

The Quarterly Report

VOLUME 12 ISSUE 4 JANUARY 2007
FOURTH QUARTER OVERVIEW

It was an eventful and at times tumultuous year in 2006. The ongoing difficulties in Iraq and the related shift in power in Washington D.C. were just two of the big headlines that most everyone watched with rapt attention. We too were interested in those events from a human-interest standpoint, although neither of them was especially significant from an investment standpoint. Our mission is to focus on factors that can be analyzed with confidence and that are likely to directly impact our investment portfolios, and politics and international affairs rarely meet those criteria.

Our outlook for the coming years hasn't changed significantly despite the eventful year we had in 2006. While the S&P 500 put up good numbers in 2006, the valuation picture has actually changed very little. This is because earnings have gone up along with stock prices, leaving the relationship between prices and earnings at about the same place.

Much has also been made of the recent "new all-time high" for the Dow Jones Industrial Average, and that this suggests the market is overvalued. While we don't believe that the Dow is a particularly representative benchmark, this nonetheless provides a good opportunity to think about what it means. True, the Dow is at a new all-time high. But the prior high occurred nearly seven years ago! In other words, we have only just regained the levels we last saw three-quarters of a decade ago.

To us, that's hardly a sign of irrational exuberance, and that is at least in part supported by the fact that domestic-equity mutual funds have been in net redemption mode during the second half of 2006. But what about the broader indexes that provide a more representative view of the overall market? The S&P 500 is the one we put the most weight on, and it is still more than 8% below its prior all-time high (reached on 3/24/00, almost seven years ago). And the Nasdaq is still an amazing 53% below its peak on 3/10/00. In fact the Nasdaq is

at roughly the same place it was in January 1999, before the bulk of the bubble occurred. Let that sink in a moment: if you'd bought and held the Nasdaq eight years ago, you'd have a 0% annualized return as of today. Not exactly a spectacular return from a group that includes many dynamic and innovative companies.

Where does this all leave us? First, it suggests little in the way of froth in large-cap stocks. Attractive valuations tell us the market is either cheap—meaning returns going forward are likely to be better than average—or that the market is discounting a meaningful decline in the fundamentals. We've seen signs of slowing earnings growth and a deceleration in the economy. Part of this is normal cyclical behavior, and some may be in response to the slowdown in the housing market, but in either case it is clear that we're coming off of a spectacular period of earnings growth, and things are likely to cool off a bit. But a pretty big margin of safety is probably already baked into the market. To our valuation model, the market still appears to be mildly undervalued.

It pays to be disciplined and rely on objective analysis when making investment decisions, and ignore emotion. It can be difficult at times—and in fact is the most difficult at the times it's most needed—but being rational and objective is a requirement to succeed at investing. The other message is that keeping a focus on the long term is a big advantage. Being in "reactive mode" is an almost sure-fire way to get whipsawed. The market reflects investors' sentiments instantaneously. By the time any of us start worrying about oil prices, a housing collapse, or rising interest rates, it is highly likely that the market has already priced in those concerns. By reacting to our short-term concerns, we're most likely going to be taking action to "protect" us from something that has already happened. ~ RW7 ~

"Be at war with your vices, at peace with your neighbors, and let every new year find you a better man."

~ Benjamin Franklin ~

<i>Mutual Fund Yardsticks</i>	<i>1 Year</i>
<i>S&P 500</i>	<i>15.79%</i>
<i>Average U.S. Stock Fund</i>	<i>13.11%</i>
<i>Average Foreign Stock Fund</i>	<i>27.08%</i>
<i>Average Bond Fund</i>	<i>4.96%</i>

Tull Financial Group, Inc.
640 Independence Pkwy.,
Suite 300
Chesapeake, VA 23320
Phone: 757.436.1122
Fax: 757.436.1803
Toll Free: 888.296.PLAN

Winning
Planning
Tips



Plan Limits

Pension plan benefit and contribution limits are reviewed every year and adjusted as necessary to account for increases in the cost of living. Here are the figures for the 2007 tax year.

- The maximum amount that may be added to a participant's 401(k), profit sharing, or other defined contribution plan account is \$45,000 (up from \$44,000).
- The dollar limit on elective salary deferrals to a 401(k) or 403(b) plan is \$15,500 (up from \$15,000). The limit is \$10,500 (up from \$10,000) for SIMPLE plan deferrals.
- The limit on catch-up contributions (for those age 50 or older) remains unchanged—\$5,000 for 401(k) and 403(b) plans and \$2,500 for SIMPLE plans.
- When computing benefits or contributions, the maximum amount of salary that may be considered is \$225,000 (up from \$220,000).

Year-End Personal Finance Checklist

Yes, we understand that it's January of the New Year, but it's still not too late to tie together some loose "year-end" items before the April 15th deadline. We've put together a brief checklist of items that will help you get your financial act together for 2006, or to get a jumpstart on 2007.



Fix your portfolio. Year-end is the perfect time to rebalance your portfolio. At a minimum, investors and their financial planners should revisit (or create if they don't have one) their Investment Policy Statement (IPS) to see if you need to make any changes to the asset allocation. An IPS is a written document that articulates the investor's overall investment goals and how those goals will be accomplished. It's designed to take the emotion out of investing and keep investors on track, regardless of what the market or economy is doing.

Catch up if you can. Those who have an employer-sponsored 401(k), 403(b) or 457 retirement plan, should contribute as much as possible to their plan. The maximum is a total contribution of \$15,000 for 2006 and \$20,000 for persons who turned age 50 or older by December 31, 2006.

Taxpayers should also consider—if eligible and possible—contributing to an IRA or Roth IRA. This can be a bit complicated. If you have earned income, you are always eligible to contribute to an IRA—which may or may not be tax deductible—but income restrictions may rule out Roth IRAs. You could contribute up to \$4,000 for 2006 or \$5,000 if you were over age 50 in 2006. *Of note, you can do this up to next April 15.* For the self-employed, consider starting one of the following in 2007: a 401(k) or a profit-sharing plan, or a SEP-IRA, or for potentially even larger tax deductions a defined benefit plan.

Plan that estate. People tend to procrastinate when it comes to getting their estate planning documents in order. Consider these a priority: Name guardians for your children and trustees for your assets. Make sure you have named someone who could make health care decisions for you if you are unable to do so.

Put money away for your children's / grandchildren's education. Be it a 529 Savings Plan, a Coverdell Education Savings Account, a Uniform Gift/Transfer to Minors account, or something entirely different, start socking money away for your children's future. The new tax law change causes kids under 18 (previously 14) to be taxed at the parents' rate so this could be a good time to consider switching to a 529 plan from an UGMA.

Do a Year-End Tax Projection. Most people hate tax surprises. If you do tax projections throughout the year, that could help reduce the odds of surprises next April. It's especially important for those who have to pay AMT (alternative minimum tax), exercise stock options, or have income from multiple sources.

[The Financial Planning Association]

Has your contact information changed?

Please help us keep accurate records, and notify us with any changes in your phone numbers, mailing address, or e-mail address.



Thank You!