Quarter Notes
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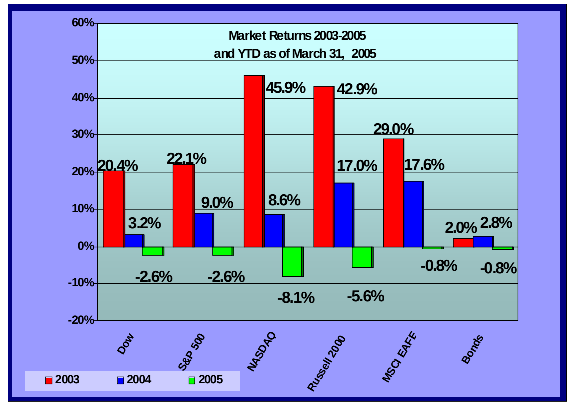
First Quarter Takes Back Some of Gains from 2004

After the robust fourth quarter which closed 2004, the markets gave back some of the gains. In NASDAQ's case nearly all the gains were given back. Oil prices are once again scaring the markets as spot prices topped $57 per barrel. With prices of other commodities rising as well, increases in prices of consumer goods can't be far behind. Because the increase in commodities prices is demand driven, growth is not likely to be stifled.

The Federal Reserve is addressing inflation concerns by continuing to raise interest rates a quarter point at a time. The 10 year Treasury now yields 4.55%. Interest rates are expected to continue higher with the 10 year Treasury rising to 5% later in the year. The Euro seems to have leveled off at about $1.30, making it difficult for European producers to continue supporting US consumers and not raise prices in dollar terms.



Like a Boy Scout……..Be prepared

Not all the current news in the financial press is negative. For 2005, the consensus estimate for growth in our GDP (Gross Domestic Product) is expected to be a solid 6%. That is comprised of real growth of about 3.5% plus inflation which is forecast to be about 2.5%. The interest rate for 10 year Treasury Bond is expected to creep up to 5%, which is still low by historical standards. Firms are reporting record profits, record cash flows, strong balance sheets and record cash as a percentage of assets.

So why is there so much trepidation by investors and predictions of doom and gloom? Well, the fears are not baseless. As we discussed in previous newsletters, there are substantial uncertainties on the horizon.

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How will Social Security be Fixed?

Politicians, economists, and analysts are each weighing in with their opinions on how to fix our nation's retirement system. With all of this attention, one would think that we have a clear picture of how to address the problem ahead. There seems to be little consensus, however, on how to proceed.

The Problem

Social Security has always been a "pay as you go" program. Taxes paid by today's workers support those currently receiving benefits.

As more baby-boomers retire, the country's Social Security trust fund will begin paying out more benefits than it will be receiving from payroll taxes, thereby running a deficit beginning in the year 2017. Projections for the current systems are showing that the Social Security trust account will be completely depleted, to zero, in the year 2041. The obvious concern is that the system will crash, no more benefits will be paid, and the Social Security system will be bankrupt.

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Market Summary

For the first quarter of 2005, all the major market indicies had negative returns.

Both the Dow Jones Industrials and the S&P 500 lost an identical 2.6%. NASDAQ was off 8.1% and the Russell 2000 lost 5.6%. International stocks performed the best, losing just under .8%. Bonds also were down just under 1%.

IRA Rollovers
The 2001 Tax Relief Act (EGTRRA) dramatically increased the portability of IRA and other retirement accounts. There is now complete portability between 401(K), 403B, SEP-IRA, Simple IRAs, 457 Plans, Profit Sharing and Money Purchase Plans. Assets from these plans can be consolidated into IRAs. Further, if the Pension Plan Trust Agreement permits, IRAs can be rolled into employer sponsored Pension or Profit Sharing Plans.

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Identity Theft

A growing problem for all of us is identity theft. If you have so far been spared, you probably have a friend or relative who has not been so lucky. According to the Federal Trade Commission, identity theft is the fasted growing crime in the US.

An amendment to the Fair Credit Reporting Act called the Fair and Accurate Credit Transactions Act of 2003 (FACTA) allows consumers one free credit report every twelve months from each of the three major credit reporting agencies. The FACTA rules on free credit reports are being phased in geographically starting with the western states. As of June 1st, Florida residents can obtain their free credit reports and as of September 1st, the remaining eastern states come on line.

To prevent abuse of your information, reports should be ordered directly from the credit reporting companies:

Equifax: www.equifax.com 800-685-1111
Experian: www.experian.com 888-397-3742
TransUnion: www.transunion.com 800-916-8800

So what are the fixes?

Private accounts are the most controversial proposal, but they have strong support from the White House. Private accounts would allow a small portion of your Social Security tax to be separated and invested in some type of investment account. The expectation is that the markets would provide higher returns on your money than the government would, and reduce the burden on the government's promise to pay. Also, you would be able to pass this account on to your heirs as an asset, unlike the program today.

The critics argue that the general public is not sophisticated enough to understand the risks involved with the stock market. They fear that people will gamble retirement savings away, or Wall Street's greedy brokers will take advantage of the unsophisticated workers. In addition, by diverting money into private accounts, a funding gap is created for today's retirees which legislators must find a way to fill, along with the enormous costs to set up and administer so many private accounts.

Other suggestions are to keep the current structure in place, but change the variables underneath the existing financial structure:

- Increase full benefit retirement age to age 70 by mid-century. (This is already scheduled to increase to 66 in 2011, and again to 67 in year 2027.) The effect will slow down the depletion, but will there be enough jobs to support a 65+ age work force segment?
- Increase the SS tax on wages to 15.9% from the current 12.4%. Nobody wants higher taxes, but the sooner we raise them, the smaller the increase. If we wait too long, the increase necessary would be impossible to attain.
- Change the cost-of-living-adjustment (COLA) to the price index instead of wage growth. The effect will be a decline in annual benefit increases for inflation, but it will reduce the drain on the SS trust account.
- Increase the amount of wages subject to SS taxes. Currently, only the first $90,000 of wages is taxed for SS benefits.

What will be the best solution? It could be some time before we get that answer, but it will probably be some combination of the suggestions above. What we do know is that something must change to keep Social Security alive for our heirs, so all of this attention is quite welcome.

We wanted to thank all our clients who were so prompt in returning our client questionnaire. We appreciate your taking the time to give us your feedback and will continue to work to maintain your confidence in our work

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We are experiencing unprecedented trade and federal budget deficits, an expensive war (in both human and monetary terms), a weakening US dollar, rising interest rates, record levels of US consumer debt, and the continued threat of terrorism.

Foreign governments are continuing to support our dollar by buying massive amounts of US debt. This is an ongoing source of concern. If Japan and China stop buying US bonds, interest rates could spike up and recession could follow. But realistically, these governments are not going to abruptly stop investing in US debt because it is in their best interest to keep their goods attractive to US consumers and to keep their citizens employed. Therefore, we do not expect significant changes in their tactics. It is likely that there will be a slow and steady effort to diversify away from a concentration in US debt.

This should enable the Federal Reserve to continue to raise interest rates slowly over the foreseeable future. A slow rise in interest rates could be absorbed more easily by our debt-laden economy without choking off all growth. If interest rates move up too fast, we could head into another recession. If interest rates rise too slowly, then we have greater risk of inflation. It is for this reason that we believe we are in a "range-bound" economy. The economy is growing, but slowly. There is inflation, but it remains modest. Interest rates are increasing, but at a measured pace.

We can't know with any certainty when we will emerge from this range-bound state, or whether the exit will be favorable or unfavorable for investors. We need to be prepared. Portfolios must be structured to cope with uncertainty. We need bonds in our portfolios for stability and crisis protection; we need equities for growth and inflation protection; we need international investments to protect against weakness of the US dollar. In summary, we need to maintain diversified portfolios.

Flash! US Supreme Court ruled Monday April 4th, IRAs protected from creditors as are other qualified pension plans.