Lassus Wherley ...a view from the top

Building Better Futures

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"The Next Chapter"

The Last Twelve Months

Over the last year we have experienced just about everything you can think of. We have gone through an inflation scare, rising interest rates, a positive economic outlook turning to slightly negative, housing prices continuing to fall, and it is beginning to look as if there is no short-term solution to the war in Iraq.

And yet, we continue to see reasonable returns in broadly diversified portfolios. The reason is there are always some asset classes that are performing well even as others are going backward. Recently, domestic real estate has been going backward while international real estate has continued to experience positive returns.

Looking forward to the next 12 months, inflation and employment will continue to be among the most influential factors in shaping the economy. For the last few years inflation has been the monster that has remained in hiding. In spite of expectations of higher consumer prices, inflation (CPI) has averaged less than 2.5% over the past 12 months. We remain worried about rising inflation but globally, the inflation picture remains benign.

Consumer spending, housing and debt are the next topics of concern. The housing market continues to be depressed, but the impact has been primarily in specific regions rather than across the country. The primary areas impacted are Florida, Nevada, southern California and the Sun Belt. We haven't seen a direct impact on consumer spending yet, but we may see a slowing later this year. Consumer debt, especially mortgage debt, continues to be a concern. We expect to see some negative impact over the next 12 months, but many other factors will also play a role in the health of the financial markets.

New Asset Class Analysis

We have begun to add **Emerging Market Funds** to some portfolios. These markets which include Brazil, Russia, India, and China continue to grow and to offer opportunities. They are certainly higher risk but provide potential for significantly higher return. We are reviewing all portfolios to determine if it makes sense to add this type of fund. We will only add a small percentage for those clients where we determine it is in line with the objective of the portfolio.

Private equity refers to a type of investment in which the equity is privately held stock rather than publicly traded stock. Private equity funds are pools of capital, typically limited partnerships, that are managed by a general partner.

The rise of the modern private equity buyout industry began in the 1960s, when huge conglomerates were a big deal. Large companies with rising stock prices bought smaller companies in many unrelated businesses on the expectation that they could leverage management skill and achieve economies of scale. Like the conglomerates of yesterday, the private equity firms of today buy businesses and leverage their management skills to increase value.

While private equity is the current rage, it is not easily available to most investors, partly because it is difficult to participate in private equity deals unless you can invest several million dollars in one deal. Also, much like hedge funds, expenses in these deals are exceptionally high. We are not currently recommending these funds.

What Has Changed With iRebal?

We have received a few questions about some of the changes we have made since we began to use iRebal, our new state-of-the-art rebalancing system.

Question: The model report I received was initialed by someone other than Diahann. What has changed? **Answer**: We have instituted an on-line review process to make sure that reports are sent out as quickly as possible. Diahann reviews and approves the trades that these reports reflect online prior to them being printed. This allows her to approve them when she is in the Florida office or whatever location she may be working in and speed up the process.

Question: I noticed that 1 of my 5 accounts hasn't had any trades placed in it in several months. Is that a problem? **Answer**: The new system allows us to rebalance across all accounts. This means that sometimes we can rebalance in 1 or 2 accounts and don't have to make changes in the others. It allows us to reduce transaction costs and be much more efficient in our rebalancing.

Question: I noticed that some of the trades or purchases were dated several days after the first investments were sold? Why the delay? **Answer**: If the investment being sold has a longer settlement date, meaning the dollars will not be available for several days, then we must wait to place the buy orders. This is typically true when we sell stocks or ETFs (exchange traded funds). It isn't as much of a problem with mutual funds.

Question: Can't we wait to sell some of these stocks or funds next year since I already have such high capital gains? **Answer**: We could wait. However, there are several factors that we consider before making that decision. The first is that not taking the gains may increase the risk level of your portfolio too much. For example: large cap stock has done really well and you now have 35% instead of 32%. That higher percentage exposure means that if the market goes down, you have a higher risk of loss. The second consideration is that with capital gains at an all-time low of 15%, it makes sense to take gains now. The after-tax return is still pretty good. There are situations where we will determine that it makes sense to take some gains now and delay the balance, but it is done on a case-by-case basis.

Please let us know if you have any questions concerning your investment program or if anything changes in your life that may affect your overall objectives or investment program. And…...remember our mantra……...**We are long-term investors, and what happens on a day-to-day basis isn't relevant to our investment program.**

Have a great summer!