LFM&P

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

October 3, 2003

Outlook & Trends

Over the last three months, the financial markets have experienced considerable fluctuation, but finished almost where they began, with stocks slightly higher and most bonds showing positive returns as well. The economy is picking itself up. The trends that have prevailed for the last several years appear to be changing. To navigate through the uncertainty, 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

The good news is that the economy grew at an annual rate of 3.3% during the 2^{nd} quarter, a substantial improvement over the 1.4% rate registered during the three months before. The bad news is that a good chunk of this growth may be artificial, based on government spending increases. Hopefully the government spending and tax cutting stimulus “primes the pump” to the point where growth is able to sustain itself. Many economic indicators are strong or improving. Residential construction continues to lead the way, but retail sales and industrial production are also up. Analysts’ expectations for profits have been increasing at a 10% annual clip since the beginning of the year. Inflation continues to be low (anywhere from 0 to 2.2% depending on how you measure it), which means that companies do not have much leeway to raise prices and must increase profits by improving productivity. Improving productivity is another way of saying cost cutting, which has resulted in stagnant employment conditions. It is logical to expect that the economic growth cycle will not be self-sustaining until new employees and new capacity are needed.

The lack of inflation and the possibility of deflation are still very much on the minds of the Federal Reserve. Government policy is strongly directed at increasing inflation by cutting taxes, creating a federal budget deficit and abandoning its strong dollar policy. The relationship goes like this: as the government spends more than it earns, it promotes inflation by pumping up the money supply and making the value of the dollar cheaper. As the dollar loses value versus other currencies, foreign goods become more expensive to us, but our goods become less expensive abroad. This increases our costs for imported goods, but also increases our exports, economy and hopefully jobs at home. Increased exports and profits from foreign trade should be good for investors, but there is a fly in the ointment. The falling dollar reduces the returns of foreign investors who own US stocks and bonds. If they decide to sell their positions rather than absorb the currency losses, they will put downward pressure on US stock and bond prices. Typically, strong stock markets have been associated with a strong dollar.

Financial Markets

As measured by the S&P 500, stocks gained as much as 6.6% during the last quarter, but then lost most of it in the last 8 days. Gold led the way, reflecting the weakness in the dollar, accompanied by technology and international issues. Energy, utilities, airlines, and drug stocks brought up the rear. Bond prices dropped significantly early in the quarter, but most recovered their losses and finished ahead. High yield, short- term, mortgage, corporate and municipal bonds all outperformed US Treasury issues.

Because of the improved earnings prospects, stocks remain undervalued by 34% relative to treasury bonds according to the “Fed” valuation model. The price / earnings ratio of the S&P 500, another measure of valuation, stands at a less impressive 17 times estimated operating earnings (and 33 times actual current earnings), which is high compared to most periods other than the “bubble” years of the late 1990’s. If analysts’ expectations of corporate earnings continue to improve at the 10% annual rate of late, then stock prices could rise by a similar amount without these valuation measures deteriorating. Eventually, over the long term, however, both measurements are likely to return to “normal”, which would work to restrain (or depress) both stock and bond prices.

The relatively flat quarterly stock performance in the midst of improving expectations is probably traceable to seasonal factors and the lopsided Bull/Bear sentiment discussed in our last letter. Stock prices tend to advance in the November to May period, so the seasonal effect will become supportive soon. Sentiment still remains stubbornly high, although it could drop to more normal levels on a stock price correction.

Planning

The economy and markets have provided many opportunities and dangers over the last several years including record setting bull and bear markets, unprecedented mortgage refinancing opportunities, and both high and low interest rates on savings. As an investment manager and advisor, our goals are to preserve and grow clients’ wealth, while paying close attention to their preferences and risk tolerance. A problem with today’s financial marketplace is that there is an emphasis on selling products, such as mutual funds, insurance, annuities, bank accounts etc. with only a limited connection to each client’s personal financial needs. Since there is no personal connection between mutual fund managers and their shareholders, funds are necessarily managed to achieve *their* objectives. It is the shareholder’s responsibility to assure that a fund is right for them. Ongoing financial management and planning fill this gap. If you do not use the services of a financial advisor who devotes ongoing energy and attention to your long-term objectives, you have implicitly taken on these responsibilities yourself. Maintaining a financial plan is important to make sure your current investments fit your future needs. We suggest that you make sure you consciously consider these issues and make sure you are comfortable with your conclusions.

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

Dave
David C. Linnard
President

Barby
Barbara V. Linnard
Vice President

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.

Linnard Financial Management & Planning, Inc.
46 Chester Road
Boxborough, MA 01719

DCL@LinnardFinancial.com
BVL@LinnardFinancial.com
978-263-0025

A Registered Investment Advisor