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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.
Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

As we finish 2002, we have experienced another unusual and extreme year with interest rates near 40 year lows and the longest stock bear market since the Great Depression. During these times, when it is definitely not "business as usual", it is helpful to have a perspective of where we are in the continuous flow of economic events, as well as having a financial plan as a guide. Hopefully this letter will help you with the perspective.

Economy

The economy continues to try to find its footing. Interest rates were recently lower than they have been at any time since 1963, because the Federal Reserve is flooding the banking system with money in an effort to re-inflate the economy. Much of that money is going straight into savings accounts and providing mortgages for homebuyers. Consumer spending has kept the economy alive. Consumers have found bargains in new and refinanced low interest rate loans for houses and cars as well as computers and other technology items. Low prices, however, also mean low corporate profits, which result in unemployment and lackluster stock market performance.

Because of the strength in the consumer and service areas, the economic malaise has been restrained, but perhaps has lasted longer than usual. In many ways, conditions resemble the economic downturn of the early 1990s (including a possible war in Iraq), which followed the real estate boom of the 1980's and the subsequent Savings and Loan implosion. If the unemployment rate peaks here at 6%, it will be the lowest unemployment peak during any recession since 1972. In fact, during the expansion periods of the 1980's, it was thought that unemployment might not ever get much *below* 6% again after hitting a high of 11%. Unemployment, however, is affecting consumer confidence, but surveys suggest people believe conditions will be better in 6 months.

Financial Markets

The stock market registered at least a temporary bottom during early October. NASDAQ stocks, which are heavily represented by technology companies, led the advance during the last quarter, but all sectors participated. It is yet to be seen whether this gain is sustainable.

Rising profit expectations are one of the elements that drive stock prices higher. Other elements that contribute are low interest rates and a growing willingness of investors to accept risk. As mentioned above, interest rates are very low, so this condition is supporting stock prices. Analysts' expectations of future profits have not changed significantly for the last year and a half, and this is creating a drag. Lastly, it is not clear whether investors' risk aversion has reached a maximum level or not. Paradoxically, the best time to buy stocks is when risk aversion is at its highest and nobody wants to own them. Individual investors are clearly not enamored with stock investment, which is favorable, but market commentators are perhaps too optimistic, suggesting there may be room for more selling.

Unfortunately, bottoms in financial markets can only be identified with any certainty well after the fact. It is reasonable to think that at some point earnings expectations will improve. When they do, stock prices will begin to rise. As they rise, investors will become less skeptical and some of the money gathering in savings accounts will find its way into stocks, fueling a new advance. As stocks rise and the economy expands, it is also reasonable to expect that interest rates will rise again, bond prices will fall from their current highs, and the mortgage-refinancing boom will be over, for at least several more years.

Planning

The best way to navigate through uncertain times is to have a plan and a defined strategy to follow that fits your individual needs and goals. Although the future movements of the financial markets cannot be foreseen with precision, it is the long-term perspective that will ultimately define your success in your financial future. Fortunately, it is not necessary to know the unknowable. Over a lifetime, good and bad economic conditions come and go. It is more important to define and maintain a strategy that works for you and can be expected to deliver the results you wish. Depending on your outlook and temperament, your strategy could disregard cyclical economic changes or attempt to insulate you from the adverse results of change.

During times like these, having a sound financial and investment plan can help you to keep focused on what's important – your financial goals and obligations, regardless of the current conditions of the financial markets. Your plan should reflect how you expect to meet your life needs and map out a strategy with which you are comfortable. Knowledgeable confidence helps you to not be sidetracked by the temporary conditions occurring at any given time.

Historically, equity investments have been the only way to stay ahead of inflation and taxes and the best way to accumulate savings for retirement and children's education costs. However, as has become quite clear over the last several years, equity investments can involve considerable risk, so it is important for your plan to consider risk, especially for those investors who must withdraw income in the near future.

If you would like help managing your investments or planning how to reach your financial goals, please give us a call.

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