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Commentary
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Market Performance

If, as it is said, the markets need to "climb a wall of worry" to go up, good things must be in store! With anxiety about war in most people's minds and hearts, the stock market continued to decline during the first quarter of 2003. US stock indexes declined 3.6% while European large companies declined 14.65%. Investors who turned to the bond markets as a safe haven saw a meager .56% gain in taxable bonds during the first three months of 2003. Municipal bonds declined by .44% due to the prospects of competition from dividends from corporate stocks.

Rikoon-Carret's US stock portfolios declined 5.1% overall while our international stocks declined 11.12%. Both of our bond portfolios increased, with taxable bonds going up 1.7% and municipal bonds increasing .94%. Since political events have had such a direct impact on the markets, we will be devoting a special section to geo-politics followed by a short recap of germane economic events.

Geo-Politics

Current political events have driven the markets into a difficult position. Putting aside one's personal and political views, it is clear that the outcome of the current military strike against Saddam Hussein's regime and subsequent US led activities will effect the markets dramatically in the months ahead.

Because the long-term outcome of America's efforts to establish and maintain economic hegemony across the world is unclear, it is likely that any projections about stock or bond market returns will be almost meaningless. Since the first of this year, the stock market has moved in tandem with sentiment regarding the war. A quick victory for US and UK ground forces would be positive news but not without drawbacks. At the beginning of the year, the market reacted adversely to news that the US was going ahead with the war on its own. Once the war started, investor enthusiasm was clearly exhibited due to a steep and rapid decline in oil prices. While military victory will lead to regime change, it is unclear how US will administer the territory, people and natural resources that will come under its control. Any rally is at risk if suicide bombers show up on American soil.

The cost of financing the US and UK's military actions and subsequent reconstruction efforts makes me believe that the US will seek to use Iraqi oil to pay for the war. One point of view is that using those resources to rebuild Iraq would be a positive for the US markets. No matter what happens, the balance of power in the region will change. Counter strikes against the US or its allies are almost sure to follow and that will be the true test of whether or not the market rally will be sustained.

Another crucial aspect of events will be whether the US deficit will balloon in order to pay for the war. It is also possible that the US's silent partners, such as Japan and Kuwait, will enter into the financial equation and pay for some of the costs of war and occupation like they did in 1991 and 1992.

In the event that the American public has to pay for the war, and if popular sentiment around the world remains strongly anti-US, our economy will likely slow down. Except for companies directly benefiting from reconstruction efforts, business activity will likely slow down, while at the same time, interest rates might rise. This scenario is called stagflation and was last seen in the late 1970's.

A major concern of investors living off the income of their portfolios is whether or not, on a long-term basis, economic activity will pick-up. If it does, as the Federal Reserve hopes, it would push interest rates up. If consumer confidence and business spending plummets due to continued terrorism, there is a chance that deflation could become a concern. Most economists are more concerned about deflation than inflation, since it involves a more serious unraveling of the economy and is harder to deal with than inflation.

If weapons of mass destruction are found in Iraq but they are not used in the course of the war, the markets will breathe a sigh of relief and move upwards.

Economic Events

The major news event of this spring is the Bush administration's proposed tax cuts. They argue that reducing income taxes and reducing or eliminating the tax on corporate dividends will stimulate the economy by promoting investment on the part of wealthy investors. It is very likely that we will see some kind of tax bill passed, though perhaps not to the degree that the President has proposed.

The intellectual argument of the administration is that individual investors help corporations create the most job opportunities and growth for the economy, which benefits everyone. Government spending is increasing now much as it did during the 1960's when the Vietnam War and social programs were funded by our deficit. The US government will be pressed to avoid losing control over interest rates and inflation if it starts to crowd out private spending due to a political agenda that does not work.

One result of a reduction in the tax on corporate dividends will be that stocks, especially those paying dividends, will become more attractive. Investments such as municipal bonds will decline in value. Municipal bond issuers will then need to pay more interest in order to attract investor funds and this will provide good opportunities for people looking to buy new municipal bonds.

Corporate earnings and profit reports are starting to come in for the 1st quarter of 2003. They look much weaker than expected even though the economy seems to be growing at an extremely low rate. This slow growth would normally be a harbinger of better economic times and higher stock prices. The price of raw materials has increased in most areas, excluding the price of oil, and this is another sign that industrial activity would be poised to resume if the economy was freed of the threat of continued war.

Many companies' capital expenditure and hiring plans have been put on hold, pending the outcome of military action in the Middle East.

The conclusion of overt war should bolster the confidence of businesses and consumers, who will start spending again. At that point, businesses will begin to purchase new equipment and computers, which bodes well for the forlorn technology sector.

Personnel Financial Planning

Beginning this quarter, we are pleased to present several short summaries by our staff about topics we believe will be of interest to our readers.

Juliana Henderson

It is a pleasure to be able to report to our clients and friends that we are now working with a design firm to create a website that will provide a convenient way for clients to view their portfolios. Clients will log on through a secure sign-in and view all accounts either individually or as a combined portfolio. There will also be different reports such as "Income Year to Date" and "Realized Gains and Losses Year To Date". The latest industry research, news, commentary and quotes will also be present so that users can learn more about individual investments in their portfolios.

We are hoping that the site will be up and running by early summer and will keep you posted as to the unveiling date!

Stephen Madeyski

As everyone knows, the markets are going through rough times and bonds are paying historically low yields. There is at least one ray of sunshine however - mortgage rates are at their lowest rates that we can remember! 30 year fixed rates are around 5.75%, 15 year fixed loans are at 5.00% and variable rates are even lower. We are often asked if it makes sense to refinance. Here is an example that illustrates the variables involved. Let's assume that you have a $100,000, 30-year loan at 7 %, principal and interest payments are $665/month. If you can refinance at 5.75% over the same time period, it will reduce your monthly payments to $584/month, a saving of $81 a month or $972 per year. How can you tell if it is worthwhile spending the time and effort involved in the refinancing process? If the costs of refinancing (appraisal, title insurance and other charges) come to

$2,000, divide $2,000 in costs by the monthly saving of $81. This shows you 25 months that it will take to recoup your out-of-pocket expenses. If you are planning on staying in the house for over 2 years, refinancing could be a good idea. There are other alternatives available as well. Shortening a loan term from 30 years to 20, 15 or even 10 years, may increase your monthly payment, but the total amount of interest paid out will be substantially reduced. Refinancing a 30-year loan to a 15-year loan will save $26,000 in interest over the next 15 years. Another little known fact is that if you make one extra payment per year on the anniversary of your loan, a 30 year loan will be paid off in full in 20 years. Similarly, a 15-year loan, with one extra annual payment, will be paid off in 10 years! So, think about taking advantage of the low interest rate environment during these tough economic times. If you have any questions on refinancing, please give us a call.

Jeff Sand

The basic purpose of insurance is risk management, whose objective is to protect you and your family from the occurrence of negative events. Another way to look at it is transferring the financial risk to an insurance company for a fee.

Here is some information we use in the evaluation of whether or not the purchase of long-term care (LTC) insurance might be an important consideration for clients. Current research indicates that up to one third of men and one half of women past the age of 65 will spend time in a nursing home during their life, with the average stay being close to 2 ½ years. The cost is high: almost $56,000 a year, though it can run much higher in some urban areas. Medicare only covers nursing home costs for a very short period following a hospital stay to recuperate from an acute illness or injury. Medical and nursing home care costs are increasing faster than the rate of inflation. The assets needed to pay for long-term care have to come from either your savings, portfolios, or possibly, LTC insurance.

We have experience with analyzing annuities, life, health, disability and long-term care insurance. If you are considering any of these, or would like to review your existing policies, we can help to identify the most important variables and also research cost effective alternatives.

Events

Our quarterly Tea will be held at our Santa Fe office at 510 Don Gaspar, Thursday, May 15th at 3:00 p.m. In order to better serve our clients in the Albuquerque and Taos areas, we will be scheduling quarterly gatherings in these areas over the next few months. The main focus is to discuss how alternative investment vehicles are performing and the possibilities of diversifying by using currencies other than the US dollar, as well as prospects for specific municipal bond strategies.

Our hopes and prayers go out for the safety of innocent people from all nations and the preservation of species of all sorts. May we keep this uppermost in our minds and hearts in the upcoming months.