

SECOND QUARTER 2007

In what was a volatile quarter, the S&P 500 ended with a gain of 5.8%. The current rally found several occasions to pause before resuming its historic run, one that has seen many of the popular averages reach new all-time highs. We are encouraged by the markets' ability to continue rallying in the face of a litany of troubling developments. Worries about unforeseen events that can derail the markets are nothing new. What is new on each occasion however is how investors choose to react.

Among the reasons assigned to explain recent volatility is the emergence of risk awareness around everything from sub-prime mortgage defaults to several big hedge funds suffering high-profile losses in their debt portfolios made up of Collateralized Debt Obligations (CDOs). These highly sophisticated – complicated to most people – debt instruments are made up of slices of the pools of mortgage debt issued by mortgage companies and banks and sold to investors such as pension funds and hedge funds, but also to banks and insurance companies looking to put excess cash to work. These pools of debt are vast in number and size, thanks to the explosion of mortgages created during the real estate boom years. When the bond market began to sell off earlier this spring and investors started asking to have their money back, some hedge funds were faced with a liquidity crunch. Sales of these pools are problematic because of the difficulty in valuing these complex instruments. In this particular case, Bear Stearns, the parent company of the two hedge funds in question, was able to solve the cash problem without having to sell holdings. For now then, the bond markets have settled down although investors' appetite for investments involving risky debt seems to have cooled.

When Northstar invests in fixed income securities for your portfolios, we only use highly rated or insured tax free municipal bonds, investment grade corporate bonds and US Treasury and agency issues. Turnover is typically very low and maturities tend to be short to intermediate term in nature. We buy bonds that mature at various points in time to lessen the reinvestment risk. For all of these reasons, the bond portion of your portfolio is significantly insulated from the risk and volatility described above.

We often receive questions from clients regarding the amount of capital they should consider accumulating for their retirement years. For most clients, they would like to generate enough retirement income to preserve the lifestyle they were leading prior to their retirement years. Charles Farrell, the newest addition to the Northstar team, has developed a series of personal financial ratios that provide you with a quick check on the progress you are making toward your retirement plans.

Similar to the way investment advisors use financial ratios to benchmark a company's financials, Charlie has developed several personal financial ratios (Savings to Income, Debt to Income, and Savings Rate to Income) that are designed to help individuals benchmark their personal financial status and goals. The ratios are based off of one's income and change with age.

The Savings to Income Ratio will provide you with a basic roadmap for building your retirement assets. At various ages, Charlie's ratios tell you how much savings you should have compared to the income you are earning. The ratios will help you stay on track to retire at age 65. The ratios are designed to target a retirement income that is between 70% and 80% of your pre-retirement income. This should be a comfortable level of income considering that you are no longer required

to save for your retirement years, won't be paying FICA tax, and the kids should be out of the house.

Here are the Savings to Income Ratios

Age	Savings to Income Ratio
30	0.1
35	0.9
40	1.7
45	3.0
50	4.5
55	6.5
60	8.8
65	12

To use the chart, take your current income and then multiply it by the Savings to Income Ratio that corresponds with your age. For instance, if your income is \$150,000 and you are 50 years old, your Savings to Income Ratio should be 4.5. Thus, you should have approximately \$675,000 in investable assets (\$150,000 X 4.5).

If you would like to explore these concepts in greater detail as they may relate to your personal finances, please feel free to call your portfolio manager. Charlie's ratios were originally published in an article he wrote for the Journal of Financial Planning in January 2006, and have also appeared numerous times in the Wall Street Journal.

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