

July 27, 2006

Dear Investor,

If one were to write a brief history of the economy of the past ten years, the first five might read like a fairytale; the last five more like a bad dream.

The fairytale: Once upon a time, (between 1995 and 2000) an Empire that for a time had lain barren began to flourish - thanks to a suddenly booming economy. The Empire's government was operating at a surplus. Company pensions were fully funded. Internet enterprises, dot.com start-ups and an explosion of technology-related purchases triggered by Y2K fears sent the markets soaring and made making money easy. While the real estate market was slower to catch the wave, everything else the people touched turned to gold - especially in the stock market, where it appeared no one could lose. The future seemed very bright indeed, which made the Empire's people optimistic.

Then, alas, the Empire rounded the corner to the new millennium - and the fairytale became a bad dream. The Y2K threat was over and all the money spent on preparation for it had been expended, leaving corporations light in the pocket. Dot.com companies were dying off like flies, taking with them the peoples' dreams of attaining great riches the easy way. Corporate scandals and terrorist attacks were soon to follow, making the people fearful and spoiling the illusion that good times would continue indefinitely. Time elapsed, the economy slowed, the Empire's economic markets dropped, and confidence fell sharply among the people. A large dose of reality had to be swallowed by all.

Luckily, the Empire's wizards, magician and knights-in-shining armor came to the rescue. The wizards (the President and Congress) lowered taxes, the magician (the Federal Reserve [the Fed]) lowered interest rates, and the knights (the Justice Department and the US Military) took on the corporate crooks and terrorists. Historically low interest rates allowed the real estate market to jump on the bandwagon, leading to a boom in real estate and a much-needed economic recovery. The sun began to peek through the clouds, to shine once more on this Promised Land. The Kingdom started to enter fairytale mode again.

The people began to celebrate, which made them all the more dismayed when the magician (the Fed) saw the need to put a damper on the fun. In June 2004, the magician began raising interest rates in an effort to ensure that things didn't get out of hand. As the song goes, the magician didn't want us to "party like it's 1999" all over again. Over the past two years, the magician has raised interest rates 17 times to the now current 5.25 percent. On August 8, 2006, the magician will likely raise rates for the 18th consecutive time. How many more times will the magician perform the act? And how might this tale end?

These are valid questions that deserve some analysis. On the bright side, the raising of rates has helped temper a booming real estate market. That's good! Prices aren't rising as quickly, builders are offering more incentives to would-be buyers, and houses have stopped selling like hotcakes. Soon home-sellers will likely have to lower prices to move inventory faster. On the darker side, continued rising rates run the risk of not just slowing real estate but perhaps busting it. This is not so good!



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