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Did You Know...?

News you can use for your financial well-being

October 2006

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Expectations for 2007

The economy has been changing in the second-half of 2006, with oil prices declining, real estate weakening, and the Fed taking a neutral stance after two years of rate hikes. Here are key points from SEI's recent conference call regarding expectations for the coming year:

- The economy will slow a bit in 2007
- Energy prices will stabilize around current levels (oil \$60/bbl, gas \$2.60/gal)
- Housing prices will still be weak through much of 2007
- There's a good possibility the Fed might cut rates sometime in 2007 to keep the economy on track

Chances of a recession are low as employment and wages are strong (the consumer has \$) and corporate profits and margins are strong (companies have \$).

Dow 12,000!

The Dow Jones Industrial Average recently reached an all-time high, crossing the 12,000 mark for the first time in history. Just four years ago, the DJIA bottomed out at 7300, so this has been a 60% up move from those dark days of doom and gloom. The more broadly based S&P 500 (which includes 500 stocks versus just 30 for the DJIA) has rallied 75% from its low over that same timeframe.

While I'm usually not one to celebrate such occurrences, in light of the historic decline experienced from 2000-2002 I think we should all enjoy this recovery. The decline was the biggest in the stock market since the Depression, so all investors were put to a huge test of wills. This recovery is the reward for the patience and foresight we've had over that tough time.

That said, my main goal as an investor is to constantly learn from my experiences. As the saying goes, "Those who ignore the past are doomed to repeat it". What can we learn from this historic decline and strong rally back in stocks?

1. **Smash the crystal ball.** You can't predict the future, not even top Wall Street analysts making \$10mil/yr predicted the decline, and many didn't predict the rally back. Your strategy should be based on your own personal plan, so don't make wholesale investment changes based on astrology/ headlines/ elections/ barber's recommendations/ etc.
2. **Ignore your emotions.** I'm sure we all felt like throwing in the towel on stocks in October of 2002: the market was tanking, we were going to war in Iraq, the economy stunk, etc. In fact, at that very time the market was hitting its ultimate bottom for this cycle. Thousands of investors pulled tens of billions of dollars out of stock mutual funds in October of 2002: in fact, this was the largest outflow of money from stock funds **ever**. I call this "puking"—investors finally puked up their stocks, and that was the end of the decline. Those who made that type of emotional decision are now regretting it. Don't let emotions dictate your decisions!
3. **Diversify.** The incredible run up in Internet and technology stocks sucked in many investors, and the subsequent decline was very painful. Even in diversified portfolios, investors suffered from the tech stock debacle, but might have only had 15% of their portfolio in that arena. No matter how much of a sure thing something appears to be, never, NEVER, put all your eggs in one basket. Sounds simple, but look what's happening in real estate right now.

This cycle was emotionally and financially stressful for many, but please overcome your desire to erase it from your memory and focus for a minute on the lessons learned from such an event. How did you react, what did your gut tell you to do, what changes did you vow to make going forward? By doing this, you can't help but become a better investor.

Success Stories:

While we're on the subject of celebrating the stock recovery/learning from the historic cycle of 2000-2006, I wanted to share with you an excerpt from the letter I sent to all clients in October of 2002. These were dark days in the investment world, and it was hard to find a reason to be optimistic. But here's what we told you:

October 4, 2002 (Dow closed at 7528, 3% from its ultimate low and up 60% since)

We would liken this bear market to an 8.5 earthquake: such an event is possible, but extremely rare. It will end at some point, but rather than trying to predict when, we believe now is the time to look at ways to position your portfolio for the recovery. Looking back at a similar period like the Depression, one can clearly see that many fortunes were lost, but many fortunes were also created by astute investors making difficult but intelligent purchases of severely undervalued assets. Given that statistically the likelihood is that you might never see another bear market as bad as this one in your lifetime, we suggest you view this as a rare occurrence to accelerate your saving and investing plans where possible to take advantage of this extraordinary opportunity.

We know that buying stocks is not a popular strategy right now. The press and television have scared the American public into a state of shock, and being a contrarian in these circumstances is difficult. However, we know that the reason you employ us is that you depend on us for a disciplined and educated perspective on managing your money. Our foremost concern is that you are comfortable with the level of risk you have in your investments. If you are nervous or frightened, you should not take on more risk. However, if you agree that the current historic investment conditions we are experiencing offer opportunity to the patient, educated investor, we are eager to provide you with the opportunities we have uncovered as a result of our research and due-diligence.

I point this out not so much to toot my horn (frankly, many of you do a wonderful job of that for me, for which I am eternally grateful), but to hopefully give you a nugget we can take away from this experience. Unemotional, logical, thought-out approaches to investing will give you guidance during times of uncertainty. That's what I'm here for.

Timely Tidbits:

Year-end is rapidly approaching; here are a couple of things you should be doing to prepare:

1. Make sure you take your Mandatory Required Distributions from IRA accounts if you're over 70 ½
2. Proactively consider your gains realized this year, and talk to us about opportunities to minimize your taxes

Talk with your CPA about how the 2006 tax year is shaping up, and get their input into strategies you can employ before year-end.

Quote of the month: "I was always taught to respect my elders and I've now reached the age when I don't have anybody to respect". *George Burns, actor & comedian (1896 - 1996)*

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