

# Compass Points

October 2007  
Volume 1 Issue 1

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## Quarterly Recap

By Bob Van Wetter

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Following one of the most volatile periods in a long time, the equity markets ended the 3<sup>rd</sup> quarter in surprisingly good shape. The S&P 500 ended up just over 2% for the quarter and is up 9.13% for the year. In mid-September the Federal Reserve Board lowered the Fed Funds Rate and the Discount Rate by 50 basis points in a surprisingly aggressive response to a rapid deterioration in the credit markets. This was just what the doctor ordered for the markets and the ensuing powerful rally has returned the widely-watched Dow Jones Industrial Average to an all-time high. We will leave it to others to postulate as to whether the Fed's action merely bought time and opened the door for inflation or effectively staved off a recession. What we do know is that it is going to take some time for the economy to work itself through the current credit dislocation and the ongoing correction in the housing market. The subprime mortgage debacle is complex and the breadth and extent of the losses are difficult to quantify. For now, certain mortgages and consumer loans are more expensive and the availability of credit is tightening for most people. The result of this 'forced savings' will translate to muted consumer spending and GDP growth.

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*"Today's action is intended to help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruption in financial markets and to promote moderate growth over time."*

*Federal Reserve Press Release  
September 18, 2007*

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## Bond Market

By Tim Waymire

The bond market enjoyed competitive returns of 2+% in the third quarter as interest rates trended modestly lower from 5% to roughly 4.5% on the ten year U.S. Treasury note. These returns were, depending upon your viewpoint, either thanks to or in spite of the Federal Reserve. In August the Fed responded to the extreme dislocations and illiquidity in the credit markets by lowering the discount rate 50 basis points. This move had the salutary effect of calming the markets and interest rates continued to move lower. In September, after an extremely weak payrolls number for August was reported and in response to continued

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## Wealth Management

### Have You Done A Retirement Income Plan?

*By Charlie Farrell*

While we have had an opportunity to work with many of our clients on their retirement planning, others may not have taken the time yet to analyze how they will go about generating income during their retirement years. If you are within 5 years of your anticipated retirement date, we encourage you to talk with us about developing a retirement income plan for your investments.

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*“The most challenging part about retirement income planning is that clients have multiple time horizons.”*

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The most challenging part about retirement income planning is that clients have multiple time horizons. For a portion of their assets, they are short term investors and need consistent income distributions. For other aspects of their accounts, they are long term investors and need portfolio growth to keep up with the effects of inflation. The multiple time horizons and need for constant income creates significant challenges to maintaining and growing a fixed pool of capital for 30 or more years.

Many investors are surprised to find out that inflation adjusted distribution rates as low as 5% can put a portfolio's long term survival rate at risk. Over all 30 year investment cycles starting in 1926, about 30% of the time investors would have run out of money prior to the end of the 30 year period using a 5% inflation adjusted distribution.

The most challenging market environments are created when investors experience a declining or stagnating stock market coupled with high inflation. The combination of these factors can put significant pressure on an investment portfolio and cause investors to deplete their assets faster than anticipated.

While these markets don't occur that often, it is reasonable to expect that over a 30 year retirement time frame an investor will face at least one of these challenging environments. Recognizing the difficulty that these markets can periodically pose, we have the expertise and experience to structure client accounts to weather these conditions.

With a combination of fixed income assets to fund current distributions and a diversified stock allocation for long term growth to combat inflation, we can help clients build secure and predictable income streams throughout their retirement years. If you would like to speak with us in more detail about your particular retirement objectives, please contact your portfolio manager.

*Bond Market*

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disruptions in the sub-prime mortgage markets, the Fed again lowered the discount rate 50 basis points and the Fed funds target by 50 basis points as well. While these moves, as well as the additional liquidity the Fed has been providing through open market operations, have had the desired effect of fostering stability in the credit markets, longer term interest rates actually moved somewhat higher after these cuts.

The Federal Reserve is attempting to keep the economy growing at a sustainable pace without stoking inflationary pressures. There is no question that the housing sector of the economy is in the midst of a deep correction and has been for nearly two years. An ongoing concern is whether or how much of this weakness bleeds over into other sectors of the economy including all important consumer spending. Briefing.com has done an interesting analysis of this issue going back to the fourth quarter of 2005. Their analysis is shown in the table below.

	Q4 2005	Q1 2006	Q2 2006	Q3 2006	Q4 2006	Q1 2007	Q2 2007
Total GDP	1.2	4.8	2.4	1.1	2.1	0.6	3.8
Consumer Spending	1.2	4.4	2.4	2.8	3.9	3.7	1.4
Nonresidential Investment	3.4	13.3	4.2	5.1	-1.4	2.1	11.0
<b>Residential Construction</b>	<b>0.5</b>	<b>-0.7</b>	<b>-11.7</b>	<b>-20.4</b>	<b>-17.2</b>	<b>-16.3</b>	<b>-11.8</b>
<b>GDP Ex. Residential</b>	<b>1.2</b>	<b>5.3</b>	<b>3.1</b>	<b>2.4</b>	<b>3.1</b>	<b>1.5</b>	<b>4.4</b>

It is very clear from the table that any weakness in the economy over this period has been isolated in the housing sector. Real GDP growth over this period has averaged 2.9% **excluding** the negative effect of residential construction. Consumer spending, which constitutes roughly two thirds of GDP, has held up remarkably well. The Federal Reserve will do their best to ensure the weakness in the housing market does not pull the rest of the economy into a recession. It appears to be working thus far.

## Northstar in the News

Northstar's portfolio managers take pride in the many ways that they are able to help clients meet their investment and financial objectives. Local and national media often tap our expertise when seeking ways to explain the ever-changing investment and planning landscape. Below are a few recent examples:

**Retiring With a Mortgage, Here's What To Do**

*Wall Street Journal, 9/19/07*

**Small Loss. Okay. Large One. No Way**

*Wall Street Journal, 10/7/07*

**Live Debt Free**

*Smart Money Magazine, August Edition,*

**"Santa Claus" rally may not satisfy volatile U.S. market**

*Denver Post - September 29, 2007*

**Metro experts give the straight scoop on what you should do in this market**

*Rocky Mountain News—August 18, 2007*

**Farrell -- maker of 'personal financial ratios' -- joins Northstar**

*The Denver Business Journal - May 25, 2007*

**A \$1 Million Retirement: How to Get There From Here**

*Wall Street Journal, May 16, 2007*

**A warming world or a rising tide**

*Denver Post, May 9, 2007*



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