Review for the 3rd Quarter 2007 and Future Outlook

A wild ride followed by a smooth landing

Investing in financial markets in the third quarter was like riding a roller coaster with no brakes. The experience was not pleasant and everyone was relieved when it was over. Despite all the ups and downs, the Dow Jones Industrial Average recovered nicely to finish the quarter up 487 points, or 3.6%. Big technology stocks fared particularly well with the Nasdaq 100 index up 8.1%.

Financial markets catch a cold – and then recover

The quarter took a turn for the worse as the problems with sub-prime mortgages – or loans to homeowners with less than stellar credit – began to spread to the overall financial markets. There were concerns that several major mortgage lenders were experiencing liquidity problems and consumers would have trouble obtaining new loans for mortgages, which could trigger a recession. This thinking caused a domino effect of negative sentiment that sent stock prices much lower.

There were also concerns that hedge funds were having liquidity problems and this would undermine the financial health of major investment banks and commercial banks. While some of these concerns did in fact become a reality, the worse case scenarios that many investors feared did not materialize.

We got it right

As the crisis continued to worsen, we sent a letter to all our clients offering reassurance and our professional perspective. Although the history books are still being written, it appears we got it right when we said:

"It's important to note that it's been about four years since the Dow Jones Industrial Average has experienced a significant correction. However the astute investor knows that this is the time to find compelling bargains. We continue to invest for the long term and feel strongly that this is the best approach during these times."

The Federal Reserve steps in

Sentiment improved in late August when the Federal Reserve and other central banks began to inject cash into the financial system. This was followed up with more good news on September 18th when the Fed cut its short term lending rate to 4.75% from 5.25%. This larger than expected rate cut triggered a huge rally in stocks, prompting the biggest one day percentage gain for the Dow Jones Industrials since 2003 – and the hope that the economy would stay on track.

Interest rates move lower

After the dust settled and credit markets calmed, the yield on the benchmark 10-year Treasury note ended the quarter at 4.579%, compared with 5.034% three months earlier. Demand for treasuries increased as many investors sought out 'safe haven' investments to ride out the storm. The increase in buying activity caused the yield to fall which is very helpful to many parts of the national economy because many other interest rates are linked to the 10-year Treasury rate.

Large stocks and technology benefit

When investors finally came back to stocks, the focus was towards less-risky 'household name' companies that are found in the Dow Jones and S&P 500. Large stocks outperformed small stocks in the quarter with the S&P 500 index gaining 1.6% in the quarter while the Russell 2000 was down 3.6%. The technology heavy Nasdaq Composite index gained 3.8% for the quarter. Technology stocks benefited from the perception that they are less vulnerable to sub-prime mortgage problems.

Outlook for the future

We are encouraged by the recovery of stocks in the 3rd quarter and continue to see many compelling values. However, we are concerned about consumer spending and its effect on the U.S. economy - especially going into the crucial holiday selling season. Oil prices remain stubbornly high with crude prices hitting $81.66 a barrel, up 16% for the quarter. The good news is that the 4th quarter has traditionally been very positive for stocks and the soon to be released corporate earnings reports will either confirm or deny that trend.

Do you have a financial plan?

We believe that a formal financial plan tied to your specific goals can enhance your investment outcome. Earlier this year we added Jennifer Simes CFP® to our team and it has generated proven benefits.

As part of a comprehensive financial plan, Jennifer creates tailor made recommendations incorporating all assets under our management and your personal financial affairs. We then collaborate together to formulate a plan while considering your goals and objectives. Issues like saving for retirement, college planning, budgeting and estate planning are some of the areas that can be addressed.

Finally, we review your current investments in conjunction with your plan. We look at diversification, balance, risk tolerance and the taxation of assets. Once implemented, we recommend an annual review while making adjustments as need to attain the goals we have identified. Fortunately, many of our existing clients are taking part in this process and benefiting from this comprehensive review. We encourage all our clients to take advantage of this valuable service.

We are here for you

We appreciate and recognize the trust you have put in us and your confidence continues to be our highest priority. Please contact us with any questions – or to schedule a review of your account.