

# BEYOND THE HORIZON

3rd Quarter, 2006 Issue

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## MARKET UPDATE

For the past six or seven weeks, the equity markets have been struggling due to investors' jitters about oil prices, rising interest rates, and concerns about the world's economies slowing down. In our opinion, it's also a result of the market gaining so much in the first quarter. The cooling off we needed seemed to unfold, though, all at once - in a matter of a six-week period. We expected a selling off in May, just not to this degree. Despite the downturn, we have merely given up the gains earned during the first five months of this year.

The good news is that we don't see this as the beginning of the end. This is not the way markets would typically act IF we were headed for a bear market. Market cycles tend to peak when investor sentiment is at its highest and, conversely, tend to bottom when sentiment is low. Do you think Bill Gates and Warren Buffet would be giving away their fortunes now if the future for stocks was bleak? We must remind ourselves that if we want to participate in the upside potential of the market (i.e. the money-making part), we must be willing to accept that there will be periods of downside. Rest assured, we feel your pain. We personally own many of the same holdings our clients own.

Moving forward, the increased level of volatility we've been seeing may be here to stay. In fact, looking back historically, this volatility could be considered headed back to normal levels. Emotion management will be key! We realize our clients are level-headed about the markets. However, if there is anything we can do to help alleviate concerns you might have, don't hesitate to call us.

The challenge is not to get distracted. We shouldn't manage money based on a six-week time frame. Over the long-term, stocks have tended to have the highest returns, though they fluctuate the most. Based on data from Ibbotson Associates for the past 50 years, stocks have earned an average annualized return of 10.94% per year (as represented by the unmanaged S&P 500 composite index for the period ending 12/31/04). Though the past is no guarantee of future results, it shows the ability of stocks to

beat inflation over time. While S&P stocks earned 10.94%, inflation for that same 50-year period was 4.01% (as represented by the Consumer Price Index, published by the Bureau of Labor Statistics).

Good forces are still at work for U.S. equities. Corporate America is healthy with record levels of cash flow, liquidity, low inventories and solid earnings. According to The Kiplinger Letter, there is currently \$640 billion held in cash by the S&P 500 firms, excluding banks and utilities, which is rising. They also report “financially, firms haven’t been in better shape in 30 years, with debt levels falling as well”. Additionally, price-to-earnings ratios (P-E) for many companies are lower than we’ve seen in some time, with some at levels not seen for a decade.

There are always opportunities to make money. Sometimes they’re a little harder to find or take a little longer to uncover. At this point, we’re not jumping in or out of anything, although setbacks could be used as buying opportunities. Looking ahead, we see a few long-term trends on which to capitalize. The common thread among most of following trends is saving money and resources:

- **The world is getting older faster.** Demand will continue for those companies who offer more cost-effective and efficient products and services for the aging population.
- **More attention will be paid to environmental issues.** Focus will be given to how we can fight the affects of global warming with “greener” technology and products.
- **We may have seen the end to low inflation.** Companies will continue to focus on cost-cutting measures.
- **The developing world is growing richer.** This will add many consumers who will demand middle-class products and services.
- **Demand for commodities will continue to exceed supply.** Though still in their infancy, alternative energy sources such as solar, ethanol, and wind are expected to bring in the quickest growth in business, as reported by Kiplinger.

In the meantime, it is uncertain whether or not the current sluggishness in stocks will end or if it will get worse in the short run. For the markets to recover, we need to see them hold at these lower levels for a while. If we see them recover too quickly, we will likely see the choppi-ness continue into summer and fall.

Seasonally, we are headed into a weak part of the year for stocks. Remain patient! Wealth is not accumulated or earned in a matter of weeks or months. There is no secret formula to investing, but discipline surely helps.

*Sources: The Kiplinger Letter, June 23, 2006 issue; TheStreet.com article, “Turn Short-Term Fear Into Long-Term Profit”, May 31, 2006; American Funds, “Your Ticket to Retirement” brochure, 2005; Genesis Partners Newsletter, June 19, 2006.*

## FOR YOUR INFORMATION ...

- Just a reminder of our summer hours. Our office closes at noon on Fridays in the summer. The message on our answering machine provides a cell phone number to reach us in the event of emergencies or to place trades.
- Three of our individual stock picks for clients with managed accounts made the list of “America’s Fastest-Growing Small Companies” in the July/August issue of *Fortune Small Business*. This is FSB’s sixth annual list. Those stocks that made the list are Laserscope, J2 Global Communications and Ansys. [Disclaimer: This is not intended to be construed as an indication to buy any of these stocks.]
- Have you visited our new website launched in February 2006? Use it as a resource— to access your accounts, get the latest market news, refer to our previous newsletter articles, etc. Visit us at [www.horizonfinancialadvisors.com](http://www.horizonfinancialadvisors.com). Share us with a friend or family member.
- Last month, the IRS announced that it will stop collecting the Federal Excise Tax on long-distance telephone service. Taxpayers will be eligible to file for refunds of all excise tax they have paid on long-distance service billed to them after February 28, 2003. Interest will also be paid on these refunds. Taxpayers will claim this refund on their 2006 tax returns. In order to minimize burden, the IRS expects to announce soon a simplified method that individuals may use “so taxpayers won’t have to spend time digging through old telephone bills”.

Sources: *Fortune Small Business, July/August issue; Internal Revenue Service, www.irs.gov, IRS Notice 2006-50 or IRS Bulletin 2006-25 dated 6/19/06.*

## INVESTMENT CORNER

In many cases an investor’s largest asset, excluding their home, is their retirement plan at work. It could also be where most, if not all, of regular savings is going. That’s why it’s important to make the most of this investment. But all too often this asset is ignored until the employee receives a notice from Human Resources regarding changes in the Plan.

Don’t put your retirement plan on auto pilot. It’s important that your plan is properly managed. Here are some helpful hints:

- 1) Maintain diversification - It is proven that diversification helps reduce risk. Despite how well a certain asset class or sector is performing, you should never have most or “all of your eggs in one basket”.
- 2) Know your retirement plan - Your employer’s retirement plan document may offer benefits of which you are not aware. For example, some plans allow employees to roll over a portion of their account into a self-directed IRA. This could provide you with more freedom and flexibility for managing this asset by having a broader range of choices.

- 3) Don't let an inactive plan become stagnant - If you change jobs, consider executing a Direct Rollover out of the old employer's plan into an IRA. This option also gives you more flexibility for managing the asset.
- 4) Make sound decisions regarding the allocation of your plan. Avoid commonly made mistakes.
  - a. Don't chase a hot sector or allocate based on which fund or sector had the best past performance.
  - b. Resist the temptation to rebalance the portfolio too often.
  - c. Avoid allocating too much into any one asset class, style, or sector.
  - d. Don't exclude cash and bonds from your portfolio solely because they historically have earned lower returns.
  - e. Resist timing the market and jumping in and out based on market ups and downs.
- 5) Review the account on a regular basis - It's a good idea to re-visit your investment allocation, as well as contribution levels and beneficiary designations, from time to time. Adjustments may be necessary if changes occur in your goals or life circumstances.
- 6) Take advantage of employer matching - Maximize your contributions to get the most employer matching that is available. After all, this is free money going into your account.
- 7) Small employers should review their existing retirement plan - Changes in tax laws have brought about new plan types that may be more advantageous for the employer, as well as the employees.

If you have unanswered questions regarding your retirement plan at work, get the answers. Contact the Plan Administrator or your Human Resources Department.

FOR MORE INFORMATION ON THIS SUBJECT MATTER OR TO RECEIVE A COPY OF OUR FORM ADV, PLEASE CALL OUR OFFICE.

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