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Glenn Woody
Certified Financial Planner

Stability over Risk?

A philosophical debate is emerging in economic and investment circles coming out of the recent financial crisis and ensuing deep economic recession.

The question is, do we face:

- A dynamic, volatile economy with painful periods like this last one to get faster long-run growth, or
- A more stable economy with fewer crises but also slower growth over time?

The debate is giving rise to three arguments, the three that would be obvious. There are folks who support each of the two questions framed above. Then there is a third group claiming that we can have both faster growth but avoid the very highest peaks and the deepest troughs.

Two of the three give rise to some degree of increased government regulation and control.

We all know that the economy is cyclical, that we alternate between boom and bust, so to speak, and that recessions are a part of it. We have had twelve recessions since the end of WW II. Anything that happens twelve times in 64 years can be called repetitive.

By the way, there are three definitions of the end of a recession:

- Economists need to see two consecutive quarters of increasing GDP (the reverse of the start of a recession).
- The media will tell us the recession is not over until everything gets back to the prior level.
- To an investor, the end of the recession was last March 9.

The lesson: Don't wait for the media and the economists to tell you when to invest.

The case for faster growth: Overemphasizing stability in the wake of the recent crisis will mean less wealth for future generations.

The case for stability: We shouldn't tolerate the panics and depressions of the past, we want prosperity but without crisis, as crisis hurts prosperity.

The case for both: This tension must be managed, not denied; accept ups and downs but avoid the extremes.

Left alone, recessions will self-correct, they just do it too late. In a recession, people work harder and spend less, resulting in the correction.

As this debate progresses, remember that you cannot just gather the golden eggs without feeding the goose.

Happy New Decade

So, the clock has rolled over to a new decade. How time flies! It seems it was just yesterday that we were all worried about Y2K and the threat that everything electronic (from computers, to elevators, to coffee makers) was going to malfunction at the stroke of midnight.

Now, there is a great debate over what to call this new year: “two-thousand-and ten”, or “twenty-ten”, or “2K10”?

The media, in their typical role of hyping the sensational (read that “negative”) has already been making much over the fact that this past decade was the worst, in at least a century of stock market history.

That is true, but it is true only because the decade of the 1990s ended in the biggest stock market bubble in history. The bubble was centered in technology stocks, and had you avoided that overblown sector, you would have done fairly well over the last ten years.

Furthermore, not only were the 1990s extraordinary, the 1980s provided near record returns. Never before in history had investors experienced two back-to-back decades of such pro-

portions. That gave rise to cock eyed optimists envisioning 15% annual returns forever in the future. There were even books written about “Dow 35,000”.

The last ten years have brought us back to earth and simply cancelled out the excesses of the 1990s.

Some analysts are saying that now sets the stage for a return to more 6%-7% after-inflation returns over the next 10 years. Others are less optimistic.

Tax Reporting Data

With the prior year now behind us, attention begins to turn to the task of gathering the data necessary for completing your tax returns for 2009.

Timing-wise, the schedule calls for both our office and Schwab to get the investment-related 2009 data to you by mid-February.

Schwab will send the official 1099 reports initially by mid-February. However, they expect to have some corrections to their early data that will result in some number of corrected 1099's to be sent later.

The 1099's report dividends, interest and capital gains initiated by the mutual funds themselves. The capital gains/losses generated by the sale of mutual fund shares initiated by our management are not reported on the 1099. You will receive that information from us no later than mid-February. We will send those reports in phases depending on your billing cycle.

However, if you and your tax preparer feel the need for some advance numbers by which to figure your fourth quarterly estimated tax payment, due by January 15, call us to request the reports which we can generate and send directly to you either by mail or email.

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# Market Highlights

## January 2010

### Positive:

- The Index of Consumer Sentiment posted a 7.6% gain in November from the prior month and was 22% above the reading in December of 2008.
- The Conference Board Leading Economic Index for the U.S. increased 0.9% in November, the Coincident Economic Index increased 0.2%, and the Lagging Economic Index decreased 0.4%.
- Real (adjusted for inflation) gross domestic product increased at an annual rate of 2.2% in the third quarter of 2009. In the second quarter, real GDP decreased 0.7%.
- The unemployment rate edged down to 10.0% in November, and nonfarm payroll employment was essentially unchanged. In November, employment fell in construction, manufacturing, and information, while temporary help services and health care added jobs.
- Privately-owned housing starts in November were 8.9% above the revised October estimates, but that is 12.4% below the November, 2008 rate.
- Existing-home sales rose 7.4% in November and are 44.1% higher than in November, 2008. Current sales remain at the highest level since February, 2007.
- Advance estimates of U.S. retail and food and services sales for November increased 1.3% from the previous month and 1.9% above November, 2008.
- Personal income increased 0.4% in November and disposable personal income increased to 0.5%.
- Economic activity in the manufacturing sector expanded in November for the fourth consecutive month.
- New orders for manufactured durable goods in November increased 0.2%. This was the second monthly increase in the last three months.

### Mixed/Cautious:

- Sales of new one-family houses in November, 2009 were 11.3% below the revised October rate and 9.0% below the level of November, 2008.
- Construction spending during October, 2009 was estimated to be nearly the same as September, 2009. However, the 2009 figure is 14.4% below the October, 2008 level.

### Informational:

- In November, growth, small cap and domestic funds produced better returns than their respective counterparts.

## FYI: Short-Term Observations

*These comments are offered for your information and thought. They are short-term and tactical in nature. We invest for the long-term, three to five years plus. Don't confuse these short-term observations with what may be the best decisions for the long-run. Some even believe it is confusing, at best, and distracting, at worst, to involve short-term issues in long-term investing.*

### A Remarkable Year

**F**ollowing a very difficult 2008, 2009 started with two months of equally distressing returns. In January and February alone the Dow was off 19.5%, the S&P was down 17.5% and the NASDAQ dropped 12.6%.

However, from the low established on March 9, the Dow gained 59.28%, the S&P +64.47% and the NASDAQ +44.07%. Remarkable..... But not particularly unusual following a recessionary bear market such as we had from the October 2007 highs.

So, we think calling it a "roller-coaster" ride is a fair characterization.

Interestingly, the S&P is down about 29% from its October 2007 peak of 1565. While that is a noticeable overall decline, had it travelled that path in a straight line, it would not have provoked a fraction of the despair that it did when it fell to 676 on March 9, 2009.

But, it didn't decline in a straight line. It fell 57% to March 9 and then gained the 64% to the end of the year. That is extremely tough on investors' stomachs. In fact it was too much for some to take. Some we know of called it quits and bailed out of the market completely in February, just before the turn on March 9, missing the 64% advance that followed.

We take that somewhat personally. We have always considered our primary benefit to clients is to stand between their money and their emotions, to tug them over the tough spots and help to prevent their selling out at just the wrong time.

The fact that we could not provide that steadiness for some distresses us.

### Roller-Coaster Year

**T**he year is done! And what a year it was!

As usual, just looking at the overall numbers masks the roller-coaster ride we all took, complete with gut-wrenching dips and turns.

A near 20% gain in 12 months is a wonderful return, not the largest in history, but well above average. But, the path getting there was dramatic. More about that elsewhere in this issue.

Here are the results:

#### Dow Jones 30 Industrials

|                |           |
|----------------|-----------|
| December       | + 0.80 %  |
| Last 3 months  | + 7.37 %  |
| Last 12 Months | + 18.82 % |

#### Standard & Poor's 500 Index

|                |           |
|----------------|-----------|
| December       | +1.73 %   |
| Last 3 months  | + 5.49 %  |
| Last 12 Months | + 23.48 % |

#### NASDAQ Composite

|                |           |
|----------------|-----------|
| December       | + 5.78 %  |
| Last 3 months  | + 6.93 %  |
| Last 12 Months | + 43.88 % |

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