Quarter Notes

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Wall Street Greets Millenium as Growth Dominates Value

Happy New Year

- *International Stocks rebound*
- *Small Growth explodes*
- *Bonds have the second worst year since 1973.*

Firestone Capital Management files annual updates to our ADV registration form. If you would like to be sent a copy of the form when it is filed, please call the office we will be happy to send you one.

Bits and Pieces

60% of all stocks lost money in 1999.

The 30 year Treasury Bond closed the quarter with a yield of 6.48%.

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Y2K Bug Squashed

We all survived the first days of the new Millenium without Y2K disruptions. We took Y2K seriously and so did the rest of the world. We prepared and triumphed over the Millenium Bug.

The stock markets recovered from their third quarter slump. Growth overwhelmed value this year. *(see chart)* We saw excellent fourth quarter performance from both large and small cap growth, as well as, international positions. All major indices finished the year in record territory.

It was a different story in the bond markets. Bonds had one of their worst years ever as the Fed raised interest rates three times taking back the three interest rate cuts of the preceeding year.

Real Estate struggled for the second straight year despite strong demand, excellent fundamentals and high yields. Historically low P/Es in this sector should make value investors drool.

Equity markets displayed a split personality. The second quarter gave us more broad-based growth in the S&P 500 than we had seen in quite a while. In the quarter ending in June, 73 stocks accounted for 100% of the S&P 500's return - which was a big improvement over 1998. Depressed cyclicals, small stocks and even REITs experienced nice gains.

These gains evaporated in the third quarter as the Fed increased interest rates. By the end of the 3rd Quarter, only 11 stocks accounted for 100% of the S&P year-to-date return.

In the fourth quarter technology dominated. Technology stocks looked like the "shooters" during the 60s, rocketing to, what we believe to be, unsustainable heights.

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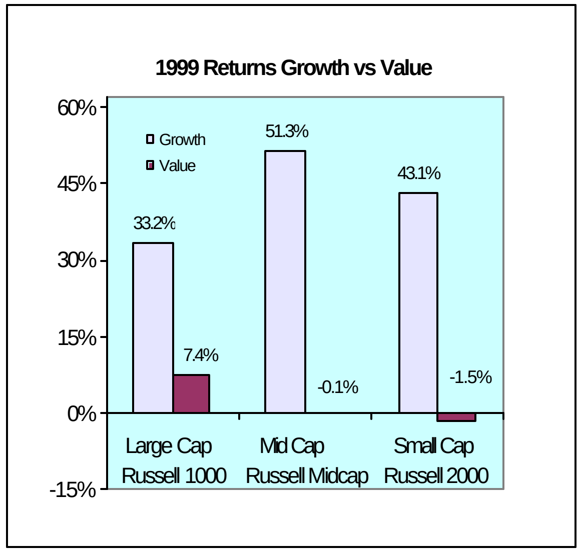

Although it is taking all our resolve, we believe that growth and value will return to their historical equilibrium and that diversification will best serve our client's long term goals.

Bond Watch

The bond markets have become extremely skittish about inflationary pressures causing further increases in interest rates. As interest rates rose the value of bond portfolios fell.

The truth is that an overall strong economy, continued growth, and record low unemployment, is normally the environment in which we might see inflation rise. What inflation we are seeing is increasing at only a modest pace.

Despite the tight U.S. labor market, globalization is constraining price increases, as the global economy becomes more sophisticated, means of production can be relocated to other areas with the lowest cost of production. This should keep inflationary pressures of a fully employed domestic work force from heating up too fast.

A second reason inflation appears to be held in check is increasing productivity. Companies with increasing worker productivity can afford to absorb some increased cost of labor.

There is no Social Security Trust Fund

The Social Security Trust Fund doesn't exist and it never has. Our Social Security is a "pay as you go" system. Instead of collecting taxes and investing them, the government uses taxes collected today to pay the benefits for workers currently receiving checks. The US Social Security system has $3 to $8 Trillion in unfunded liabilities depending on how it is calculated.

We recently participated in a forum concerning Social Security reform conducted by Bill Shipman of State Street Global Advisors at the Conference for Advanced Planners.

The problem with a pay as you go system is that benefits are financed by today's workers. This was feasible when birth rates were higher and people died younger. In 1950, life expectancy was 67, with normal retirement at 65 a

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worker was expected to collect benefits for an average of two years. Today, the average life expectancy is 76 and increasing and the US actually has less than zero population growth.

Put another way, in 1950 there were 16 workers paying into the system for each person drawing benefits, today there are 3. A "pay as you go" system, at maturity, where we are now, is impossible to be anything but a bad deal.

Three areas being discussed for reform:

- **Raise FICA Taxes** - This doesn't solve the problem of a fewer workers supporting more retirees, it just postpones the crisis.

- **Cut benefits** - Either by reducing checks or by delaying retirement dates. This is a politically impossible solution. It also won't address the current unfunded liability and just postpones the inevitable crisis.

- **Carve out for Private Accounts** - Convert some portion of Social Security to a true investment account which enjoys market rates of return and is vested (i.e. funded with real dollars), like a pension plan. This solution is gaining support among those politicians who truly understand the issue.

Currently Social Security monthly checks replace approximately 42% of a worker's pay check. Growth in available funding is limited to the increased productivity of workers and new entrants into the work force. This has averaged about 2% per year.

Shipman calculates that, if we transition to a market-based system (mandatory "carve outs" into private accounts, invested at market rates), each one per cent "carve out" invested at 4.5% would replace 11.7% of a workers pay. If the return was 5.5%, the replacement rate would be 15%. A small '"carve out"(2-4%) could erase the unfunded liability and provide us with greater benefits. Costs for such a system are estimated to be .19%-.38% per dollar of investment - inexpensive, compared to alternatives.

Given the upcoming Presidential election, we expect Social Security reform to be a hot topic and one we need to watch. We want you to understand these issues. If you would like more information please call us for details.

Reporting Fund Distributions

When a mutual fund distributes capital gains or dividends to its shareholders, the fund appears to loose value, sometimes substantially so. However, the reality is that the shareholder's position is maintained when a distribution occurs, it simply takes a different form.

An example might help clarify the exchange. If you own 100 shares of XYZ fund, which has a pre distribution net asset value of $10 per share, you have an investment worth $1000. If the fund makes a $.10 per share distribution, the net asset value drops to $9.90 per share but you have 101.01 shares if you reinvested the distribution and 100 shares plus cash of $10 if you did not reinvest. In either case, you still have your $1000 position. Of course, if you are investing in a taxable account, you will have tax issues to contend with. That is why we often delay the purchase of new mutual fund positions in taxable accounts toward the end of the year, just before many of the funds make their annual distributions.

Here are some terms commonly used when discussing distributions:

- Ex-dividend date - The date dividend is deducted from net asset value

- Dividend reinvestment date - The date dividend is paid

Tips for the Quarter

Florida residents need to be aware of changes in the intangible tax laws. The maximum tax rate has been reduced to .15 per $100. Also remember the cash in your Schwab One account is not a taxable item.

Remember IRA contributions can be made until April 15. Consider Roth IRAs for working Children

Worth Every Penny . . . Forbes Magazine lists financial planners as item #61 on its list of 100 things worth every penny in its winter edition. But you knew that already.