vehicle neutral consulting platform than today's wrap fee programs which narrowly focus on just mutual funds or managed accounts. They could provide the raw process technology of advice as a means to harness distribution to other Goldman businesses. They could provide more traditional asset management services packaged as separate accounts. The possibilities are endless, and Cortez and Pastore will be exploring all the options in creating Goldman Sach's strategy around the investment management consulting business model.

Goldman Sach's is one of the world's preeminent investment banking firms and is arguably the single most successful financial enterprise in investment banking, earnings, margins and bonuses within the global

financial services industry. It is highly entrepreneurial and is a magnet for the industry's best and the brightest. It was Goldman Sachs who pioneered the idea of putting high level financial advisors on investment banking teams that could address the personal investment implications of various deal structures with the principals of prospective companies to be underwritten. This almost invariably leads to Goldman managing the assets of the principals of the firms they underwrite.

Goldman maintains a \$50 million investment minimum before their advisory services are engaged. Goldman's advisory services has evolved to four-person advisory teams that include expertise in trusts, estate and income taxation, investments and

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counsel. Merrill, without question, is the most powerful commission brokerage franchise in the world, but that is not what will drive the financial services industry well into the 21st century. Schwab has set its sights on owning the high-end of the advice marketplace where all the assets are. It is aggressively changing every aspect of its

internet-based platform to facilitate the delivery of high level advice. It has acquired U.S. Trust which is an important brand for high level advice, which will provide access to the processes and methodology of high level advice and which has a relatively small but highly entrepreneurial staff who is fast, adaptable and totally committed to the

vision of high level advice. Merrill might want to consider how committed its people are to the delivery of high level advice. An "A" player in the commission brokerage model does not translate into an "A" player in the high level advice business model, and it is going to take "A" players to win the asset game. ■

## Cortez And Pastore Join Goldman Sachs to Create and Execute the Firm's Consulting Strategy

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investment strategy, but unlike the Northern Trust Service model, at Goldman each team is headed by an investment banker. This is because Goldman uses their advisory services as their primary methodology for relationship management. The investment bankers and analysts are in and out very quickly, but Goldman's banking clients use its advisory services at least weekly and often several times a day. This inundation of investment-related questions requires the investment banker to have an advisory services team. This facilitates continual contact with investment banking clients almost daily and positions Goldman to win secondary banking and underwriting opportunities after the initial public offering.

Although advisory services is an important part of Goldman's business, just one investment banking offering could generate far more revenue than all the revenues generated by Goldman's entire advisory services enterprise. Last year, Goldman hired 100 investment bankers to head up relationship management teams which affirms their approach to advisory services is very much a subset to their investment banking business.

Bob Pitti who has built advisory services businesses to support investment banking at First Boston, Montgomery Securities and Thomas Weizel Partners, observed, "These businesses thrive in a partnership business structure where everyone is interested in growing the firm's overall revenues because as owners and partners, everyone is rewarded accordingly. In a corporate environment, this level of service may not be possible because the individual banker is

compensated only on the deals they generate, thus spending time building long-term relationships is far less important than doing deals. At Goldman, they view advisory services and its associated relationship management as protecting its investment banking franchise."

As you might expect, Goldman's process for providing high level advice at the highest end of the high net worth market is

provides but may not necessarily manifest themselves as formidable stand-alone services. Extraordinary emphasis is placed on defining the client and their unique needs and circumstances (asset study/investment policy) and in creating an investment strategy (strategic asset management) and constructing a custom investment portfolio for each client. Stan Coglemen heads a 12-person asset allocation group with five

Ph.D.s which create custom investment strategies for clients. The more complex the client's financial circumstances, the better for this group. Cogleman's group has created manager of manager limited partnerships around specific investment management styles similar to Frank Russell's approach and has an impressive array of public and private investment vehicles (trusts, foundations), tools and methodology necessary to literally handle the most intricate and

complex investment strategies.

With the firm having extraordinary sophistication in using third party managers, Cortez and Pastore have a wonderful platform to take Goldman's services outside the firm for use with third party investment management consultants who have high net worth clients with substantial assets. The promise of Goldman Sach's becoming more attuned to the trend toward high level advice, both inside and outside the firm, is an exciting prospect. The Goldman Sach's name commands great attention in the marketplace which may well translate into their becoming an important supporter of the investment management consulting industry, particularly if Rick Cortez and Peter Pastore can influence the firm's direction. ■

**ALTHOUGH ADVISORY SERVICES IS AN IMPORTANT PART OF GOLDMAN'S BUSINESS, JUST ONE INVESTMENT BANKING OFFERING COULD GENERATE FAR MORE REVENUE THAN ALL THE REVENUES GENERATED BY GOLDMAN'S ENTIRE ADVISORY SERVICES ENTERPRISE**

totally customized. Each client and their circumstances are unique. Though investment banking was the catalyst for creating the relationship, the Advisory Services Group has extraordinary experience in trust, income and estate taxation, investments and investment strategy, and has successfully worked with the principals of large firms which have gone public. This very impressive client list in concert with the impressive capabilities of advisory services makes Goldman Sachs a very formidable competitor. The six services that comprise the investment process (asset study, investment policy, asset allocation, portfolio construction/manager search and selection, performance monitor, tactical asset allocation), are all incorporated in the services Goldman