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LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

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Outlook & Trends

So far this year, bonds have been stronger than stocks – just the opposite of last year and the opposite of what you might expect in an economic expansion. What gives? To stay on course toward your financial goals, it is helpful to maintain an accurate 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 economic engine is still chugging forward, although not as fast as earlier in the recovery. The simulative effect of last year's tax cuts and lower mortgage rates have dissipated somewhat, and economists are predicting a growth rate more in line with the US economy's long-term growth trend. The Federal Reserve's policy is to return short-term interest rates to a neutral level, removing the artificial stimulation that low rates have provided for over two years. Energy prices, which are increasing at a 10% annual rate, have given a temporary nudge to inflation, bumping it up to 2.7%, from the 2% it would have been otherwise. Personal income is increasing at a 5% rate, while corporate profits are up 20% from a year earlier. One piece of anecdotal evidence supporting the economic improvement is that the economy is no longer the primary issue for the presidential candidates.

Financial Markets

It is important for investors, savers and homebuyers to distinguish between short-term and long-term interest rates. The Federal Reserve plays a major role influencing rates for short-term debt like US Treasury bills and shorter bank CDs. Rates on long-term debt and mortgages are mostly affected by the government's financing of the national debt, corporations' need to borrow money, and investors' view of the long-term inflation outlook. When the Federal Reserve makes money easily available, short-term rates are low. As economic activity picks up and concerns about inflation increase, long-term rates rise, as they did until the middle of this year. When the Fed removes its artificial stimulus, short-term rates move up, but investors become less concerned about inflation and may simultaneously drive long-term rates down. This is what has been occurring over the last three months, and why bond prices have risen. Going forward, as the economy continues to expand and competition for available financing increases, long-term rates are likely to move up again, causing bond prices to drop.

Investors behave very much as a group. Groupthink tends to go to extremes, and the highs and lows of stock (and bond) prices reflect those extremes. In earlier editions of *Outlook & Trends,* we have commented on the exceptionally high degree of bullishness among investment advisors since the beginning of the current bull market. The bullish attitude was like the burner in a hot-air balloon, driving stock prices higher last year. Since then, the overly optimistic sentiment has been throttled back, and is beginning to approach more normal levels. As the emotional fire has cooled, stock prices have slowly lost altitude. The pattern resembles 1972, which resolved itself in a continuing bull market and a resurgence of investor optimism.

We have also commented on the relative valuation of stocks and bonds according to the “Fed model”. Recent trends have increased this discrepancy, recently making stocks close to 40% undervalued with respect to bonds. While there is no way to know if the sentiment pattern will repeat, the valuation measurement and 20% profit growth rate should bode well for stock prices as long as these conditions continue. On the downside, in addition to the potential risk of geo-political disruption, the first year after a presidential election typically produces the worst stock performance of the four-year term.

Your Financial Strategy

There are good strategies to provide for your future, and there are poor ones. “We’ll cross that bridge when we come to it.”, as a personal financial strategy, leaves quite a bit to be desired. A better approach, which is followed by many, is to work hard and continuously save for the future. This may be a prerequisite, but without considering what the future plans are likely to cost, or how these goals will be met, there is considerable room for improvement. For want of a well-considered approach, many retired people, who depend on their savings, wind up using their principal to live. This weakens their ability to produce income from their decreasing investment value and protect against inflation, which may be their biggest financial challenge.

As all travelers know, the key to getting to where you want to go is to plan your route ahead of time, follow a map, and measure progress by watching road signs or a compass. The financial journey is the same:

- Identify your objectives,
- Develop a strategy, and
- Frequently check your position against your interim goals and update your strategy when necessary.

There is no right or wrong strategy. Each person’s should be as individual as they are. The important things are to ***have one***, and to be ***confident*** that your strategy, like a map, will take you where you want to go.

It is possible to think of many reasons to put off, or avoid considering these issues, but lack of know-how should not be one of them. *LFM&P* can provide you with on-going and personal advice and active investment management. Just as problems usually do not improve with time, your financial options decrease as time goes on.

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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