

## PRESIDENT'S LETTER

### First Quarter 2006



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#### “30+ Years of Lessons Learned”

First quarter  
2006 finished  
strong, and the  
economy seems  
to be continuing  
to grow at a very

solid pace. In fact, Q1 finished stronger than most people had anticipated with the Dow up 3.66 percent, the S&P up 3.73 percent and the NASDAQ up 6.1 percent.

Here are a few somewhat hypothetical questions: Can the economy continue to grow and can the market continue to produce these types of returns?

Let's deal with the market first. I doubt it *can* continue to produce these returns because that would result in a high double-digit growth in each of the indices. While we all would enjoy that, I seriously doubt that will happen.

With regard to the economy, that is a tough call. I think consumer spending will start to slow. For most people, there is little money left over to use for high-dollar expenditures that require second mortgages or home equity loans. While real income has risen, I am not sure it has risen enough to keep up with the consumer spending we have seen over the past 18 to 24 months.

The real keys revolve around two areas: interest rates, and oil and gas

prices. First, as interest rates continue to rise, how far will they go? Obviously, if the Federal Reserve continues to hike interest rates, that could have a negative impact, and one area where this could be felt relatively quickly is in the housing market. Many people today have variable rate loans, so if interest rates continue to rise, homeowners could see their mortgage payments go up substantially, thereby reducing the amount of money normally spent on other consumer goods.

Of course, it should come as no surprise that what happens to the price of oil and gas is crucial. As the price continues to rise, it acts like an extra tax on our income. Yes, we are still early in the year as of now, but my strong suspicion is that the economy has yet to feel the real impact of higher interest rates and higher energy prices. As both continue to work their way through the economy, I think economic growth will begin to slow. Keep in mind that the economy has continued to grow at a solid pace, which has surprised most people. I do not see a huge slowdown, but I do see things slowing some.

In addition, this particular time in the current presidential term has historically not been positive for the markets, so the economic result puts us at the same place we've been for the past several years. Notwithstanding the fact we have had a very strong quarter, I think the remainder of the year will be relatively volatile in the markets; much of the return we have gained so far probably lost during the next few months. However, we still have the opportunity for a strong fourth quarter finish that will result in positive returns in the overall market for 2006.

Again, let me just sum up by saying that the two keys to watch include energy prices and interest rates. If energy prices begin to level off, which I think they will at some point in time, and if interest rates stop going up and perhaps even come down later in the year – which I also think could happen – then I think the market will react positively. However, until that happens, I think we may be riding a “bucking horse.”

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The continued uncertainty with Iraq, Iran and Afghanistan, combined with this much uncertainty about interest rates and energy prices, does not bode well for the markets.

With Carter Financial Management celebrating its 30th anniversary in 2006, you may remember I said I would dedicate my next two or three letters to some of the lessons learned over my 33 years in financial planning. This is an exciting time for us, but I also think it is an appropriate time to look back over the past three decades to see what we can learn from them.

Perhaps the most important lesson is the absolute importance of planning; there is no doubt in my mind that people who have a financial plan do better than those who do not. While you do not need a financial plan to

accumulate millions of dollars, I strongly believe that those who have financial plans use their assets more efficiently, and overall, make much more informed and better financial decisions.

When I began working in this business, nearly everyone I worked with was an “accumulator.” In other words, they were people who were just starting to build their nest egg for retirement. Interestingly, many of those people are still clients of ours, and it has been fascinating to watch their net worth grow through the years as they have either entered or are approaching retirement. These clients have met their financial goals and objectives, which definitely reinforces the importance of planning.

However, our practice is different today. Many of the clients coming in are not accumulators. Instead, many already have built a substantial net worth and have assets that exceed what is needed to meet their retirement income objectives.

Their main interest is to maintain their net worth and purchasing power through retirement, as well as explore ways they can pass their assets to their children and grandchildren. Others look for ways to leave a legacy, either by what they leave to their heirs or through creative charitable gifting.

In addition to a financial plan, you also need to have – as part of that financial plan – a solid, and many times, creative estate plan. The objectives of our clients vary substantially. Some of our clients’ number one desire is to leave a nest egg for their children, others want to leave a legacy by making substantial charitable contributions, while a few do a combination of both.

Today, estate planning is complicated by the fact that we have a temporary situation; estate tax laws have a sunset date of 2010. If something is not done, we will revert, in 2011, to the estate tax rates that were present in 1997 with a top rate of 55 percent and a unified credit of \$1 million.

Most people believe (and I am one of them) that Congress will ultimately make a decision to alleviate the uncertainty about the estate tax. However, what the estate tax will look like in its final form is still a mystery. I seriously doubt that it will be eliminated. Most believe Congress will set aside a \$2 million to \$3 million exemption per individual, with perhaps some special provisions for closely held corporations, as well as a special agricultural exemption.

You want to be in a position to change your plan quickly, so my advice is not to wait until Congress finally decides on a bill, but to work with your attorney to make sure you already have your estate plan established.

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At the current time, we feel that Small Cap investments and REITs are fully valued. If you have not taken profits in these two sectors, you may wish to do so. With regard to the REITs, if you still need to maintain your current percentage allocation in real estate, you may want to shift some of the money over to an international REIT. For Small Caps, I would look to take those profits and put them

into a non-correlated stock market investment, such as commodities or some specialty-type investments that have come on the market in recent years. Or, invest in the Large Cap Growth sector, but remember that the Large Cap Growth asset class has been the second worst performing asset class for the past five consecutive years. One thing we have always stressed is to buy the asset class that is out of favor, not the “hot dot.” We are not saying eliminate the positions in Small Caps or REITs, just consider taking profits from them.

We are well into our 30th year and have many exciting things happening. I will continue to provide you with specifics on lessons learned in my next few newsletters, but let me also urge you to put the Carter Investment Conference on Saturday, Nov. 18, on your calendar. We already have two outstanding speakers, both of which are of national stature, and we should have a third speaker confirmed some time in mid-summer. It is going to be a great educational conference and a lot of fun!

Join us for this and other exciting opportunities.



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President

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