Quarter Notes

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Retirement Notes

Only 37% of Americans believe their standard of living during retirement will be equal to or greater than the lifestyle they maintain during their working years. *Source: Mercer Workplace Survey*

Running on Empty - 55% of working Americans are either somewhat or very concerned about running out of money in retirement. *Source: Society of Actuaries*

Retiring early? Don't forget the cost of health care could be the largest item in your budget until you reach Medicare eligibility.

Annual ADV Offer

Each year the SEC requires that we notify clients when we are updating our ADV Part II. If you would like a copy of the updated form, please call the office. We will be happy to send one out to you.

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Economy Appears Slowing as New Year Begins

Volatility continues. The final quarter of the year normally delivers positive returns, but not in 2007. All the major indices suffered quarterly losses. The economy is slowing, but with1-1½% growth, the likelihood of recession is still only 50-50. The Dow gained 6.4% for the year. Its 4.5% decline for the quarter marked its first fourth-quarter loss in a decade. Tracking the broader market, the S &P 500 lost 3.8% for the quarter and managed a gain of only 3.5% for the year.

Falling interest rates and a flight to safety helped the 10-year Treasury climb 10% for the year. The yield on the 10-year Note finished the year at 4.03%. A rebound in technology shares carried the NASDAQ to a 9.8% annual gain, but it too fell in the final quarter, dropping 2%. The markets are reflecting investors' concerns about credit problems, real estate woes, $100 a barrel oil, and fear of recession. For the first time in years, large stocks outperformed small. The Russell 2000 lost 7% for the quarter and 2.7% for the year. International stocks did no better, falling nearly 5% for the quarter. For the year international stocks rose 8.6%.

Index	12/31//2007	% YTD
Dow Jones Ind.	13264.8	6.40%
S&P 500 Index	1565.15	3.50%
Nasdaq Comp.	2340.68	9.80%
Russell 2000	735.07	-2.70%
MSCI EAFE	2253.36	8.60%
10 Year Treasury	4.03%	9.98%

Is Now a Good Time to Invest?

This is one of the most frequent questions asked of advisors. The answer must be the same as always: "We can't know for sure."Certainly this past quarter has been a harrowing ride for investors. In November, heightened uncertainty resulted in recurrent daily swings of hundreds of points. Logic tells us "Buy low, sell high." Our stomachs generally advise us the opposite. Aside from the practical difficulty of determining the market bottom, a new study from the Schwab Center for Financial Research concludes that timing might not be all that beneficial.

Mark Riepe and his group constructed five investor types, tracking them over a variety of 20-year periods. Each invested $2,000 according to the investment strategy typical of their investor type. Investor One is the perfect market timer who uses his extraordinary prowess to buy at the lowest point of every year. Investor Two consistently buys in at the beginning of the year and is in for the long haul. Investor Three dollar-cost-averages, investing equal allotments every month. Investor Four has terrible luck and somehow manages to invest at the market top each year. Finally, Investor Five absolutely refuses to invest in the stock market and puts his money into Treasuries. Any guesses as to who does best?

When tested over a series of 62 20-year periods, it seems that the Investor One, the perfect market timer, does best, but not all the time. The most interesting finding in the study is that perfect timing does not give you that much of an advantage. From 1987 to 2007, the perfect market timer beat the immediate investor by only $4,905 ($146,761 compared to $141,856). The immediate-investor strategy also conclusively beat out dollar-cost-averaging by a margin of over $7,000.

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Liquidity Issues

The housing slump has claimed one of America's most affluent zip codes, Wall Street. A number of high-profile banks wrote down over $80 billion. The Federal Reserve and the European Central Bank (ECB) "injected liquidity" to increase availability of short-term funding. Banks frequently lend long and borrow short. In essence, they borrow money from depositors and other to finance loans. It is critical that the banks meet the balance between short-term assets and long-term liabilities. Some of these assets were aggregated subprime mortgages. The fear of defaults made banks reluctant to lend to each other, leading to the liquidity problems.

Over the years, banks invented ways to make risky investments while keeping them off their balance sheets. It is hard to determine where the bad investments are and who holds them. Our Fed and the ECB realized that to relieve the stress on the banking system, they needed to provide funds to meet obligations. By making funds available to sound institutions, the Fed has lubricated the financial system.

Some consider the injection of cash a bailout. However, it is the mandate of the central banks to keep the banking system functioning properly. So while some institutions have created a mess with their financial wizardry, we simply cannot allow an atmosphere of irrational fear to seize the availability of funds. The moves by the Fed and the ECB seem to be working to provide relief which hopefully will resolve the liquidity constraints.

Retirement Planning Part II

In April, we examined the appropriate withdrawal rates to sustain needed cash flow in retirement. We determined that a 4-5% withdrawal rate in a balanced portfolio is sustainable without substantial risk of running out of money.

How do we determine which assets get liquidated and in what sequence we choose to distribute? The order of distribution can make a big difference. For discussion purposes we will assume that clients have three sources of possible retirement cash flow: Social Security and defined benefit pensions; retirement savings like IRAs and 401Ks; and individual savings in non- retirement assets.

Three key issues merit consideration when planning distributions: 1) What asset classes and accounts to include, 2) the order in which these should be distributed, and 3) the annual withdrawal so as not to run out of money.

We start the retirement analysis with the Income Goal. The first line in our retirement cash flow comes from Social Security benefits. Next we deduct pensions and other continuing income sources such as business income or real estate income. What remains is the amount we need to draw from either retirement accounts or our individual savings.

How should we decide how much comes from each pot? While it is tempting to withdraw from personal savings first, since no taxes are generated unless gains are generated by sales, this strategy can be short- sighted. Imagine the scenario if you have spent down all your non-retirement accounts and all that is left is your IRAs. If you needed to buy a car, you would have to withdraw not only the amount for the purchase, but also to cover the tax liability generated by the withdrawal. It is a much better option to tax-diversify your cash flow.

One solution is to withdraw funds from your IRA up to the limit of what will keep you in or around the lowest tax bracket, and then look to your taxable investments to fund the difference. Since everyone has a different situation with taxable pension money received or continuing post-retirement income coming in, no solution is right in all circumstances. However, various scenarios can be run, with the assistance of your CPA, to limit the negative tax implications and plot the best course for you.

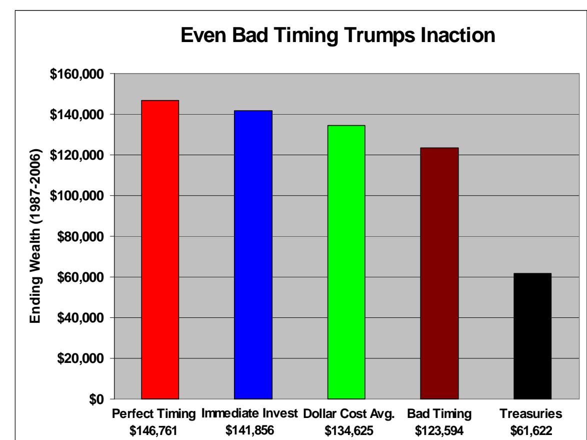
The Right Time to Invest

(Continued from Page 1 Column 2)

The worst investor was the one who placed all his money in Treasuries. His strategy produced a significantly smaller return than all the others, even the investor who has the worst possible market timing ($61,622 versus $123,594 from 1987 to 2007).

To see if this trend held true for a variety of time spans, it was back-tested to include time periods of 30, 40, and 50 years beginning in 1926 and onward. To no surprise, the results were consistent with the earlier findings, other than a few outlying periods where dollar-cost-averaging beat immediate investing. Why does this hold true? Although buying low consistently seems like an attractive strategy (if you forget the impossibility of actually determining where the low is), it requires the investor to keep a lot of money out of the market and miss powerful opportunities for appreciation that come from long-term compounding.

What should you take from this? A long-term investor can conclude that the strategy of sitting on money and waiting for the "best" time to invest is extremely difficult, and is likely to fail in the long run. Furthermore, even if you happen to have the worst timing, you will still come out far ahead of those who choose not to invest at all. If you are averse to committing too much money at once, dollar-cost-averaging, although lagging immediate investment, may be the strategy for you.



Best Wishes for a Healthy, Happy and Prosperous New Year