LFM&P

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

The several months since the last issue of *Outlook & Trends* have borne out our suggestion that the financial markets were strong and seemed to be following the four-year presidential election cycle. As this issue is written, there are no over-hyped media stories to clarify or crises to explain. Instead, we have instead taken this opportunity to present a story at the end of this letter that compares common financial approaches to a sailing voyage. It shares several conclusions that we have distilled over years of separating fact from often-repeated financial fiction.

In each of the last two January issues, we have updated you on the results of our MarketAware℠ risk management approach. They are also included again this January on the enclosed sheet. The results continue to show that it has been possible to achieve good investment returns while simultaneously managing risk through asset allocation.

On March 20, 2007, David will be presenting another class through the Concord-Carlisle Community Education program. This one is entitled "Asset Allocation and Your Investment Results". Asset allocation is the primary factor that determines the results your investments will achieve. Since many people's financial future is strongly influenced by their investment results, asset allocation exerts a major influence on financial health. If you would like to find out more about what it is and why it is important, please join us. You can get registration information at http://ace.colonial.net or call (978) 318-1540.

Economy

This type of economy is often referred to as "Goldilocks", named after the baby bear's porridge that is "just right" - not too hot, and not too cold. Unemployment remains low at 4.5%. The growth rate of consumer prices has dropped back to just below 2% along with lower oil prices, giving the Fed little immediate reason to raise interest rates. The real domestic economy grew at an annual rate of 2% during the third quarter, which is below normal and also less than the prior quarter's measurement of 2.6%, but corporate profits continue to rise strongly at the same time. The 30% annual profit increase recorded by the government's Bureau of Economic Analysis is the strongest since 1984. Although analysts are suggesting that this rate will moderate to 9.7% by this time next year, continued profit growth is expected to be helpful to equity investments.

The economic dark spot continues to be home construction and sales, which is the sector that helped to reduce the economy's overall growth rate when mortgage interest rates increased. The median existing US home sale price dropped 3.5% over the last year. The South led the decline with a 7% drop, followed by the East's 5.2%. Home sales may be stabilizing, however, as sales of existing homes have increased slightly and the number of months worth of houses offered for sale has leveled off.

Financial Markets

In comparison to real estate, the stock market (as measured by the S&P 500) turned in a better than average year, returning 15.7%. Bonds only returned about 2.1%. Bonds and stocks together would have produced an overall gain of about 8.7% in a typical balanced portfolio consisting of Exchange Traded Funds (ETFs). A similar account that contained regular open-end mutual funds would have gained about 7.8%, slightly less than the ETF approach, reflecting higher mutual fund management fees. Stock gains came during the last half of the year when the Fed stopped raising interest rates, leading the usual upturn in the four-year presidential cycle by several months. The relative outperformance of equities versus real estate was just the opposite of our experience during the first several years of the decade. This is a good time to look back and recognize that the path to wealth is not paved with only stocks, bonds, real estate or commodities. Each is just a different type of asset that will have good times and bad. In our view, successful investing comes from maintaining awareness of economic and market conditions and a long-term commitment to the investing process, but not being inflexibly married to a single investment or asset class.

An Allegory

Let us tell a fictional story about three sailing ships for hire in a harbor on the east cost of the US. All three were very similar, very capable ocean-going vessels.

The person who hired the first ship had no particular destination in mind, and after an enjoyable morning's sail down the coast a storm began to brew. The novice traveler became fearful and demanded that the ship return to the safe harbor. He gained some experience from his sail, but accomplished nothing else for his time and expense.

A second voyager hired the next ship with the intention of crossing the ocean and reaching England. Although he had a firm destination in mind, this person decided to economize and sail by himself. He was successful and prosperous in his own trade, but his seafaring knowledge was limited. He had believed the shipbroker, who told him that with this very special ship, he need not worry about high winds and storms. He should just keep half of the sails raised at all times. He could lash the wheel and the ship would steer itself in a northeasterly direction while he slept comfortably in his cabin. Unfortunately, when the inevitable storms appeared, our naive sailor was mercilessly tossed around, without the knowledge or ability to lower the sails or reset the ship's direction. Although the ship survived, our traveler was glad to get off alive four months later and, not wanting to sail again, decided to make do by living in Brazil where he had landed, far from his intended destination.

Another traveler, who had no more knowledge about sailing than the first two, hired the third ship. He also wished to reach England, but he realized that to do so effectively, the ship needed a captain and a crew. He hired a captain who kept the ship on course during good weather and bad by charting their position and adjusting their direction. During good weather and favorable winds, the captain hoisted all the sails and made excellent progress. When the crew spotted bad weather on the horizon, the sails were furled and the ship gracefully rode out the storms. They reached England in two weeks.

In this story, the ship is analogous to your mutual fund or 401(k) retirement plan. It is a vehicle that is only capable of transportation. By itself, it has no direction-setting or decision-making capability. It cannot automatically steer a course to your life destination. It does not protect you from adversity. There are other lessons as well:

1) You must identify your goals and be committed to your course in order to get anywhere at all.
2) Although the industry may tell you to ignore economic conditions and just endure the market storms, following this advice can lead to underestimating risks and a bumpy ride.
3) Making one course decision, then going to sleep, is a recipe for winding up far from your goal.
4) Know the difference between a shipbroker and a hired captain.
5) When the success of your journey is at stake, economizing on expertise may wind up costing much more.
6) Ongoing management can lead to a straighter path, a smoother ride, and a more enjoyable journey

To learn more about *LFM&P* investment management and financial planning services, our client goal-centered financial philosophy, and to better understand the value we can bring to your financial life, we encourage you to contact us or look at our website, www.linnardfinancial.com.

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