

BEYOND THE HORIZON

3rd Quarter, 2008 Issue

MARKET UPDATE

Inside This Issue:

Market Update	Page 1
Is It Time for a Family Meeting?	Page 3
F.Y.I.	Page 3
Investment Corner	Page 4

In light of recent developments in the equity markets, we are including an expanded commentary of Market Update in this issue.

We started this year having just completed five consecutive years of gains for stocks. For this reason, as well as others, we felt that 2008 would bring changes to the equity markets. At the end of the second quarter, the Dow was down 14.4% year-to-date with the S&P and Nasdaq close behind at -12.9% and -13.6%, respectively. In the short period of time since the quarter ended, stocks have taken a dramatic turn for the worse and have now edged into bear territory. As defined by FINRA (Financial Industry Regulatory Authority), a bear market is a decline in stock prices over an extended period of time and can be accompanied by an economic recession, rising inflation or rising interest rates. One generally accepted measure of a bear market is a decline in stocks of 20% or more over at least a two-month period. As of July 9th, we have experienced a decline in the S&P 500 of approximately 20.5% from its highpoint last October. As stated in our first newsletter issue for the year, declines in stocks of 10% or more normally occur about once a year. Declines of 15% or more occur about once every two years.

If we expected 2008 to be a tough year for stocks, why didn't we recommend shifting out of equities or getting out of the market? Getting in and out based on market movements is considered "timing" the market. This is a very risky strategy, as we have often discussed. Research offered by Transamerica Life Insurance Company illustrates this point. They looked at returns for the S&P 500 during the period of 1970 to 2007. Their research shows that the best-performing month for the year accounted for an average of 72% of the year's return. Missing the best month resulted in a 7.1% average decline in annual returns. Additionally, five times out of the past 38-year period, the best-performing month's return kept stocks from ending negative for the year. Since it is impossible to predict the best-performing month in a given year, a strong case is made against market timing. For investors with long-term goals, the risks to total returns from market timing may be greater than staying in the market during ongoing fluctuations to ride out the ups and downs.

While market declines may be hard to tolerate for those already invested in stocks, it can present opportunities for those who are holding cash, getting into the market, or buying in on a regular basis through automatic investment plans or employer-sponsored retirement plans. A few months ago, we had the opportunity to hear Steve Forbes speak at a conference hosted by Lincoln Benefit Life Insurance Company. His advice regarding the current stock market

environment was to be a buyer during market downturns. That is how truly successful investors view the market. But most investors continue to make the same mistake time and time again. Rather than buy stocks when they're down, they wait to buy them when they're back up. We can think of no other industry where consumers react conversely to price movements in this way.

There are very valid issues, however, that continue to plague the economy, consumers, and the markets, such as the ongoing crisis in the financial markets and rising oil prices. It is apparent that skyrocketing oil prices are driving this recent market decline. But what is driving oil prices? The forces of supply and demand have remained unchanged. Some say it's a conspiracy toward Democracy. Others say it's speculation. Then others attribute this to fear. Perhaps it's a little of everything. In the meantime, our lack of taking action as a country to be less dependent on oil hasn't helped either.

When will the bad news end and the markets find their bottom? How long will it take for the economy and the equity markets to turn around? Though the past is no guarantee of the future, looking back at history can serve as a guideline. In terms of the economy, history tells us that the U.S. economy typically expands for a period of six to 10 years then recedes, entering a recession for a period of six to 24 months. We are certain that our economy has slowed. However, we do not have data that proves we are in a recession. Therefore, it is difficult at this time to say where we are in the economic cycle. As for stocks, the S&P 500 has shown positive returns in 55 of the last 74 years and negative returns in the remaining 19 years. Of those negative years, we experienced three back-to-back negative years only twice, two back-to-back negative years once, and single negative years 11 times. If history can serve as a guideline and we are entering a bear market, it is more likely that this current downtrend will not last for several years. We certainly do not see ourselves repeating what transpired during the last bear market of 2000-2002 for a number of reasons. First, the last bear market was preceded by a huge run up in all stocks, as well as a considerably higher Prime Rate, and stock P-Es (price-to-earnings ratios) averaging in the 30s. Second, 18 months after the bear market began came the terrorist attacks on 9-11. Soon thereafter we found our economy in a recession. Today, P-E ratios of stocks in every sector are at or near five-year lows, according to Hays Advisory. The average P-E of the S&P 500 is now at 15.3, half of what it was prior to the last bear market. Additionally, interest rates today are considerably lower.

The doubts and issues facing our economy today seem especially prevalent with this year being an election year. But today's challenges are not unique. We have constantly faced crises throughout our history such as wars, recessions, oil embargos, etc. We believe the enclosed brochure by American Funds is helpful in illustrating several points. First, it shows that stocks have historically performed well during Presidential election years, regardless of party affiliation. Second, it shows that investing in good quality stocks and mutual funds, such as the Investment Company of America, can help investors withstand crises and uncertain times.

We thank you for the continued confidence and trust you place in us as your advisor. It is especially important during challenging times like these to keep things in perspective to avoid making investment decisions based on emotion. We applaud our clients' patience and hope our efforts as your advisor will help you to stay the course towards meeting your financial goals.

Sources: MarketWatch website at www.marketwatch.com on 7/1/08; FINRA website at www.finra.org; Wikipedia website at www.wikipedia.org; Hays Advisory Sector Notes dated 7/7/08; "Beyond the Horizon" newsletter, 1st Quarter, 2008; "Coming Up Short" published by Transamerica Life 3/08; 2007 ICA Guide; historical index quotes obtained from www.marketwatch.com.

Disclosure: Though the Investment Company of America fund is mentioned in this article, it should not be construed as a recommendation to purchase the fund. However, the prospectus for Investment Company of America can be obtained upon request, as well as the American Funds quarterly statistical update for June 30, 2008.

IS IT TIME FOR A FAMILY MEETING?

It's been nearly 20 years since we became an independent advisory firm. As time has passed and our clients have aged, so have their needs and circumstances. This has often warranted a change in the financial recommendations we have made. Here are some examples of issues that may require a change to your investments or your financial plans:

- you are considering selling your home to move to an apartment or senior community
- a spouse may have passed
- tax law changes may have affected your estate plan
- gifting may now be advisable
- you may now be over age 70-1/2 and required to take mandatory IRA distributions
- a decline in the health of yourself or your spouse
- using a living trust may no longer be as beneficial or may possibly be detrimental
- having all your assets avoid probate may not be advisable
- beneficiary changes or a review may be needed

Performing a review of your affairs on a regular basis is always advisable. However, as your needs and circumstances change, we strongly recommend you review your affairs to determine if adjustments are needed. As one ages, it is also advisable to get other family members involved.

We encourage our clients to have a dialogue with their family. Schedule a family meeting to review your affairs and discuss concerns. As our clients are aging, we find ourselves spending more time working with their family members. Getting them involved now results in a smoother transition later. If you would like us to have a meeting with your family, call our office to schedule an appointment. Doing so may give you peace of mind in knowing that you have a support system in place to help you when needed.

F.Y.I.

- A reminder that our summer hours are in effect. Our office closes at Noon on Fridays. However, in the event of an emergency or to place a market trade, we can be reached by calling our office. The answering machine will provide you with our emergency contact number.
- Congratulations are in order for two of our staff members. Suzanne Satler, our Client Service Representative and senior staff member, has successfully completed the examination for the Pennsylvania insurance license. She previously obtained the securities license in 2002. Having these licenses will enable her to execute all transactions if George or Laura, our advisors, are not available. Congratulations also go out to Darcy Pacelli, our Administrative Assistant, for her pending marriage to Dan Cochran of O'Hara Township later this month.
- We are in the process of implementing a new client management system in our office. The new system will help us more efficiently and accurately track client account information, provide better client reports, and increase the level of security for protecting and storing client data. We continually strive to make improvements in our business that will enhance the service we provide. Our office may be closed for short intervals of time over the next few weeks for training. Bear with us while we learn the new system.

INVESTMENT CORNER

In every newsletter issue, we devote the final section to highlight an investment product, concept, or service that we believe is timely, adds value to our clients, or is being used in our practice. This quarter we are highlighting a fixed annuity offered by Integrity Life, an A+ rated insurance company. Here are the basic features of Integrity's "SPDA II" annuity:

- current rate of 5.10% fixed for the first five years; variable thereafter but never less than 3.00%
- no risk to principal
- tax-deferred interest
- seven-year surrender charge period
- ability to withdraw current interest or up to 10% of the account value each year without penalty
- no penalties in the event of death
- no penalties in the event of nursing home confinement until age 81

There are a number of advantages to investing in a fixed annuity. It is a versatile product and can be useful in many circumstances. A fixed annuity can be suitable for an investor who is not comfortable with risk. It can also be used as a qualified plan (i.e. for retirement plan monies or IRA contributions) or as a non-qualified plan (i.e. with regular savings). One primary benefit the annuity offers is the ability to earn tax-deferred interest. If an annuity is used to fund a retirement account, such as an IRA, the interest and principal are already tax-deferred by nature. However, if the annuity is used for non-retirement plan monies, the interest is tax-deferred. In other words, the interest is not reported as taxable income until withdrawn. An annuity is often used as an alternative to CDs and mutual funds because of the tax-deferral. The earnings from a CD or mutual fund outside a retirement plan are taxable. However, if those monies are placed in an annuity, the earnings become tax-deferred. This feature is especially attractive for retirees since it helps to shelter income to minimize taxation of their Social Security benefits. Another benefit of the annuity is that it bypasses probate upon death when beneficiaries are named. Lastly, there are typically no fees or costs to the investor to purchase a fixed annuity.

Conversely, there are reasons not to invest in an annuity. Because there are no fees, the annuity policy carries a surrender charge period, which is typically five years or more. Surrender charges apply for withdrawals during that period, except for withdrawals of interest or for death purposes. Therefore, the annuity would not be suitable for monies that are considered emergency reserves or that will be needed in the near future.

Please be aware that NOT ALL ANNUITY PLANS ARE ALIKE. There are many products on the market that we would not recommend to our clients. If you would like to learn more about Integrity's annuity product mentioned above OR other types of annuities, please contact our office.

Highlighting this topic in no way implies that it is suitable for everyone. For more information regarding the taxation of an annuity, consult a tax advisor.

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