2nd Quarter 2005 Newsletter

7/20/2005

Quarterly Newsletter

Top Wealth Managers Rated by Bloomberg

Financial Connections was again recognized as one of the top 500 wealth management firms in the United States.

Newsletter Highlights

For Clients and Friends of Financial Connections

There were a variety of positive signs for the economy in the first half of 2005:

- Good economic growth
- Strong job creation
- Low inflation
- Good corporate profits

Yet the markets reacted more to investor concerns about:

- Rising oil prices
- Economic slowdown
- Increases in the Federal Reserve Bank's federal funds interest rate.

At the end of June, bond indexes were up, though many investors had expected them to declin (bonds have an inverse relation to interest rates). Investors had also expected currency and commodities to increase: so far commodities have done so, but currencies have not. And domestic and international equity indexes were down or flat for the year. (Clients: See your Portfolio Performance Summary for a listing of the indexes.) So what happened?

Interest Rates
For the past few years, many investment professionals expected interest rates to rise. Though t Fed increased short-term rates, the expected increase in longer-term rates did not occur. Alan Greenspan calls this a conundrum he can't explain. Some experts take the view that rates are r more likely to remain low for at least the next several years.

What a Low-Rate Environment Might Look Like
Those in the "rates-will-stay-low" camp explain that U.S. consumers' actions affect economic factors globally, and that what fuels consumers' spending is an unsustainable inflation in the prices of assets such as homes. In the meantime, exporters from overseas are happy to sell us goods, and their central banks loan the proceeds back to us by buying Treasuries. These transactions weaken their currencies versus the dollar and keep our interest rates lower. Our rising interest rates in turn keep asset prices inflating. Low rates depend on this interchange holding together. But the interchange also has its drawbacks:

- Weak growth in corporate earnings could easily discourage stock investors.
- We Americans still don't save enough. In an economic downturn we will be in big trouble, and it's hard to imagine the market wouldn't reflect this.
- Consumers continue to spend, and many withdraw money from the equity in their homes (George Carlin used to call this buying "stuff").

So while it's possible that low interest rates would keep the global economy on track and gener good stock market returns for a while, there are risks.

- We have a current account deficit that won't go away without an eventual dollar correctior is at an all-time high as a percentage of Gross Domestic Product (6.4% of GDP).
- The biggest impact might come from the decline in foreign capital inflows that have sustained demand for Treasuries and thus kept interest rates low.
- We are dependent on the foreign capital to fund our budget deficit.

Though the dollar rebounded against the euro this year, it may be a temporary blip. The French and Dutch "No" votes on the European Constitution caused some conjecture that the European Union might break apart. However, from our readings, this is unlikely.

Summary
Where does all this leave us? We design a core investment portfolio that diversifies your holdin among bonds (domestic and international), stocks (domestic and international), large and small companies. Our objective is to preserve more of your capital when the markets decline and participate when the markets increase.

We have mailed quarterly reports to our clients. Please give us a call if you'd like to get togethe for a review. Please let us know if a situation arises that might cause us to re-evaluate your portfolios.

SERIES EE BONDS — NOT WHAT THEY USED TO BE

From 1982 up to May 1, 2005, a Series EE bond had a variable interest rate that was reset eve 6 months. Now, if you buy a Series EE bond, the interest is fixed at the same rate for the life of bond.

The change will save the government money in a rising interest rate environment because it means lower payments on this section of the national debt.

Daniel Pederson, author of "Savings Bonds: When to Hold, When to Fold and Everything In-Between," said that "this change underscored the need for investors to keep track of each individual bond they own."

Many employees buy Series EE bonds through a payroll deduction. We think that practice shou be re-evaluated. If you hold Series EE bonds and would like to discuss them, please give us a call.

OUT AND ABOUT WITH FINANCIAL CONNECTIONS

Investment Advisor Magazine

Jill co-authored an article about the differences between financial planning for married and unmarried couples. It was published in the April 2005 edition and its title is "Together But Separate." If you would like a copy for you or your friends, let us know.

Conferences Attended

Jill was conference chair for PridePlanners, a nonprofit organization dedicated to financial advisors serving gay, lesbian, single, and unmarried people. This was the third PridePlanners conference and the first one held on the West Coast (Palm Springs). Twenty-three states were represented. The agenda was very technical, and attorneys taught most sessions. Because the laws for married people don’t apply to unmarried people (single or couples), financial planning c be very different. It was a very successful conference. Jill is glad that responsibility is behind he

Bond University

Brian and Jill attended a two-day program about individual bonds and bond markets. We buy ta free bonds in some instances and may prefer individual bonds in addition to bond mutual funds

National Association of Personal Financial Advisors (NAPFA — the fee-only financial advisor organization)

Its national conference was held in Tampa, Florida this year (fortunately, the humidity wasn't to high). The most common message from speakers was the change they expect to see over the coming decades.

- Rising interest rates
- Increased demand for raw materials and oil
- Global growth primarily focused in China and India.

TD WATERHOUSE AND AMERITRADE

Ameritrade plans to acquire TD Waterhouse for $3 billion. Toronto Dominion Bank, TD Waterhouse's parent company, will remain part owner of the combined financial services company, TD Ameritrade.

Historical Perspective

Both companies are in the financial custodial industry. Ameritrade made its money on the profit from "day traders" and other Internet trading activities. Since the burst of the technology bubble volume at all custodians declined substantially. TD Waterhouse has custody of $41 billion in assets from financial advisors—its institutional clients—compared to Ameritrade's $4 billion.

Ameritrade has only two offices, and TD Waterhouse offers Ameritrade a physical presence on the retail side. We anticipate the majority of the changes under the new company to be on the retail side. However, some of the quality software developed by Ameritrade will be valuable to t institutional side as well.

It is anticipated this merger will take six months to occur. If you have any questions, please don hesitate to call us.

Little Known Facts of Interest

Fun Facts

The Tea Bag: the New York tea and coffee merchant Thomas Sullivan started handing out samples of loose-leaf tea in a small, hand-sewn silk bag in 1904. He assumed people would transfer the tea to a strainer to taste his product. Instead, people dropped the entire bag in ho water—and the tea bag was born.

That same year Richard Blechynden, a tea seller at the St. Louis World's Fair, failed to sell his ware in the hot weather so he poured his tea over ice. The new drink was an instant success. Iced tea accounts for 80% of the 136 million cups of tea quaffed by Americans annually.

Financial Fact

According to the Investment Company Institute, a 65-year old woman has twice the potential t live until age 90 as a man. And if she spends more time in retirement, she also needs more money.

WHY INVESTMENT HISTORY MAY NOT REPEAT ITSELF

Our path to a retirement nest egg is not the same as our parents' or grandparents', and our expectations of the future need to be amended.

Some of the changes that require us to modify our outlook for the future are:

- Increase in life expectancy
- Decline in corporate pension retirement plans (since 1985, 80,000 of the 112,000 pension plans were terminated, *U.S. News & World Report*).
- Decline in savings rate
- Increase in debt (mortgage, home equity loans, credit card and car loans)

Today's environment

Stock prices go up when companies earn more or when investors are willing to pay more to buy the company's stock. Over the past 20 years, this dynamic favored investors. Corporate profits increased, inflation slowed, and interest rates fell to historical lows.

But today corporate profits grow at a slower pace, and investors are less willing to pay high pric for stocks. Operating in reverse, this dynamic doesn't leave much room for an increase in share prices. And stock dividends (a portion of investment return) that used to average 3% are down 1.8%.

So according to Ibbotson, a leading investment research and consulting firm, the returns seen i the last 20 years are unlikely to occur in the next.

And of course, Social Security Benefits for the future are unknown.

What to do

Those in their 20s and 30s need to start saving more and earlier. It's the same prescription for those older, who should also try to align their spending with their income. Our money has to las longer in an environment of lower investment returns.

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