Wealth Health
Personal Wealth Management

5 Becker Farm Road
Roseland, NJ 07068
Tel: 973.535.9577
Fax: 973.535.9777
info@WealthHealthLLC.com
www.WealthHealthLLC.com

2005 Year in Review, 2006 Outlook

Our previous commentaries spoke of market storms and with a quick look at the forecast we see that it's still raining. When considering the economic climate of 2005, we encountered a series of Fed rate hikes that began back in mid-2004, where the short term interest rate target rose from 1% to the current 4.25%. These rate hikes led to the first slightly inverted yield curve that we have seen since 2000, often thought of as a precursor to a recession. We also experienced $58 billion in losses from the devastating hurricanes and a 40 percent jump in oil prices, causing many to believe that inflation may be looming. Finally, we learned of the eventual exit of Federal Reserve Chairman Alan Greenspan and the new Fed Chief Ben Bernanke. Yet, in spite of these elements, the economy remained strong in 2005, with the companies constituting the S&P 500 experiencing average earnings growth of 13%, while both income and jobs were up and unemployment falling under 5%, its lowest in 35 years.

The results of the above forces on the S&P 500 index (used as a representative gauge of the US equity market in general) produced a 4.9% gain. While this return is not in line with our long term equity return planning assumptions, we need to recognize that a globally diversified investment portfolio's return is not based on the S&P 500 alone. More notably is the upside that the various equity markets in the US and around the world posted during this same period as the chart below reflects.

Index	2005 4th QTR	2005 Annual	3-Year Annualized	5-Year Annualized
Standard & Poor's 500	2.08%	4.91%	14.38%	0.54%
Russell 1000	2.12%	6.27%	15.42%	1.07%
Russell 3000	2.04%	6.12%	15.90%	1.58%
Russell 2000	1.13%	4.55%	22.13%	8.22%
MSCI EAFE	4.08%	13.54%	23.68%	4.56%
MSCI Emerging Markets	6.83%	30.31%	34.23%	16.23%
Lehman Brothers Aggregate Bond	0.59%	2.43%	3.62%	5.87%

The way people felt about the markets in 2005 depended on their recent experiences, expectations, and their recollection of the late 90's and the huge double digit gains during the Internet bubble. In any case, while 2005 was by no means a stellar year performance wise, it did certainly present the opportunity to reap the benefits of asset allocation, as our portfolios did.

So where are we now? The same factors that set the tempo for 2005 exist today. Inflation remains tempered as its increases have almost entirely been related to higher energy prices. The issue of whether continued increases in the costs of energy will cause inflation remains uncertain. Minutes from the Fed's recent policy meeting suggest that they are getting closer to an end to the rate increases which should remove a major impediment to stock price gains. Even after the series of rate increases investors need to remember that we began at 45-year lows. All the Fed has done is reversed an abnormally loose monetary policy to avoid a deflationary downturn after the Internet stock bubble. In addition, uncertainty remains regarding Bernanke's willingness to continue these hikes as the new Fed Chief.

As mentioned above, the companies constituting the S&P 500 had earnings growth of 13% during 2005, yet the S&P 500 Index rose just 4.9%. This stall in the face of rising profits has made prices more attractive, especially for S&P 500 companies. Many experts agree that the stock market is not historically overvalued. In fact, the S&P 500 Index sells at 15-times estimated 2006 earnings (which has historically been about 20-times). The Dow is also trading at roughly the same multiple. That's the lowest since 1994! Analysts tell us that the recent strong earnings are no fluke and should persist. Corporate balance sheets are in good condition and heavy in cash. This is true overseas as international and emerging market companies may even represent better value. If the market dips in 2006, the multiples will go even lower, making companies even more valuable. More likely, if the market inches higher, multiples will move back in line with historical norms.

When looking to other assets, we see that bonds haven't budged from historical low levels, meaning investors are optimistic – at least for now- that inflation is in check without stalling the economy. Real estate investments trusts are expensive relative to earnings and dividends. With gains from real estate investments and other alternative investment cooling off, investors may be looking for a new place to put their money. In addition, as rates continue to creep up, we believe that, in most cases, the days of flipping condos for profit before construction even begins is behind us. This scenario may lead to a considerable amount of real estate investment finding its way back to the equity markets.

Having said all of this, wisdom reminds us of the inherent risks that remain for investors. Many of the potential opportunities mentioned above are also poised to threaten markets in 2006. To name a few, we have not forgotten that we are still at war, that mother nature can slam our lands at a beckoning call, or that energy prices can continue their erratic fluctuations, causing inflationary concerns at any moment.

We remain conservatively optimistic about the equity markets in 2006 and look to our investment managers to employ their strong stock picking abilities to add value in the face of these opportunities and threats. While a sinking tide lowers all boats, we believe strongly in the principle that the best way to navigate through the equity markets is to invest in high quality companies at reasonable values. In addition, we remain committed to our asset allocation principles and to customizing our client portfolios based on individualized financial planning needs. We are prepared to make alterations to our clients' portfolios as their financial situations change.

As always, we pledge to put our clients first in whatever we do. We are grateful for your confidence in us and extend to you our most sincere wishes for happiness, health and prosperity in 2006!

Sincerely,

Richard Coppa, J.D., LL.M, CFP Darin Gartland, CFP, EA

Please contact us at 1-973-535-9577 or e-mail any questions to us at info@WealthHealthLLC.com.