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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

For those readers who remember, the Kingston Trio sang a song about Charlie and the MTA. The song began, "These are the times that try men's souls". There have been many such times in the past. In fact, they are probably more prevalent than those described by another song that you might remember – "The Days of Wine and Roses". In this issue of *Outlook and Trends*, once again we try to provide some perspective for your financial thinking.

The Economy & Markets

The economy is continuing to improve, albeit at a somewhat sluggish pace, supported by government deficits and Federal Reserve monetary policy. The current conditions are, in some respects, reminiscent of 2003-2004, which was also called a "jobless recovery". Leading indicators are climbing strongly now. They had weakened last summer when the Fed temporarily ended its monetary support. That program, called "quantitative easing" (or QE1) injected money into the economy and supported the government's fiscal deficits by buying increasing US Treasury debt. When the economy began to stall again, the Fed began a new support program (QE2), which is due to expire in June. Hopefully by that time, the economy will be able to survive without life support. We will see then, if the improved economic conditions are a sustainable trend. They may simply be a reflection of the Fed's artificial prop.

Some parts of the economy are doing well. Retail sales and corporate profits are growing strongly, suggesting that consumers have money and stock price gains have momentum. The extra cash in the economy, plus a weakened dollar, both resulting from "QE2", have made exports and new investment the strongest growth areas. On the other hand, hard-pressed state and local government cutbacks have been a drag on growth, now that the "stimulus" spending has wound down. On balance, however, there has been improvement, with a growth rate of 3.1% and unemployment dipping below 9%. Neither of these results is great, but they had been worse. Real estate continues to be weak with prices at their lowest point yet, dropping another 2.7% over the year.

The stock market trended upward during the quarter, taking a time out to consider the Middle East unrest and the Japanese earthquake and nuclear disasters. Bonds were generally flat, and commodities were mixed. Silver was strong, while uranium suffered from nuclear fallout.

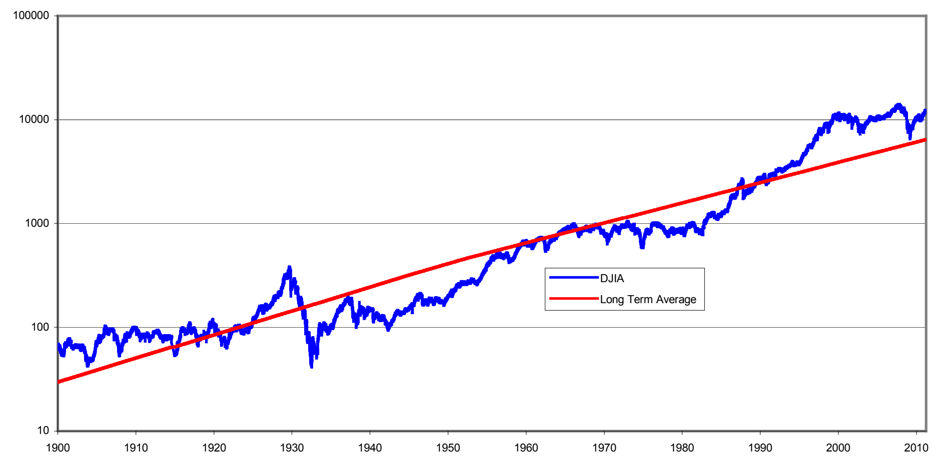
Rocks and Hardplaces

Government economic policy appears to be between the proverbial rock and hard place. For years, the government has supported the economy through Keynesian deficit spending (see our last issue), and by reducing interest rates when necessary. If it were to continue, the government's virtually unrestrained deficit spending will, at some point, spook lenders and cause them to slow down or stop buying US debt. This reduction in demand by the lenders would cause interest rates to rise. If (or when) rates rise, the effect on the economy will be contractionary.

Typically, the Fed fights economic contractions by reducing short-term interest rates. If the Fed would like to keep rates low, it would have to step in to replace the private or foreign investors, and buy the Treasury's debt (QE). This amounts to the government borrowing from itself, which is an economic charade. The Fed and government recycling (or "monetizing") its own debt is the modern equivalent of printing money. Excess dollars sloshing around the world reduce the dollar's value and possibly its soundness as well, potentially causing rates to rise more and the economy to contract more. The government is reaching its borrowing limit for the same reason. If it cannot borrow, it cannot increase deficit spending to support the economy. If it continues to borrow heavily, the increasing debt will again increase interest rates, offsetting the desired simulative effect. On the other hand, if spending is reduced to improve the soundness of the government's finances, the reduction may dampen growth in an economy that has become addicted to government support. The longer the government maintains its policy of super-sized deficit spending, the rock will continue to squeeze ever tighter against the hard place until there is a fracture.

Although we may face an economic challenge today, there have been times that have been more difficult. Sometimes it is worthwhile to step back and get a longer-term perspective. What can we see in the chart of the Dow Jones Industrial Average? The chart reflects the economic conditions that prevailed over the last century and is also proxy for the feelings of the US population, rising to emotional highs and falling into depression.

Dow Jones Industrial Average 1900 - Now



1) The first impression is that the economy continues to grow over the long-term, despite occasional set backs and rest periods. The "rest periods", like we have today, are just as prevalent as the periods of growth. The rest periods were anything but restful for people at the time. The Great Depression during the 1930s and the inflation of the 1970s were periods that caused hardship.

2) There are boom times when the economy gets ahead of itself. These times are not "real" in the sense that they are not sustainable. Although when actually living during the period, like the late 1990's, the good times certainly seem real, but planning decisions that are made expecting those times to be normal and to continue indefinitely are likely to be faulty. A long-term setback will inevitably come that will last until expectations and people's actions change. You can see that this period typically lasts about a generation, when a new group replaces the older.

3) Likewise, investment strategies that work well sometimes do not work during other periods. It takes time to recognize that conditions have shifted. After the 1960's, you heard little more about the "one-decision growth stock" (the one-decision was "Buy", and never sell). Similarly, you are less likely to hear about the merits of "Buy-and-hold" being the only valid investment approach today than you heard ten years ago.

4) While the graph shows the grand sweep of time, unfortunately our lifetimes are likely to fit inside the scope of the graph. While we can look at the graph with detachment, in reality some people's entire retirement can be a victim of a "rest period". For others, building pre-retirement wealth can be difficult. These times can make a real difference in lifestyle. Whether retirement falls during a growth or rest period is the luck of timing. However, for people who retire in a period like today, expecting investments to produce long-term average returns (the red line) may be overly optimistic and lead to faulty planning and execution. To address this issue, LFM&P "stress tests" its retirement plans by seeing how the challenging 1970s period would have affected current retiring clients' resources.

A good plan, executed well, that can survive a tough economic climate, is likely to be an investment worth far more than the cost. To learn more about our client goal-centered financial planning and management services, please call or e-mail. We invite you to look at our website www.linnardfinancial.com.

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