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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

Economic and financial market conditions remain cloudy. Economic growth has slowed down further from a previously lackluster rate. The stock market has largely been flat for almost five months, but this is not unusual for the summer period. Overall the economy is mixed. The outlook is uncertain, and for most people, the economic story is confusing at best. In this issue of *Outlook & Trends,* we will try to explain what has happened and provide some background clarity, so that you might have a stronger foundation for your financial decisions going forward.

Before we start, however, we would like to invite you to check out our newly expanded website www.linnardfinancial.com. Like *Outlook & Trends*, it is written with the hope that it will help you to better understand a few financial planning and investment issues that are either obscure or are still heavily promoted, but outdated. We would appreciate your e-mailing any feedback that you can give us.

The Economy

It is said that people who say, "This time is different", do so at there own peril. But this economic downturn *is* different from most of the ones we have seen. The Federal Reserve has intentionally engineered and controlled most of the recent economic slowdowns. They start recessions by raising interest rates. This reduces business profitability, slows economic activity, and cools down the inflationary pressures that have built up from an overactive economy. Higher rates and tighter credit are maintained until the economy has slowed down sufficiently. When the Fed decides inflation has come under control, they lower rates again, which stimulates borrowing. Activity picks up again. In order for this process to work, there must be pent-up demand just waiting to use the lower rates to go back to work and start the growth process all over again.

But this time was different. Too many people and too many companies had borrowed too much this time, with too little collateral security. Borrowing magnifies both gains and risk. Borrowing reduces maneuverability. When the economy slowed down and profits were reduced, the slim safety layer of collateral evaporated, and borrowed debts could not be repaid. In some cases, the lenders who were not repaid were also borrowers and might not have been able to repay their own obligations. The threat of defaults sent a shockwave through the entire house of cards. The government stepped in and injected "TARP" money to keep the system from collapsing.

After the fact, some people and companies began to recognize that their debt had been excessive and had jeopardized their financial health. They cut back their spending and decided to pay down their debt. Other people and companies had no choice. Their mortgages were underwater; their credit cards were maxed out. They could no longer tap their homes and plastic to keep up their accustomed spending. What happened to the companies that sold goods to the people who would no longer buy? They too cut back. They laid off employees. The laid-off workers then had to cut back even further. Some could not afford their mortgages, so their homes were foreclosed. Foreclosed homes reduced housing prices, so other people with over-extended mortgages went further under water.

When you start a gasoline lawn mower engine, you pull the cord and create a spark to ignite the fuel. The engine will not start without both the fuel and the spark. During a typical recession, the Fed intentionally starves the economy for fuel, but the spark remains, so the engine quickly accelerates when the fuel is provided again. This time, the Fed and government have provided plenty of fuel with record low interest rates and large bond purchases, but there has been no spark. This time there is little pent-up demand to get the economy moving again. Despite the government pumping trillions of dollars into the economy, the recent lessons learned about the effects of overextended debt remain a powerful force. Fewer want to borrow, fewer want to spend, fewer want to lend.

The government is good at providing fuel. Politicians love to spend. Unfortunately the spending is coming from more debt. The government indebtedness is replacing the private indebtedness. We saw how the private borrowing problem ended. Can we assume that the government actions will have a different result? Recalling the parable about the goose and the golden eggs, government officials have been too interested in dividing up the golden eggs without paying enough attention to the health of the goose.

In a usual recession, the problem is inflation. Too much money is available. Too many people want to buy, causing prices to increase. The more money there is, the more inflation there is. This time there is an unprecedented amount of money available, but if few are interested in buying, there is no inflation; there could be deflation instead. The Fed just said that the inflation rate is lower than they would like to see it. They are concerned about deflation. Few buyers cause fewer sales, more layoffs, and then even fewer buyers. Flooding the engine with fuel does not work. A spark is needed. Businesses must see that they can invest profitably, that they can hire profitably.

Once the spark occurs, what will happen to all the excess fuel that is sloshing around? What will become of the debt that has been incurred? How will it be paid off? Increased taxes? Not likely. That could do the goose in for good. It will likely be handled the way it has been in the past. Pay off the debt with cheaper dollars. Inflation.

Planning

The good news is that, while this time is different, the US economy has been through times as difficult or worse. They were not magically resolved, however. The economy has been resilient, because the people have been resilient. We recognize and learn from our mistakes. We correct our ways. To stay ahead of the forces, we must personally engage. We must evaluate our financial habits and attitudes. We must question the assumptions that we built during a different time.

One reason that there is no spark is because people and businesses are stuck. The economic shock, coupled with uncertain legislative changes, has caused us to freeze. Like a deer in the headlights, we are uncertain which way to turn and hesitant to make new commitments. Although the rules to the game of life may change, if we know what the rules are, we will eventually figure out how to play and, like the deer, which way to turn. We need to remain aware of our personal financial condition. We must have a process for evaluating our ongoing financial health. Maintaining awareness is the vaccine for potential financial paralysis.

Yes, this time is different. You can anticipate that it will be different for a while. How should a person cope in this kind of uncertainty? Evaluate your position and plan. Practice the basics. Plan to build a cushion. Plan to keep your expenses below your income. Plan to keep your assets above your obligations. Plan to avoid using debt for discretionary expenses. Plan for the unexpected loss. Plan to save and invest. Even retirees should be plowing back part of their income into investment to protect against inflation. Manage your investment risk.

If you need to build, rebuild, adjust or review your financial plan and strategy, we suggest you seek a Certified Financial Planner™*,* who acts as a fiduciary. Choose a fee-*only* advisor like *LFM&P* that does not receive commissions or rebates from selling you financial products like load funds and annuities. 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. Once again, we encourage you to look at our newly expanded website, www.linnardfinancial.com.

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