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Commentary
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Market Performance

The final quarter of 2004 accounted for all of the year's gains because in the weeks after October 25, the U.S. and international stock markets staged a sharp year end recovery. At the close of the 2004, the Standard & Poor's 500 was up 8.99% while the Dow Jones Industrial Average was up 3.15%. Both of these indexes were showing declines for the year in mid-October and so you can see that the 4th quarter rally was substantial.

It is hard to say that the rate which corporations are earning profits justifies these lofty stock levels. With interest rates rising slowly and according to a measured plan, some investors are finding few alternatives to putting money into stocks. Going forward, the Fed has indicated that it will continue to raise rates. So that, come the next recession, it will be able to lower them in order to stimulate the economy when it is needed.

The technology laden NASDAQ composite gained 8.6% in 2004. It still has to more than double in value from where it is now to return to the levels of March 2000. The Standard & Poor's Index still remains 26% below its record level of the same date.

Optimism abounds on Wall Street that interest rates will remain relatively low and that inflation will continue to be benign at approximately 3% per year. In order for this to occur, foreign buyers, most notably the central banks of Japan, China, and Korea, need to continue to purchase our treasury bonds in order to hold up the U.S. dollar and hold down interest rates.

The Rikoon Carret investment portfolios did well in 2004. Our U.S. stocks gained 9.45% while our international portfolios gained 14.7%. The Dow Jones International 50 Stock Index gained 12.27% during 2004.

In the bond arena, investors were nervous about the 10 year treasury market, which some people thought would lose ground in 2004, but it did not. The U.S. bond market gained 1.7% while the Rikoon Carret U.S. government corporate taxable bonds gained 2.62%. In the tax-free area, our portfolios gained 2.76% versus the market's gain of 1.13%. In summary, the Rikoon Carret portfolios beat their relevant benchmark comparative indexes in all areas in 2004

A Call To Order

The U.S. national debt was raised to 800 billion dollars this last quarter and it will, no doubt, be raised further. As the costs of maintaining global, political and military leadership grow, and as our productive capacity diminishes, our nation's fiscal options have become narrower. Our international balance of trade, the amount we buy from other countries less what we sell to them, is going deeper in the red. We are addicted to cheap consumer imports. The U.S. dollar's slow but steady decline versus the other major world currencies is one sign that international confidence in our economy is waning. I do not believe, however, that we are near the point where a crisis is imminent. The slow steady way the dollar is going down is beneficial to U.S. companies because it effectively lowers the price to foreign consumers of U.S. goods. The weak dollar does raise prices for you and me, because when we buy foreign made goods, our dollars don't stretch as far. This amounts to hidden inflation.

Even as the deficits mount, there are compelling reasons why things are not all going to fall apart. As Americans continue to borrow more and produce less, foreigners may end up calling the shots as far as our domestic interest rates. This will impose financial discipline on us and it can also be seen as a loss of autonomy.

Japan, Korea and China need us to consume, and our twin deficits and sick dollar are visible signs of a deeper shift in the political and economic tides that are now shaping the future. Asian governments, who want their youth to have jobs, are able to keep building more factories to absorb the millions of people streaming into urban areas from the country because we buy their "cheap" goods. Our trading partners therefore will continue to assist us in maintaining our consumptive habits.

There are many intelligent, energetic and powerful people whose job it is to keep the system rolling along. Pundits who predict an imminent collapse of our economy are, in my opinion, wrong. Our consumer society is essential to the world's economy. This may not be helpful to the environment or the other species who cohabitate the planet with us. Keeping the current economy based on U.S. consumption, may also turn out to be inimical to political liberties. By now, most voters understand that politicians have a vested interest in their constituents not knowing the truth. It is important to those who prize law and order that news of the U.S.'s declining standard of living be kept under wraps. Confronting the reality of outsourcing our manufacturing jobs is too painful. The nation's red ink means unless we start saving, personally and as a society, our nation's capital, is being depleted.

The party ain't over 'til it's over, and my sense is we are unlikely to face cataclysmic events such as an uncontrolled run on the dollar or de-facto national bankruptcy. It is in no one's best interest for an international crisis to occur. By continuing to run large deficits and giving up our productive capacities, we are inexorably changing places with others within the web of world finance; from calling the shots to eventually being called to order. Losing our economic autonomy is bad, but it is a welcome alternative to war. War has been the traditional way that people have dealt with economic power shifting from one type of society to another. Perhaps we can consume our way out of hegemony and into a negotiated consortium. Fighting our way out of deficits through trade wars or with troops is not effective. We can continue to go on spending in the same way we have been for the last 50 years, perhaps even for a decade or two. Our job, as somewhat informed investors, is to find ways to navigate within this environment and find places to put our money that feed both our financial and ethical appetites. These paths may be narrow and untraditional but they do exist.

Offsetting Traditional Investments with Alternatives

Investors can now review their portfolio in light of the continued and strengthened Republican domination of the executive, legislative and judicial branches of our government. Due to the financial straightjacket we have fashioned for ourselves it is ever more challenging to find a strategy that will provide at least 2 out of the 3 classic goals: safety, income and growth.

Investing used to be like checkers. People used to believe in the connection of corporate well being and the health of the stock and bond markets. Individuals were able to save money and have confidence that the stock market would provide for the growth of their nest eggs. For more safety, bonds provided a lower return but enough to protect a decent standard of living. Alas, individual investors are learning that the new world order is not this kind of comfortable place.

Traditional investing, like checkers, was a fairly simple game, easy to learn, taking moderate skill to do well. Investing today is like three dimensional chess which requires us to look far ahead into the future. It requires us to expect the unexpected, to develop a complex tree of risk management techniques.

Three dimensional chess, requires constant contingency planning, which means postulating the question of, what if this disaster unfolds? With low interest rates but high gas prices, what happens if bond rates stay at 3% for the next 15 years? If mortgage rates remain low so we can afford a bigger house, what do we do about runaway inflation in healthcare costs? We now question the premise that using traditional stocks and bonds will provide enough for retirement.

Global forces now making traditional investing inadequate include the decline of the U.S. dollar, increasing prices for natural resources and brutal international competition for decent jobs. It is likely that full employment will never come back to the U.S. Our technological and educational advantages have been mitigated by the development of very competitive schools abroad. Interest rates cannot be allowed to go up very much as individuals and governmental entities would be unable to sustain their current spending levels. We must run to stay even. A crack of confidence caused by high rates would trigger investor fears and perhaps flight.

We are in for a long period where investors will have to work longer and harder to achieve decent investment results. Many necessary kinds of investments will not be able to be researched from the comfort of our homes over the Internet. New investments may not be convenient, due to specialized paperwork required by law to invest in private deals, and there may be more complex tax laws which govern them. What a hassle! We believe that private real estate deals will outperform REITS publicly traded stocks, and small but effective hedge funds that can manage multiple currencies will outperform stock indexes. Natural resource investments such as oil and gas, sustainable lumber and energy transmission companies will help investors augment their income. A wide variety of income investments is necessary such as might include covered call funds, long-short funds and diversified high yield bonds. All of these vehicles strive to allow investors to receive steady current cash flow, especially if the broad markets remain lackluster.

10 Financial Mistakes To Avoid

In my twenty-five years in the financial services business, I have found that there are financial mistakes that act as barriers to achieving financial independence. Here are the top ten with strategies you can use to reverse course.

1. No well defined goals. Without a goal, it is hard to have motivation. For example, young couples often have a burning desire to own their own home. This is so important to them that they will focus much of their financial energy on the goal until it is achieved. To achieve this kind of focused energy, write down the two or three financial goals that are most important to you. Then, develop a brief written game plan for achieving them.
2. Rotating credit card debt. The typical working adult has at least half a dozen credit cards. The number of cards isn't the issue--it's that most people end up not paying off their entire bills each month. The result is a rising tide of debt that strangles one's financial future. My suggestion is to only have one or two cards and use them only in emergencies until you are able to pay off the balances on all of your credit cards.
3. No savings for emergencies. Whether it's the loss of a job, an unexpected auto repair, or a serious illness, sooner or late, there will be unexpected bills. Without adequate savings, people end up borrowing. One strategy for dealing with this is to set up an automatic deposit to a savings account equal to 2% of your take home pay.
4. Not capturing your company's 401(k) plan, especially if the company matches some of your deferral with company money. It is not unusual to find matching contributions of 50% to 100% of the first 6% of pay. Sign up now for at least the amount of contribution that is matched by your employer.
5. Buying too expensive a car. Over their lifetime, most people will spend more money on automobiles than any other single recurring purchase. We estimate that the typical couple spends in excess of $1 million on auto purchases during their lifetime! People are concerned with driving the "right" car and they're often willing to overpay for "stature". However, cars begin to depreciate in value as soon as you drive them off the dealer's lot. The greatest depreciation occurs during the first two years. Try to commit to keeping your current auto until your loan is paid off. Then, continue to make payments to a new car purchase account until you have enough money to buy your next car for cash. In the future, buy a car that is at least two years old but still under manufacturer's warranty. This will allow you to own a nice car, free of debt. Generally, the longer you own a car, the better off financially you will be.

6. No cash management planning. Don't groan…Budgeting does not have to be burdensome or time consuming. If you don't budget, you're far more likely to have no money left at the end of the month. Most people spend more than they earn. The end result is escalating debt and debt payments that generally result in it becoming more difficult to get yourself back on track. It is helpful, especially at the start of this new year, to commit to setting up a budget and following it for the next 12 months. The easiest way to do this is to use a computer program such as Quicken (www.quicken.com). Be sure to "budget for success" which means your budget should include an investing component and reducing debt should be a high priority.
7. Inappropriate insurance coverage. Insurance premiums can easily soak up 15% or more of take-home pay! The biggest abuser is life insurance. Often, I find people are paying too much in premium for too little coverage. If you're the breadwinner for your family, your first priority is to have enough coverage to provide dependents with adequate financial support should you die prematurely. This will often require $500,000 to $1 million or so of term life insurance.
8. No will or living trust. 85% of adults either have no will/trust or one that is seriously out-of-date. Obviously, this is a financial issue that doesn't matter until you die. Then, it can matter a great deal to your surviving loved ones. If you die without a will, who your property goes to will be determined either by property title or by state intestate laws. State laws may produce an undesirable result, especially if you have children who are minors. Think about your current will. Does it reflect your current wishes? If your answer is 'no' or 'I'm not sure' or you don't have a will, contact an attorney who specializes in estate tax law. I can provide references if you e-mail me a request.
9. No retirement plan. Financial independence rarely happens by accident. It takes a great deal of thought and work. The biggest mistake most people make is thinking this is something that can be done 'later'. The problem is that later is often too late because the key to accumulating enough money for a comfortable retirement is to start a systematic investment program early on. Retirement planning involves many complex calculations and assumptions. Your strategic game plan should be reviewed and updated often, at least annually.
10. No fitness plan. It may seem strange that I would list poor physical fitness as a top ten financial mistake, but unfortunately, too many people don't take care of their physical well being. The result is poor health which exacts an increasing financial toll just when you would otherwise be ready to start enjoying retirement. Instead of traveling or recreating or just staying at home, you end up traveling from physician to physician. Try committing 30 minutes per day to an exercise program. It can be as simple as walking for 30 minutes. The goal should be to walk a minimum of 10,000 steps each day (about 3 miles). As you progress, introduce weights into your program. Even lifting light weights helps stabilize and increase bone density. Or, come adventure racing with me!

Personnel News

Please note this section is now being written by my assistant, the inimitable Beth Humphreys.

It's always a tough choice for us when we decide which charities to donate our "in lieu if holiday cards" money to, and here's a list of where our funds went this year: The Empty Stocking Fund; Kitchen Angels; Youth Shelters and Family Services; and St. Elizabeth's Shelter. We're grateful to have such valuable local charities helping our community.

After an arduous search bordering on hopeless, Patricia Cody, our Operations Manager, found and bought her "dream" home in Albuquerque. She and Jake (her adopted canine roommate) have moved in, and although she gets anxious sometimes about repairs (she fixed the heater thermostat herself!), they have adjusted happily to their new home.

Juliana Henderson, our chief when Rob is out of town, on the other hand, is anxious about her latest canine adoptee, Jonah, because he loves to carry his bed down the road in snow, rain, and mud. It's an all-season event! Other than that, he and his pal, Byrd, have fun together so life is good in the Henderson household. If anyone has any suggestions on how to curb Jonah's bed dragging habit, Juliana would welcome them. Also, Juliana has started a trend with her marimba lessons by getting friends to join her class, and says they now have quite a "girls group" going. She promises to entertain us at a future tea just as soon as she knows more than half a song.

Jeff Sand, our most senior portfolio manager, has new used ski equipment he bought from the swap meet which he hasn't tried yet. With the weather this winter, and the fabulous base at the ski area, he's looking forward to Stephanie's ski lessons starting so that he can sneak in a few runs himself. Also, his family has inherited a rabbit and the jury is still out on this addition to his family. Anyone interested?

As for myself, the perpetual student, I am taking some community seminars at St. John's College. I go to the James Joyce In Santa Fe reading group every Thursday morning and report that literature has never been more rowdy and boisterous as the opinions collide (it's a reading group for goodness sake!).

Dan Pierpont's news, our junior portfolio manager, is all about family. He and his wife, Hannah, celebrated their daughter Natalie's first birthday in their new home. Oh, and a newly painted home at that, after several long-haul painting weekends! Also, over the holidays (aka university intersession), Dan's brother Brandon interned with us. (Internship is a cool way of saying "paper shuffling," but he helped with other business matters so who knows, we may have influenced his future.) Dan-the-family-man is settling in, and settling in well here in our Rikoon Carret family too.

Dana Hees, our administrative queen pin, went to the Tournament of Roses Parade to re-live her childhood New Year's in Pasadena where she grew up. She says the post-parade gin fizzes are still top notch!

As for Rob, on February 12th he will participate in the 52 mile Mt. Taylor Quadrathon, which is a 6 hour race (for him) that includes road biking, running, cross-country skiing, and snow-shoeing (whew!). And then, on April 1st through the 3rd, he and two friends will do the Smokey Mountains Adventure Race. That is a 40-hour challenge including mountain biking, trail running, paddling and orienteering (which he admits to being his weakest skill). Anyone up for trekking in the woods with a compass and USGS maps should be in touch!

Event Schedules

Mark your calendars for our upcoming Client Teas. The next one will be February 17th, and it will start at 3:30 p.m., a half hour delay from our usual time to allow for some of the parking from the legislative session to clear out. If you need some help with parking, please call us. After that, the next two teas will be held at our regular time of 3:00 p.m. on April 14th and June 9th.