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2007 Market Review ~ Future Retiree ISO Educ Finl Prof for LTR

January 2008 - Stocks were battered in the fourth quarter of 2007 by a litany of economic cross-currents including concerns about corporate profits, a weak housing market, higher energy prices, and continued havoc in credit markets. Indexes posted nearly across-the-board losses, with Real Estate at the bottom of the heap, sinking 13.5%. This was followed by Domestic Value, with Small and Large Caps dropping 7.3% and 5.8%, respectively. The only bright spot was International Emerging Markets, advancing 3.7%.

The turbulence in the stock market sent investors to seek a safe haven in bonds, with all broad sectors improving. Reflecting a weaker dollar and lower interest rates, Global Aggregate gained 3.3%, U.S. Aggregate rose 3.0%, and International Emerging Markets added 2.1%. Consistent with the credit-market mayhem, U.S. Corporate High Yield was the only loser, shedding 1.3%.

The Federal Reserve continued to address the credit-market distress by lowering the Fed Funds rate twice during the quarter, each time by a ¼%, to 4.25%. Despite the Fed's cuts, institution-to-institution borrowing remained somewhat frozen as financial companies sought to avoid the appearance of desperation. In attempt to stimulate liquidity, in a coordinated effort with other nation's central banks, the Fed for the first time offered financing through a "term auction facility." Meanwhile, the gale-force flight-to-safety sent the yield on the 10-year Treasury Note below 4.00%. At quarter-end the 10-year Note was down 60 basis points to close at 4.02% (the yield as of January 11th was 3.79%).

Volatility was the catch phrase associated with market activity in 2007. Mergers and acquisitions mania continued to propel stock prices higher during the first half. But by summer, after both the Standard & Poor's 500 Stock Index and the Dow Jones Industrial Average set all-time highs, worries about a poor housing market and tight corporate credit put the kibosh on leveraged-buyout deals and led stocks to lower levels.

August marked the end of the Federal Reserve's more than year-long, on-hold stance when it added liquidity to the financial system by engaging in open-market operations and, in an unusual move, cutting only the Discount rate by ½%. The Fed followed up by dropping both the Fed Funds and Discount rates by ½% in September and another ¼% at each of its next two meetings in October and December.

Wide swings in stock prices were in play for the second half of the year, as nearly every day brought news about another company's woes in the credit markets. Although most broad stock-barometers managed to advance for the year, the returns for underlying asset classes were mixed. With the dollar sustaining its decline against other currencies, international-stock investors continued to be well rewarded. Leading the foreign pack in 2007 was International Emerging Markets, soaring 39.8%, followed by International Developed Large Cap jumping 11.6%, and International Developed Small Cap edging ahead 1.8%. International Emerging Markets and International Developed Large Cap extended their string of double-digit upside moves to five years.

Performance was wide-ranging and atypical on the domestic front as Large Caps outperformed Small Caps and Growth succeeded Value. Large Cap ranged from up 11.8% for Growth to down 0.2% for Value, while Small Caps varied from 7.1% higher for Growth to 9.8% lower for Value. Notably, Real Estate Stocks (as measured by the Dow Jones Wilshire REIT Index) backtracked for the first time since 1999, unloading 17.6%, as a result of the credit-market morass and fears about a slowing economy.

The chaos in credit markets initially led to a massive re-pricing of risk in the residential mortgage and corporate credit markets, widening bond spreads and lowering fixed-income prices. But the shift to less-risky assets and a weakening dollar left U.S. bond investors in good stead. Global Aggregate rallied 9.5%, U.S. Aggregate expanded 7.0%, and International Emerging Markets tacked on 5.2%. Things were weaker in more narrow domestic sectors, with Municipals inching up 3.4% and U.S. Corporate High Yield eking out 1.9%. Meanwhile, U.S. Treasury Bond investors benefited as the yield on the 10-year Note sank 68 basis points for the year from 4.70% to 4.02%.

Below are rates of return for selected market indices for the fourth quarter of 2007, full-year 2007, and the three, five, and 10-year averages as of December 31, 2007.

	4Q:2007	2007	3-Yr. Avg.	5-Yr. Avg.	10-Yr. Avg.
Equity (Stock) Indices					
Domestic Large Cap					
Russell 1000 - Growth	-0.77%	11.81%	8.68%	12.10%	3.83%
Russell 1000 - Value	-5.80%	-0.17%	9.32%	14.63%	7.68%
Russell 1000 - Blend	-3.23%	5.77%	9.08%	13.43%	6.20%
Domestic Small Cap					
Russell 2000 - Growth	-2.10%	7.05%	8.11%	16.50%	4.32%
Russell 2000 - Value	-7.28%	-9.78%	5.27%	15.80%	9.06%
Russell 2000 - Blend	-4.58%	-1.57%	6.80%	16.25%	7.08%
Real Estate (Dow Jones Wilshire REIT)	-13.54%	-17.55%	8.46%	18.27%	11.05%
International Developed Large (MSCI EAFE)	-1.71%	11.63%	17.32%	22.08%	9.04%
International Developed Small (MSCI EAFE)	-4.80%	1.79%	15.55%	26.84%	NA
International Emerging Markets (MSCI EM)	3.66%	39.78%	35.60%	37.46%	14.53%
Fixed-Income (Bond) Indices					
Lehman Brothers					
Global Aggregate	3.26%	9.48%	3.88%	6.68%	6.32%
U.S. Aggregate	3.00%	6.97%	4.58%	4.43%	6.04%
U.S. Corporate High Yield	-1.30%	1.87%	5.49%	11.31%	5.88%
Municipal	1.36%	3.36%	3.90%	4.30%	5.24%
International Emerging Markets	2.08%	5.21%	9.15%	13.25%	10.52%

Source: www.russell.com, www.wilshire.com, www.mscibarra.com, www.lehman.com

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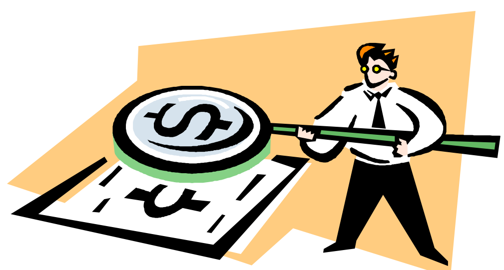

If you were to place an ad to find a financial advisor, it may appear something similar to the above (translation for those who have not perused the personals: *Future Retiree In Search of Educated Financial Professional for Long-Term Relationship*). Whether you are interviewing for employment or seeking professional services, it's been said that the process is essentially a vetting comparable to dating. I once called a doctor to learn more about him and his services. I began by asking his age and where he obtained his education. Although he answered all of my questions, he was clearly surprised and also added that he hadn't been asked these types of questions since his dating days!

Regardless of the type of professional advice sought, the process should be the same. The parties involved should obtain information and a comfort level about whether to proceed to the next step. Any hesitation on the part of an interviewee/advisor to freely answer questions certainly would be very telling.

Over the past year, these articles (all available at www.kaloramawealth.com/news.html) have covered the "what," "how," and "why" of Portfolio Spring-Cleaning. In April, we initiated this series with *Portfolio Spring-Cleaning Revisited* to provide a framework for "what" should be done to organize and optimize the performance of your portfolio to achieve your goals. We followed up in July with the "how" by providing the steps in the Investment Management Process (*Commencing Countdown, Engines On!*) and in October with the "why" by outlining an investment philosophy (*Who am I? Why am I here? (Do you have an Investment Philosophy?)*). As a final article for this series, below we discuss the “who” of portfolio management by suggesting criteria you should use to select a financial or investment advisor.

As an investor, one of your biggest risks is not the volatility in the securities markets; it’s choosing the wrong financial advisor. With bad advice, the performance of your portfolio may suffer as a result of earning less in rising markets, losing more in falling markets, or not achieving your long-term financial goals. The last item is the most important. After all, your primary reason to work with an advisor is to achieve greater financial security and independence, and assist you with the attainment of your financial goals, such as retirement, education, or a home purchase.

Let’s assume that by talking to people you know or through online sources you have narrowed your search to two or three advisors. The next step is to obtain the objective information you need with which to make a selection decision. Some of the pertinent criteria you should consider include:

- What credentials does the advisor have and do they maintain memberships in professional organizations? The Financial Industry Regulatory Authority (FINRA) lists 80 “professional” designations on their web site (http://apps.finra.org/datadirectory/1/prodesignations.aspx) and summarizes the experience, education, and examination requirements required, if any, for each. How much time does the advisor you are interviewing dedicate to continuing education on financial planning and wealth management strategies?

- What is the advisor’s experience? How many years have they been providing financial advice? In which areas do they specialize? Can they provide client references?

- What is the advisor’s form of compensation? Is the advisor compensated solely by fees paid by you, or are they paid commissions or compensation from a third party from the sale of financial products?

- What is the advisor’s planning process and investment philosophy? Does the advisor follow a planning process? Can the advisor explain his/her investment philosophy? What type of clients and situations do they typically work with?

- What services does the advisor provide and what products are available? If they provide investment advisory services, what amount of assets do they manage? Do they have a minimum account size? How many clients do they have?

There are several online resources available (all free of charge without any web site registration requirements) to assist you with obtaining and evaluating information about financial advisors. A great place to start is the Certified Financial Planner Board of Standards web site (www.cfp.net) which offers much information about financial planning, including a *Checklist for Interviewing a Financial Planner* (www.cfp.net/learn/knowledgebase.asp?id=8) and a brochure providing *10 Questions to ask When Choosing a Financial Planner* (www.cfp.net/Upload/Publications/185.pdf). If the advisor is a CFP® professional, you can also check their disciplinary history (www.cfp.net/learn/knowledgebase.asp?id=7).

The Paladin Registry (www.paladinregistry.com) provides tools and information to help you make an informed decision in your selection of a high-quality financial advisor. In addition to numerous articles and presentations, the Registry has a questionnaire (available via download or email) you can use to interview your current or prospective advisor. A rating system is provided to evaluate the responses.

All financial professionals are required to be registered or licensed with federal and/or state securities regulators. However, to truly be considered an "advisor," a financial professional has a legal obligation to be a "fiduciary" by always putting a client's interests first, whereas a "broker" is not held to this same stringent standard.

A good starting point to research advisors and brokers is the Securities and Exchange Commission (SEC) web site (www.sec.gov/ investor/brokers.htm). Investment advisors are required to file a Form ADV, which should be available directly from the advisor, as well as from the SEC (www.adviserInfo.sec.gov/ IAPD/ Content/IapdMain/iapd_SiteMap.aspx). The ADV has information about the advisor's business and whether they have had problems with regulators or clients. It also outlines the advisor's services, fees, and investment strategies. If you are considering a broker, FINRA has a BrokerCheck program to learn about brokerage firms and individual brokers (www.finra.org/InvestorInformation/ InvestorProtection/ChecktheBackgroundof YourInvestmentProfessional/index.htm).

Both the SEC and FINRA web sites offer much educational information about investing and working with financial professionals.

Your relationship with a financial professional may not be a formal marriage, but it is a partnership which should be based upon trust. You need to choose someone who has the credentials, experience, and process to help you achieve your goals. Investing the time at the outset to find the right person should ensure that the partnership becomes the long-term relationship you are searching for.

Thank you for your business, trust, and referrals. Please feel free to provide a copy of this newsletter to friends and colleagues who can benefit from information about investing and financial planning. If I can be of any assistance to you or anyone you know, please do not hesitate to contact me.

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