LFM&P

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

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Outlook & Trends

We greet the new year with an improving economy and a rising stock market. Trends have changed, as they always do, from the difficult conditions experienced during the last several years. To stay on course toward your financial goals, it is helpful to have a perspective of where we are in the continuous flow of economic events, as well as having a sound investment strategy and a financial plan as a guide. Hopefully this letter will help you with the perspective.

Economy

Economy activity is accelerating, posting an 8.2% annual growth rate during the 3rd quarter of 2003. Perhaps even more importantly, employment is improving, with the unemployment rate back below 6%, new claims for unemployment insurance dropping decisively below 400,000, and net new jobs being created each month since August. Consumers continue to be a pillar of strength, while business conditions and investment have begun to take on an improving tone. The pick-up in employment and investment is a pre-requisite for maintaining the recovery. In our view, the credit goes to the same forces that we mentioned in prior letters: low short-term interest rates supplied by the Federal Reserve, the administration's tax-cuts and budget deficits, and the weakening dollar. If carried too far, all of these may contribute to future inflation. With the current inflation rate registering 1.8% and the continuing trend toward "outsourcing" manufacturing and services from lower cost overseas suppliers, this is not an immediate concern; it will take time to gauge the long-term effect. The Federal Reserve is not worried about inflation now and expects that short-term interest rates will be low for a "considerable period".

Financial Markets

Stock prices, as measured by the S&P 500, have continued to rise, but have not yet recovered even ½ their losses since 2000. Relatively speaking, the Dow Industrials have recovered more, and the NASDAQ index significantly less. It is interesting to note that while the NASDAQ has drawn a lot of media attention and almost doubled since its October 2002 low, it has only recovered 25% of its post-2000 decline. This is the financial equivalent of the tortoise and the hare fable, and a good illustration of why it is important to consider risk management to moderate visions of profits in your investment decisions.

The strongest sectors over the last three months have been the cyclicals, which outperform early in an expanding economy, including industrial stocks, industrial equipment, materials and chemicals.
Bond prices have been fairly flat.

There continues to be concern about stocks being priced too high. The most popular valuation measure, the price/earnings (P/E) ratio, is still higher than usual. This concern has not kept stock prices from moving ahead. In fact the S&P price/earnings ratio has decreased slightly since September, because earnings have increased more than prices. Analysts most recently have predicted future operating earnings to increase at a 12% annual rate, which if correct, would support an annual stock price gain of 12% without increasing the valuation measure any higher. Meanwhile the "Fed" valuation model says that stocks are actually undervalued in relation to bonds. If stocks are overvalued, and bonds are valued higher than stocks, the logical conclusion is that, at this point, the price risk of interest rate sensitive long-term bonds or bond funds could be substantial.

Planning

Whether the stock market up-turn will be short-lived or long-lasting is not predictable. The valuation argument mentioned above suggests that the shorter is more likely. If, however, the economy continues to grow with continued low inflation, a favorable climate could last a long time. As the economy and stock market climate improve, more and more people will be prompted by the rising prices to rethink their financial activities and consider putting that extra dollar into stock mutual funds, rather than their savings account. In fact, that process has already started. It will continue to grow, and reach a maximum at the next stock market top. If those people have not thought beyond the opportunities of the rising market, they will be unprepared for the losses that will follow in the next cycle.

Now is a good time to reconsider your overall financial approach. *LFM&P* believes that your financial planning should be consistent, driven by your goals, providing a steady direction to guide you through changing market conditions. That does not mean maintaining a rigid posture, however, it is more like adjusting the sails on a ship to compensate for weather conditions, while continuing to sail a straight course. In addition to the common wisdom of diversification and adjusting risk to your personal situation and goals, our investment management follows our MarketAware℠ approach that measures market conditions and adjusts accordingly.

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

Dave

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Linnard Financial Management & Planning provides investment management, financial planning and financial analysis services for people who value unbiased assistance and advice. We believe that people in all stages of financial growth and maintenance can benefit from personal assistance that is focused on their individual goals and needs. Since we sell no products and accept no commissions, we are able to evaluate the best solutions for each client. Our mission is to know each client personally and design and manage financial solutions that match their needs and goals. We will be happy to help you analyze a financial question, plan and achieve your own path to financial success, or help you manage your investments.

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