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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

Once again, the snow is melting in the northeast. The change of seasons reminds us how cyclical our financial, social, political and physical environment is. The proverbial pendulum continues to swing from one extreme to the other. Sometimes people learn from the process, but often we seem to invent new ways to make the same mistakes.

The fallout from the recent excesses in housing is the most current economic example. Not long ago, many thought that real estate was a much safer investment than the stock market, which had just taught a hard lesson to those who chased the Internet and technology bubble. Recently real estate has been the laggard and may be a potentially significant problem for over-extended homeowners and aggressive mortgage lenders.

Since the financial markets are simply a reflection of the psychology of the participants, the lessons that can be learned from studying the ebb and flow of investment values may be applicable to many areas of our lives. We offer a few observations for your consideration that may have broader applicability beyond their financial origins:

- We are better off in the long run managing our risks than ignoring risk and chasing gains.
- It is best to recognize extremes for what they are, wherever they are found, rather than falsely believing that a prevailing bandwagon mentality represents an ultimate and lasting truth.
- All investments represent some type of asset that has recognizable good and bad times. Often such times represent extremes and occur just before a major reversal. A similar effect can be seen in the fortunes of political and social structures, as well the fashionability of widely accepted, yet incorrect, beliefs.
- Diversification of ideas and power, as well as investments, leads to greater stability and safety than does concentration

Economy

The Federal Reserve Bank observes that the economy is growing moderately. It expects the moderate rate of growth to continue. The growth rate of the Gross Domestic Product, the total of all our domestic activity, is measured to be 2.5% annually. Unemployment remains low at 4.7%, and the workforce is expanding by 2% per year. Inflation remains moderate at 2.5%, although gasoline prices are rising again, ahead of the summer driving season.

During the third quarter of 2006, the most recent for which data is available, corporate profits grew at an annualized rate of 30%. Since 1948, there have only been seven periods that were stronger than this reading, and none stronger since 1984. Most of these were followed by a short period where profit growth rested for several quarters. We may be in such a resting period now.

As is often true with the economic pendulum, the very forces that provided the growth for the last several years are now producing the drag. The home real estate sector is still trying to find a bottom. There were fewer unsold houses "on the market" for sale during the winter, but there are still many more than last year at this time. Nationally, single family home prices declined by .4% over the last year.

Financial Markets

The stock market ended the first quarter almost where it began, taking a breather after the long run up that started last July. A steadily growing economy, a continuing under-valuation of stocks relative to treasury bonds, and the third year of the four-year presidential cycle are all positive factors. Toward the end of last year, prices appeared to be somewhat overextended, however, so this period of rest and short-term price pullback can help provide the headroom that is necessary for a subsequent rally.

Health Savings Accounts, Health Insurance, and Retirement Savings

Insurance, in its pure form, is a means of mitigating financial risk. It is a way to spread out the risk of financial calamity of an infrequently expected, but very expensive loss. Insurance against earthquake and fire represent this kind of application. When buying this kind of insurance, it makes sense to “self-insure” as much as you can afford, by keeping your deductibles as high as possible and saving on the premium expense. The probability is low that you will ever experience the loss and have to pay the deductible. However, make sure that the deductible is not set so high that paying it will result in your financial ruin, if the insured event does occur.

Health insurance is partly insurance in the classic sense, in that it protects against the cost of expensive medical procedures that can bankrupt an individual. But low deductible health insurance, which has high premiums, and its similarly expensive cousin, the Health Maintenance Organization, pay for frequent, small, routine illnesses as well. Since it is known by the insurers that these services will usually occur, most of their cost is included in the premium. One reason that paying the doctor through the premium, rather than paying directly from salary earnings, is popular is because premium payments are tax-free, while salary earnings are not.

The Health Savings Account (HSA) is a relatively new creation that has the effect of offering tax-free treatment of routine medical care while reaping the economies of only paying for insurance against potentially ruinous expenses. In order to use an HSA you must also have a High Deductible Health Plan (HDHP). As such, it may be an appropriate option for people under age 65 who are self-employed and arrange for there own insurance, or are an employee of a company that offers this kind of plan. The HDHP covers the big expenses and preventative procedures, while savings withdrawals from the HSA are meant to pay for routine small illnesses. The usual way of thinking about using an HSA is that the money you deposit in the HSA is tax-deductible money, and you use this money to pay your medical expenses. At some point, if you have a hard year, you may have enough expenses to meet your HDHP deductible. Thereafter, the HDHP insurance pays. If all other characteristics are equal, you “win” in any years where your expenses are less than the premiums you save due to the higher deductible, plus the amount you would have paid using the lower deductible.

Unlike former “use-it-or-lose-it” plans, you can keep unused money in an HSA growing tax-free until you and your spouse die. This presents a different way to think about, and use, an HSA. If you pay your initial medical expenses out-of-pocket, rather from your accumulated HSA savings, your savings grow tax-free just like your IRA or 401(k). When you do take medical expenses out of the HSA, the withdrawals are tax-free, whether before or after retirement. Conversely, if you take any money out of your IRA, it is a taxable withdrawal. After age 65, if you take money out of your HSA, but do not spend it on medical expenses, the distribution is taxable, but there is no penalty, just like your IRA/401(k). In addition, unlike an IRA/ 401(k), there are no minimum distribution requirements. Looked at from this perspective, an HSA can be used as an additional tax-advantaged retirement plan that may be even better than a traditional IRA.

To learn more about *LFM&P* financial planning and investment management services, our client goal-centered and risk-managed 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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