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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.
REGISTERED INVESTMENT ADVISOR

October 1, 2005

Outlook & Trends

Once again, we have short-term events dominating people's view of economic prospects. When the last *Outlook & Trends* was written in July, the focus was on the housing bubble. This month the devastation caused by the hurricanes has captured most people's attention. Underlying economic conditions generally do not change as quickly as the media's attention span. To stay on the course to your financial goals, it is helpful to maintain an accurate perspective of where we are in the continuous flow of economic events. It makes sense to look beyond today's headlines and keep an eye on the major trends. We are all personally affected by long-term shifts in economic and political conditions. Awareness and preparation can help you capitalize on opportunities and mitigate risk. A prerequisite is a sound financial plan and investment strategy.

Economy

Before the hurricanes hit, economic conditions were good and will likely to remain so, if interest rates do not increase too much. Most current indicators are based on data that was collected before New Orleans was flooded and gasoline prices spiked, so they show economic growth running at a solid, sustainable pace. Unemployment is low and corporate profits are still rising rapidly. Recent reports on sales of existing homes show an annual price gain of 15% for sales completed in August, but the Federal Reserve reported "signs of softening in some markets" in September. Commentators suggest that there will be a noticeable short-term effect from the storms, but after a time the economy will return to its previous growth path. In fact, consumer confidence, measured after Katrina, showed a big drop during September to the lowest level since 2003. Much of this reaction may be due to the rapid rise of gasoline prices. Even before the recent run-up though, higher energy prices pushed inflation up to 3.6%, fueled by a longer-term trend of higher world demand for energy and tight supplies. While gas prices may come back to earth for a time, the general trend in energy prices is not likely to reverse soon without a global recession.

If the Federal Reserve continues to see the potential for inflation, it is likely that they will continue to raise short-term interest rates. Historically, business downturns have occurred when short-term interest rates have been higher than longer-term rates. We are not yet at that point, but we may be getting close. Typically this type of tightening is done early in the 4-year presidential election cycle, so the economy cools down early and is rebounding strongly at election time. Offsetting tighter monetary policy, however, will be additional government spending to rebuild the Gulf coast infrastructure. This additional spending stimulus may be sufficient to keep the economy humming despite higher interest rates and higher inflation.

Financial Markets

Stock prices, as represented by the S&P 500, are just 1% higher than where they began the year (about 3% if dividends are included). The Dow Industrials are lower and smaller stocks are a bit higher. All in all, it has been a lackluster performance so far in most areas except energy and gold, which were up strongly. This sub-par performance does not reflect the fact that company earnings are expected to be 14% higher this year. This discrepancy continues to keep large stocks undervalued, so stocks prices may have some catching up to do to. Short and intermediate bonds have not fared much better, reflecting the Fed's interest rate policy, while long-term bonds have posted a 7% gain.

Planning for Financial Storms

Watching the devastation caused by the flooding of New Orleans, one cannot help but wonder why the levees that were intended to keep the water out were not stronger. After all, living on land that is below sea level is a major foreseeable risk. Over the years there were plans to strengthen the barriers that were never undertaken, perhaps because before the storm hit, it was not the immediate problem.

This tragic occurrence closely parallels how many people approach their long-term financial well-being. It is human nature to minimize the importance of preparing for foreseeable, but future, risk and concentrate on today, thinking, "We'll cross that bridge when we come to it." It is not unusual for people to take on the burden of heavy debt obligations, without considering that a personal storm like illness or the loss of a job could put their finances under water. There has been much talk about the inability of Social Security meet its promises to the upcoming generation of retirees, yet many people are not preparing for the retirement storm that is just over the horizon. Today's current retirees may be too comfortable with fixed income pensions and shun growth investments as risky, underestimating the effects inflation will have on their future buying power.

In the case of New Orleans, early planning and investment in the levee system, perhaps foregoing some more popular immediate projects, would have mitigated much of the risk to the life and property that was lost, and at far less eventual expense. So it is with personal financial stability. Planning for risks now, planning for the future, reducing debt, saving and investing systematically will go a long way toward shoring up your future.

Financial planning can help you see how to balance today's opportunities and requirements while building an effective approach to provide for your future. Investment management 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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