

FINANCIAL PLANNING *Outlook*



A Year of Recovery

By Craig Evans Carnick, CFP®

As we look back on 2009 and start the New Year, many investors are still wondering when we will see a healthy economy and a stock market we can trust. But it's worth noting how far we've come in the past 12 months. Even though the economy is still struggling in many ways, at the beginning of the year things were even more dire, to the point that people wondered whether we were teetering on the edge of another Great Depression.

At this point, that looks most unlikely. Entering 2010, the economy appears to be headed in the right direction. Here is a thumbnail look at where we've been this year, and where we're headed:

Economic Growth: The consensus of most economists is that the recession is over. After America's gross domestic product had shrunk for four consecutive quarters (and five out of six), it rebounded in the third quarter of 2009 with 2.8 percent annualized growth. The initial estimate for the fourth quarter of 2009 is due out at the end of January, and should cement the idea that we have grown our way out of recession.

Keep in mind that this downturn was not limited to the United States. Despite

talk about our real estate bubble and the meltdown in the banking sector fueling our problems, the European Union's recession was steeper than ours, and Japan had consecutive quarters where its GDP dropped by 13.1 percent and 11.7 percent on an annualized basis. Russia's stock market had lost 70 percent from its peak as of October 2008. Because other countries suffered even more than we did, the U.S. is well positioned to take its place as the dominant economic player when we reach full recovery.

Credit Squeeze: A big part of the financial slowdown was caused by the fact that

banks had turned gun-shy, and had become much more prudent about giving out loans. Bank loans backed by the Small Business Administration have dropped by 36 percent from their 2008 level.

Less visible was the fact that bond issues dropped off dramatically, choking off funds to business and governments that could have been used to expand the economy. After a record high of \$338 billion in municipal bond issues in 2007, the number of new issues slowed to a trickle in early 2008. But the 2009 figure is already at a record \$342 billion, helped along by the stimulus bill.

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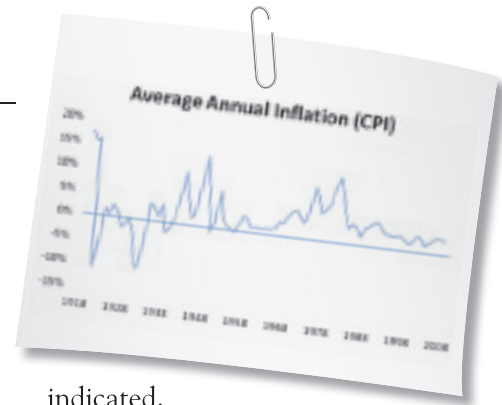


“A Year of Recovery” *continued*

Inflation: That same federal stimulus bill has created huge deficits, potentially fueling fears of inflation, which is thought to follow high levels of government debt. Thus far, it hasn't been a problem. In January, the inflation rate was a minuscule 0.03 percent, but by October, the rate had dropped into the negative at minus 0.2 percent. As measured by the spread on TIPS (Treasury Inflation-Protected Securities), the expected 10-year U.S. inflation rate is a mere 1.98 percent.

Unemployment: Joblessness remains the economy's biggest problem. In January, unemployment sat at 7.6 percent – already the highest in 25 years. Since then, it has continued to shoot skyward, currently sitting at 10 percent.

But the latest figures we have, from November, show some encouraging news on this front. The number of new jobless, at 11,000, was the smallest in two years, since the very start of the recession in December 2007. Just as important, the numbers for the previous two months were revised downward; it turns out we lost 159,000 fewer jobs than the original reports



indicated. The drop in the unemployment rate from 10.2 percent to 10 percent was most unexpected, and a very positive sign.

Housing: Along with unemployment, housing has always figured to be the laggard in the recovery, but the market seems, finally, to be gaining some steam. Nationwide, home prices have increased in each of the past two quarters, according to Freddie Mac's Conventional Home Price Index. Home sales are at their highest level since February 2007. But we still have a long way to climb: Nearly one in four homeowners are underwater on their mortgage, and homeowners have lost nearly \$6 trillion in home value since the market's peak in 2006.

Stock Markets: The Dow entered the

year at 8,776, down more than 5,000 points from its high a year earlier, and kept skidding, all the way down to a low of less than 6,600 in March. Since then, the rally has brought us back over 10,000 – putting us in positive territory for the year, but still down sharply from the market's October 2007 peak, when the Dow closed over 14,000.

The other major indexes tell a similar story. The S&P 500 entering the year at 931 and plunging to a low of 676 in March before rebounding to around 1,100 now. The Nasdaq bounced from 1,600 down to 1,268 then back up to 2,200. In each case, the tremendous gains of 2009 have not yet brought the index back to its peak.

A Long Way To Go Yet: All in all, we're making progress, but GDP growth is not yet robust enough to definitely say there won't be a double dip to this recession, and we face massive government debt from the stimulus program. It promises to be a long journey back to economic health. The people who survive it will be those who carefully plotted each step and were prepared both for setbacks and for whatever good news may lie ahead.

It's been said by many that the recession we're now emerging from was America's worst since the Great

Depression. While the severity of it surprised many of us, experienced market veterans, with their eyes on long-term goals, always attempt to factor in bumps in the road. It's difficult to tell someone they're on the right course when their portfolio has lost value. But investments should not be the only piece of your financial plan, or even the primary piece. The key is to have a comprehensive financial strategy created by an impartial advisor who embraces the concept of being a fiduciary (The client's welfare comes first!). This approach examines impartially, in a non-product sales environment all the lifetime components of success: Working satisfaction, retirement planning, risk management, passing assets and values to future generations, taxes, family, community...

Carnick & Company acts as a Personal CFO on behalf of its clients, taking fiduciary responsibility as part of the comprehensive planning process. This approach is the best way to protect yourself from down periods and to take advantage of any future positive economic currents. There will be troubling economic times again, but with a reliable roadmap to your destination, you can weather the storms and find your way. ■

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STRATEGIC DEFAULTS

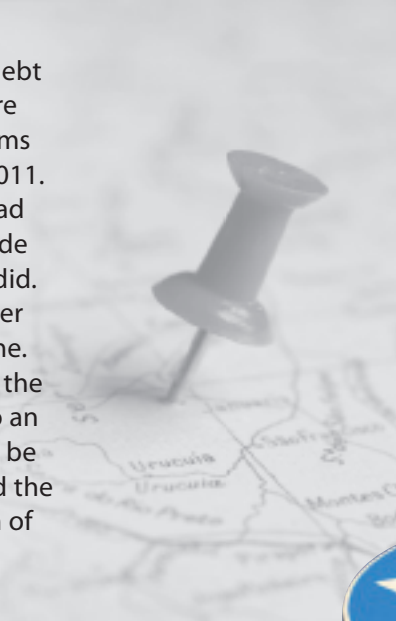
By William Moyer, CFA

What worries banks and other lenders the most these days is something called Strategic Default. This results when a homeowner who is current on their mortgage and has the ability to continue to make payments, decides to walk away from the home because the value has dropped significantly below what is owed on the loan. Millions of homeowners will decide that it's cheaper to rent than continue to make payments on a home that may never appreciate to the price it was purchased. So it's not just the people who can no longer afford to make payments due to job loss, catastrophic health costs, or other loss of income. We now are faced with borrowers

who could make payments but choose not to.

While I do understand the banks' concerns about this situation, I also find their statements about "moral obligations" to meet one's payments somewhat hypocritical. In 2007, the bank Morgan Stanley bought commercial property for \$8 billion. Now they intend to give the properties back to the lender to get out of the loan obligation because the buildings they purchased have lost 50% since their value. Morgan Stanley's spokeswoman said that "this isn't a default or foreclosure situation." Maybe not, but it sure sounds like a Strategic Default to me. The banks are saying borrowers have a moral and ethical obligation to pay even if the loan is upside-down on the house, even while they attempt to weasel out of their own obligations.

But that brings us back to how this housing/debt bubble continues to evolve. I've mentioned before that another wave of mortgages called Option Arms are beginning to reset and this won't peak until 2011. Most of these were originated in 2005 and they had five year teaser rates. The new payment will include much more of the principal than the teaser rates did. As a result, some borrowers will find the new, larger payment too much to bear on a depreciating home. So we may see more of these strategic defaults in the months ahead. By the time this episode comes to an end years from now, I doubt that a FICO score will be as relevant as it was just a few years ago. That and the entire credit bureau system will be another victim of the Great Recession. ■

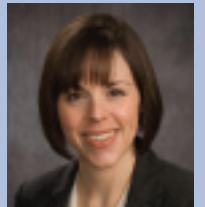


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It is with great pride that we introduce you to the newest member of the Carnick & Company organization!



For nearly a decade now, **Clarissa Hobson, CFP®**, has assisted clients in meeting their financial planning needs. Prior to joining our firm, Clarissa served as the national Education Trainer for the Principal Financial Group, where she trained the firm's financial planning employees. She was initially employed by the Principal in 2006 as a Senior Employee Benefits Specialist, and during that time worked with the firm's clients to achieve their financial, investment and retirement goals. Before coming to the Principal, Clarissa was a member of the retirement services group at AmSouth Bank, where she served as a Senior Education Specialist and Trust Officer. She specialized in educating employees on how to meet their financial goals in retirement. Clarissa is a 2001 Magna Cum Laude graduate of the University of the South in Sewanee, TN. ■





Craig Evans Carnick, CFP®



Clarissa R. Hobson, CFP®



Bill Moyer, CFA



William Van Keulen, CFP®



Kim Young

CARNICK & COMPANY

PERSONAL FINANCIAL ADVISORS

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675 Southpointe Court
Colorado Springs, CO 80906

(719) 579-8000
www.Carnick.com

Safety in Muni Bonds? Perhaps...

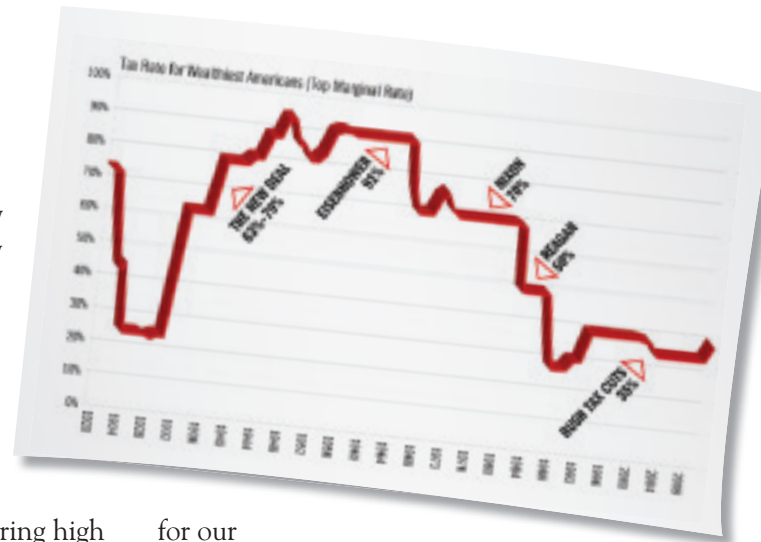
By William Van Keulen, CFP®

As personal income tax rates are sure to increase to address the burgeoning Federal budget situation, tax-free Municipal Bonds will likely deliver the consistent returns many clients seek. Yes, talking about muni-bonds is boring for most people. After all, the only thing these securities do is slowly payout tax-free income. Boring, boring, boring. Or are they? After what we've been through in the stock market the last 18 months, considering high quality muni-bonds paying reasonable returns is starting to look very sensible in the right situation.

However, we need to remember that our present economic environment is not normal. In addition, all municipal bonds are not created equal. The stresses that hit Wall Street also hit state and local governments hard. These governmental entities are seeing dramatic revenue declines from personal income, property and sales taxes. Nationwide tax revenues are down 28% and some ill-conceived community projects are now defaulting. Accordingly, governments face the possibility of rating downgrades which hurt bond values.

This possibility makes it more critical than ever to know *what* you own when investing in municipal bonds. As we manage client portfolios, we doggedly focus on those states whose budgets are manageable. We diligently avoid areas plagued by high rates of home foreclosure, unemployment or bankruptcies. If a bond issuer is heavily dependent on depressed property assessments, sales taxes or income taxes... the caution flag goes up!

In contrast, most water and sewer revenue issues are only seeing collections down 2.8%. These revenue bonds are what we seek



for our clients because the income typically comes from more stable monthly utility billings, so unless a community starts to lose population dramatically, this type of revenue is unlikely to be in jeopardy.

Lastly, the other looming bond issue is the risk of rising interest rates. Rates are the lowest we've seen since the early 70's and investors must understand that rapidly rising rates can decimate the value of long bonds. Just being in bonds for reliability of income is not enough. It's the average length of a bond portfolio that is critical due to the risk of inflation and the very likely increase in interest rates. Accordingly, our view is that short and short-intermediate bonds are best for now. Locking in now for the long term is a sure fire recipe for disaster!

Overall, the municipal bond world will be a favorable place to invest going forward. As in any investment, however, there is a "buyer beware" component that demands a lot of attention:

- Attention at purchase to buy the issues at attractive prices, maturities and backing.
- Attention during the holding period to anticipate any financial reversals requiring liquidation. ■