LFM&P

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.
REGISTERED INVESTMENT ADVISOR

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Outlook & Trends

Happy New Year! We begin 2006 with an invitation for you to take a look at our new website (www.linnardfinancial.com). The site describes *LFM&P*, our philosophy and services, and contains past issues of *Outlook & Trends*. One of the objectives of *Outlook & Trends* is to help you to see economic and market conditions as an understandable, continuous flow of financial change, rather than as isolated, media-hyped events. When read sequentially, the past issues of *Outlook & Trend*s on the website can serve as a chronology of economic change. It may provide you with the ability to see in hindsight how prior events fit into this flow. Alternatively, if for some reason you want to look back and see what the economic or market trends were in the spring of 2003, or some other time, the *Outlook & Trend*s archive can help.

Economy

The hurricanes have long since gone, but some effects linger, including reconstruction in the South and higher heating costs in the North. Nationally, however, the destruction amounted to only a blip on the economic radar. Recent GDP numbers indicate that the economy is growing at an inflation-adjusted 4.1% "real" rate, which is a 7.6% rate including inflation. The "real" rate is the most often quoted, but the higher "nominal" rate is also important, because company earnings are stated in actual dollars, and equity investment returns are a function of company earnings growth. In either case, the reading is pretty good. Other measures like capacity utilization, employment, consumer confidence and the index of leading indicators continue to rise and confirm the trend.

The real estate market continues to generate discussion, and its apparent health depends a lot on where you live. National housing prices continued to increase at 12.3% annualized rate during the 3rd quarter of 2005, while New England has cooled off, increasing at "only" a 7.8% rate, and the Rocky Mountain states roared ahead at a 19.5% rate. It is becoming more of a buyer's market, however, as the inventory of houses for sale has reached a 4.9-month supply, the highest reading since 1996.

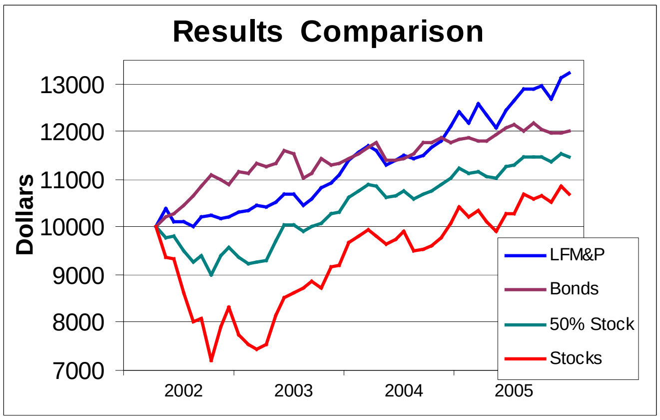
Financial Markets

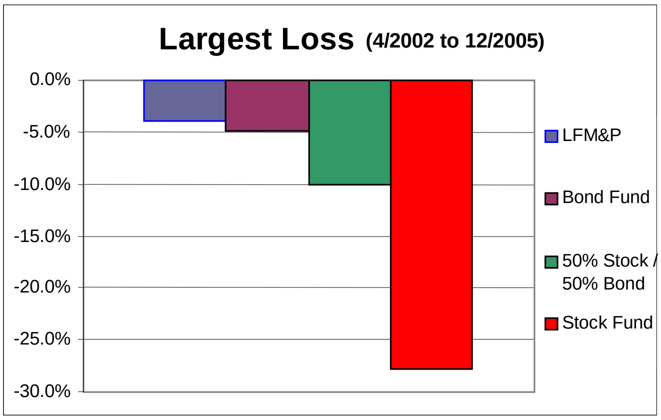
The new topic of the day is interest rates. For the last several years, interest rates have been so low as to not be of great importance, other than for people refinancing mortgages or living on an interest and dividend income. The Federal Reserve has continued to raise rates to the point where short-term rates are essentially equal to, and may exceed, long-term rates. This infrequent situation has often preceded a recession. Usually, however, this "inverted" rate structure occurs at a higher level of rates, which makes new business investment too expensive and chokes off growth. The flattening of the rate structure has occurred at a lower level today though, because our government's bonds continue to be subsidized by other countries. While predictions of a recession on this basis may be premature, it makes sense to get used to the idea that the current expansion has gone on for some time, and the economy's growth may slow, particularly if the overall level of interest rates rises.

Stock prices developed a small head of steam during the 4th quarter, but the Dow Industrial Average still closed the year lower than it began. The average had a total return of 1.6%, including dividends. The S&P 500 fared a little better at 4.8% and 10-year treasury bonds turned in a 2.9 % return. All in all, it was a lackluster year for the averages, but natural resource stocks like oil and gold, and smaller-cap stocks performed considerably better.

Risk and Return

A primary focus of LFM&P is managing risk and we urge you to consider risk as well. One way to reduce risk is through diversification. Diversification, the practice of investing in different asset classes, sometimes will also improve performance. This year, both large-cap stocks and bond returns were sub-par, but portfolios that included other asset classes, with perhaps some exposure to the energy sector, fared better. Likewise, while LFM&P's MarketAware℠ approach is designed to manage risk, it has also resulted in higher overall returns since its inception in 2002. The following charts compare *LFM&P*'s actual composite returns and risk from all its managed accounts (blue) to: 1) a widely-held stock fund (Fidelity Magellan - red), 2) a widely-held bond fund (Fidelity Government Income - purple) and 3) a comparable "moderate-risk" portfolio composed of a 50% mixture of both (green). The *LFM&P* composite includes portfolios of clients whose risk profiles range from conservative to aggressive, but essentially targets moderate risk in the aggregate. The "largest loss" chart shows the biggest drawdown from the





highest prior peak, measured on a monthly basis. The data does not include sales commissions, loads or advisor fees. The results show that during this period, diversification and paying attention to risk is not a stodgy approach, but can actually improve returns. *LFM&P*'s result show lower risk and higher returns than all of the compared categories. We do not expect that *LFM&P*'s composite results will continue to exceed both categories over the long-term. We expect that *LFM&P*'s largest loss will eventually exceed that of a conservative bond portfolio, simply because the *LFM&P* risk profile is more aggressive. We also expect that the return of an aggressive stock portfolio (red line) will exceed *LFM&P*'s "moderate" risk composite profile at some point. But while the comparisons are very favorable and could continue, the tendency to project the results into the future misses an important point. Your goal is not necessarily to maximize return or minimize risk, but to increase the chance of achieving your life objectives, whatever those may be. For each person the risk and return equation is different. To the extent, however, that you can improve your returns while controlling risk, or decrease your risk without sacrificing return, the more likely it is that you will be successful reaching your goals.

LFM&P's investment management services can help you achieve securities market returns while managing risk. If you would like help planning to reach your financial goals or managing your investments, please give us a call or send an e-mail.

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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. 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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