LFM&P

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

Readers of *Outlook & Trends* over the years know that our primary goal has been to try to provide you with clarity, independent thinking and insights that are sometimes different than the conventional wisdom. The conventional approaches often do not seem to be capable of adapting to changes in personal or prevailing economic conditions. Recent economic events have illustrated this starkly. Putting one's financial future on autopilot can wind up with disappointing results. Because future changes and outcomes are not at all certain, it is incumbent upon individuals to be aware, take charge, and manage their financial progress. With this issue of *Outlook & Trends*, we are placing our discussion of financial management ideas before our usual commentary on current conditions, to emphasize the increasing importance of planning, attention and adjustment in this era of change and uncertainty.

Adjusting Your Financial Course

In the last issue we discussed the importance of "adjusting your sails when the wind changes". We discussed how good execution was an important and necessary complement to good planning. Even for those who recognize the importance of adjusting to new conditions, it is one thing to be willing to change course and quite another to know how to do it. As the current economic debacle has unfolded, we have continued to ask ourselves what is the best way to cope, particularly for those people who are near or in retirement. Here are some of our thoughts:

- Most people understand that the prosperous growth of the 1980's and 1990's is no longer the prevailing economic climate. It is likely to be a mistake to try to relive the past and follow rules that were right for a different time, but not for today. The current national predicament was a house of cards built on a shaky foundation of debt. Those who used excessive debt leverage were the first to feel the effects. Financial self-preservation suggests making sure that credit is not used to buy merely nice-to-haves, but rather used only most carefully for serious investments that will provide a clear return.

- For those who are fortunate enough to not yet be retired or laid-off, know that your job and career is a very valuable asset. It provides a consistent financial return much like a savings account or bond investment. For people near retirement whose plans were quashed by the stock market fall, remaining in your job may be one of your best moves. Not only does it provide additional time to save and rebuild your nest egg, it also reduces the number of years that you will need to draw on your savings.

- Changes in retirement benefits away from employer pensions to 401(k)-type plans have placed the responsibility for retirement squarely on employees and the Social Security system. Social Security is not intended to be a retirement plan. It was intended to be a safety net. A financially healthy retirement requires significant additional savings. This is one area where the conventional wisdom is correct. If you still have the opportunity, invest as much as you can, as early as you can.

- But where can investments be made safely? The simple answer to this question is, "Nowhere". Investment always involves risk. There is a constant trade off between risk and return, sometimes in unexpected ways.

    - If you save in bank CDs or money market funds, which have very low direct investment risk, you have an increased risk that your returns will be so low that you will not achieve your retirement goals (and are likely to not even keep up with inflation, after taxes, for that matter).
    - Residential real estate had rarely dropped in value and became a central component of the retirement plans of many people, but is now often shunned as a retirement investment.

- Commodities and collectibles can serve as options for savings, performing best as a hedge against high inflation environments. They too have risks. Commodities can be highly volatile. Collectibles can be illiquid and hard to sell at a good price at the time you need the cash.
- Bonds are historically known as a prudent investment with lower returns and lower risk. Bond risk occurs in an inflationary environment. Inflation erodes purchasing power and is one of the greatest risks to a retiree's budget that relies solely on fixed income vehicles like bonds or fixed annuities.
- Stock prices have collapsed over the last few years and have had a negative return for the last ten years. Stocks have recently dashed many retirement dreams, just like real estate.

- Risk is unavoidable, but the good news is that it can be managed. The values of different asset types move up and down at different times. In the 1970's, commodities provided the best returns. In the 1980's and 1990's, stocks were in the forefront. In the 2000's, real estate led the price parade. What does this teach us?
  (1) Being aware, managing your investments, and adapting to conditions is important
  (2) Some degree of stability can be gained by diversifying and mixing different asset classes.

Investment vehicles have changed over the years. The popularity of no-load mutual fund and exchange-traded funds (ETFs) has increased the ability to diversify easily and inexpensively. These funds now provide the ability to build diversified portfolios using equities, bonds, commodities and even real estate. They also allow the mixture of portfolio assets to easily be changed to reflect the changing performance of different asset classes. Ease of access and the cost efficiency of no-load funds and ETFs have removed a major rationale for the old buy-and-hold conventional wisdom for people who understand the importance of managing their future.

Mutual funds and ETFs can reduce some risk through diversification, but how can you find good funds? A primary criterion is to always select no-load funds or ETFs. After narrowing the field to these, you can look at two measurements that are published in the "Ratings and Risk" section of Morningstar.com and the "Risk" section of finance.Yahoo.com. The "Beta" measurement shows how much the fund magnifies the market's movement. A higher "Beta" means the fund is taking higher risk. For this kind of fund, gains can be impressive, but may be short-lived. The "Alpha" measurement shows how good a job the manager is doing. The higher the "Alpha", the more value they are adding. We have enclosed a sheet that explains these terms further, and also indulges in a little self-promotion, showing the "Alpha" and "Beta" of LFM*&P's* managed accounts using our MarketAware℠ approach.

The Economy

In the final quarter of last year, the economy grew at a supercharged annualized rate of 5.6%, fueled by the government's life-support programs. The Economic Cycle Research Institute's leading indicators suggest that growth may be slowing, however. More employment is necessary to get back a full head of steam, but the unemployment rate (without adjustments) is 10.4%. Realtors report that existing home sales peaked in October and home prices are again flat or lower, except in the Northeast. These observations are consistent with the Federal Reserve's opinion that "the pace of economic recovery is likely to be moderate for a time".

If you need to build, rebuild, adjust or review your financial plan and strategy, we suggest you seek a Certified Financial Planner™. Choose one like *LFM&P,* who acts as a fiduciary advisor and does not sell 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. We also encourage you to look at our website, www.linnardfinancial.com.

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