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MANAGING TO RETIRE

update on market conditions and investment strategies

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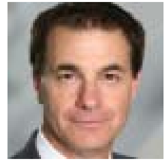

Anton Bayer, CFP

.....Take me out to the ball game .....

Here in California we have just about had enough of the rainy weather. In fact February as of the writing of this newsletter has been the wettest month in 3 million years. Here we have been patiently waiting for the sun to don our baseball gloves, mountain bikes and all other sporting equipment received at Christmas to go into the great outdoors to fulfill our weekend warrior desires (only to limp back to the office on Monday). Speaking of limping, the national real estate market has continued it's slowing from last quarter with new home annualized sales sinking 10.5% in February – sharpest decline since April 1997[1]. The west experienced the biggest decline with new home annualized sales dropping by 29% in February. The national supply of new homes for sale increased to 548,000 in January, a 22.9% increase over January 2005. Not in as bad shape is the existing homes sales market but is still experiencing slowing of sales with inventory of homes for sale also increasing[2]. This is not at all unexpected if not so well documented for the past 2 years it may be simply self fulfilling prophecy. However, the fact is every time mortgage rates rise 0.10% a segment of potential buyers become ineligible. So you might as well paint the living room (or other undone honey dos) because you're probably not moving. In the meantime, I'm going to take a break from standing under the porch with my baseball glove, tennis racquet and golf clubs watching the rain.

In this update:

- Economic Update
- Investment Strategy for Q2 2006

ECONOMIC UPDATE

For the past year I have kept my economic updates with forecasts to only one to two quarters in the future. However, in this segment

I'm going to explain what I believe will be the macro outline of the economy for the next 10 quarters.

It is important in managing your account to have some perspective on the overall trend of the economy to determine how aggressive or conservative you should allocate your account. I have stated many times in this column the importance of first determining the health and trend of the US and foreign markets before establishing your investment strategy. So here it is.

2006. I describe 2006 in my speeches as being in the eye of the hurricane. Two years ago was the presidential election and two years from now will be the next non-incumbent presidential election. We believe 2006 will be favorable for investors both in the US and foreign markets based on several factors. First, for the past 5 years average earnings growth of companies listed in the S & P 500 have increased more than 15% a year while the index annualized 5 year return is only 2.36%[3]. The appreciation in stock prices to catch up to earnings has already started. Note the first quarter increases of all the indices listed below (interesting the lack of major media reporting of the markets performance to date).

Second sign for a positive 2006 is that the fundamentals of the US economy should remain stable. Since May 2003 the US has created over 4.7 million new jobs, payrolls have expanded 30 consecutive quarters with January's national unemployment rate at a 5 year low of 4.8%. Average payroll earnings have also increased with 3.5% increase in January over same period in 2005 – a best gain in 4 years[4]. Still tame and probably for the balance of 2006 is inflation and interest rates. Therefore, we see a favorable US equity markets in 2006 and may even rival 2003. In regards to health of the US economy, let me quote Kansas City Fed President, Thomas Hoenig, who said on 3/31/06, "rates are near the upper end of neutrality…the [US] economy is near full capacity"[5].

2007. Unfortunately, the US economy may start sputtering in Q4 2006 as the winds of a perfect storm start swirling which is the impact of (1) rising interest rates, (2) inflation, (3) slowing real estate market, (4) and high oil prices. These factors may be too much for the US consumer in 2007. By mid 2007 we may be reading headlines of "slowing economy" and "recession". Bad news sells more papers than good news and there may be plenty to report by late 2007. So far this year the University of Michigan's Consumer Confidence Index has been declining during one of the best 1st quarters for the stock market since 2003 with solid job growth and rising weekly payrolls. Imagine how consumers will respond

when the economy is really slowing down in 2007.

2008. These events in 2007 set the table for an exciting presidential campaign giving all candidates and the media plenty of material to report. I believe the US equity markets in 2008 will trend similar to 2004 in which institutional and pension managers will stay on the sidelines with their capital until late October 2008.

The following reflect the performance of the major indices thru March 31,2006:

Index[7]	Thru 3/31/06
Standard & Poors 500:	+ 3.70%
Dow Jones Industrial Average:	+ 3.70%
NASDAQ:	+ 6.10%
Standard & Poors 400:	+ 7.30%
Gold:	+ 15.78%
Prime Lending Rate:	+ 7.75%

As Reported in Investors Business Daily March 31, 2006

INVESTMENT STRATEGIES FOR Q2 2006

As stated above, we believe that there are many current opportunities in both the US and foreign equity markets. The foreign markets and foreign emerging markets remain attractive especially if the dollar remains stable. On average, stocks on the EAFE index pay higher dividend than stocks in the S & P 500 index. We see countries like China and Japan growing with new jobs and economic expansion along with the growth of emerging markets that include countries like India. Therefore we would recommend increasing one's weighting into the world sector that may include foreign emerging markets category.

On the home front, US business are still benefiting from low interest rates, affordable commercial property and rising sales. This year we believe growth stocks will outperform value stocks and recommend equal weighting to small, mid and large cap sectors.

The last point is regarding the real estate industry. Without question real estate has been a leading growth industry for the past 5 years in creating jobs, wealth and new business opportunities. To quote Mark Zandi, chief economist at Moody's Economy.com, "the housing market is fading fast and the prospect is it will weaken further as rates move higher"[6]. If you need more evidence how about the recent conference on buying real estate at the San Francisco Moscone Center which was attended by a reported 61,000 people (largest ever attended event at Moscone Center)! If the real estate industry does continue to slow then a new equally benevolent industry needs to emerge to continue the US economy (oil and health care are not equally benevolent industries). I propose one new emerging industry will be technology. As mentioned in my market alert dated 3-15-06, it has been 6 years since NASDAQ and technology have been leading other industries in growth and much has changed since Y2K.

The following is our Q1 2006 allocations:

CATEGORY[8]	GROWTH PORTFOLIO	MODERATE PORTFOLIO	CONSERVATIVE PORTFOLIO
U.S. Stocks	60%	45%	30%
Foreign Stocks	25%	20%	5%
Corporate Bond	15%	35%	65%
Money Market	0%	0%	15%

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1 AP 3/26/06 by Martin Crutsinger
2 Morningstar Principia release 3/10/06
3 Investors Business Daily vol 22 no 233
4 AP 3/26/06 by Martin Crutsinger
5 Investor Business Daily 4/1/06
6 AP 3/26/06 by Martin Crutsinger

7 The Dow Jones Industrial Average (DJIA) is a price weighted Index of 50 of the largest, most widely held stocks traded on the New York Stock Exchange. The S&P 500, S&P 600, S&P 400 are an unmanaged group of securities considered to be representative of the stock market in general. The NASDAQ composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation system. An investment cannot be made directly into an index.

8 All investments involve risks, including loss of principal. Corporate Bonds are subject to credit risk, interest rate risk, and prepayment and extension risk. In general, bond prices rise when interest rates fall and vice versa. Investments in foreign markets entail special risks such as currency exchange fluctuation, political and economic instability, government regulations and market risks. Stock and values fluctuate in price so that the value of an investment can go down depending on market conditions. Stock prices may fluctuate due to stock market volatility and market cycles, as well as circumstances specific to a company. Cash include risks including credit risk, interest rate risk shortfall risk and loss of purchasing power due to inflation.

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