

1229 Lake Plaza Drive
Colorado Springs, Colorado
80906

Phone: 719-576-4500
Fax: 719-576-2302

www.sullivaninternet.com

The Financial Advisor

Pat's View

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Index percentage change since the beginning of the year:

- DJIA: -33.8%
- S&P 500: -38.5%
- Nasdaq: -40.5%
- Int'l (MSCI EAFE): -45.1%
- Barclays Aggregate: 5.2%

Source: WSJ, January 2, 2009

Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor results will vary. Past performance does not guarantee future results.

The Dow Jones Industrial Average (DJIA), commonly known as "The Dow," is an index representing the stocks of 30 companies maintained and reviewed by the editors of the Wall Street Journal.

The S&P 500 is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The Nasdaq composite is an unmanaged index of securities traded on the Nasdaq system.

The MSCI EAFE is a stock market index of foreign stocks from 21 developed countries, excluding the U.S. and Canada.

The Barclays Capital US Aggregate Bond Index is a benchmark index composed of US securities in Treasury, Government-Related, Corporate, and Securitized sectors.

A year of crisis, mortgage giants seized, Merrill Lynch and Bear Stearns sold, Lehman bankrupt, WaMu - largest bank failure in U.S. History, October 10th ended the worst week ever for stocks, Big Three Automakers pleaded for aid of \$34 Billion, job losses worst since 1974, CEO told to resign for violating trust, lawyer accused of \$100 million swindle, Madoff accused of \$50 billion Ponzi scheme, SEC's chief admitted "apparent multiple failures" to oversee Madoff's Ponzi scheme, Fed cut rates to the lowest on record, broker admitted role in insider-trading scheme, stock investors lost faith and pulled out record amounts, so the headlines go, and this does not include states, municipalities, developers, etc., trying to get bailout dollars or all the political and international issues.

This has all led to mass confusion, a host of uncertainty and down right fear, not to mention the trillions of dollars lost from average Americans' savings, 401k's and other retirement accounts. The failures include our politicians, government regulatory agencies, rating agencies, and in some cases excessively paid CEOs and their staff members, as they participated in, encouraged, or failed to stop the widespread oversights, abuses or frauds. The result of what has transpired during 2008 will take years to recover from. The impact both domestically and internationally as we go forward is huge, as we anticipate an overreaction in government regulation, loss leverage opportunities, and higher taxes, which will add up to less productivity and slower growth. On the good news side, we have falling mortgage rates, falling oil prices, positive government action by the Fed and Treasury, and President-elect Obama is developing a major additional stimulus plan. We also have America's fundamental character and competitiveness which I would never want to bet against. While we are in a crisis and maybe the worst recession in our history, to paraphrase one pundit as seen on the internet, there may be an end to the world, but this isn't it.

So the obvious questions are where do we stand? What should we anticipate? What should we be concerned with? Most importantly, what should we do? The equally obvious answers are keep your job, if you have one, work to get out of or stay out of debt, and continue to save for your long-term goals. After that, the answer is, it depends – on goals, age, savings and investments, family situation, etc. However, there is one subject that needs to be reviewed, for after the events of 2008 it has a new meaning for all of us, RISK. Historic risk management techniques did not work as well in 2008 as they generally have in the past, so given the past events and current situation, how has

your willingness to take risk changed, if at all? If we have not talked to you already about risk changes, we will ask you to fill out a questionnaire to help you assess, and help us understand, how your risk level may have changed. Once you have completed the questionnaire, we will analyze it along with your current portfolio, set up a meeting and provide you not only with an evaluation, but also provoke your thinking on ideas which may help you to reach your individual goals within the risk parameters you are comfortable with.

It seems to us it is a new financial world out there with increased confusion, uncertainty, potential changes and risk which may necessitate a shift toward safety for a period of time by modifying your asset allocation or individual assets. We cannot forecast the future, but as the winds change we can help you evaluate the changes and shift your sails. We are anticipating significant changes over the next couple of years which will translate into some type of financial impact affecting us all. While we will have changes, we will also have opportunities that we will need to be alert for as our watch words going forward become safety, income, and flexibility. Your definition of those three words ties directly to your goals.



It is not the strongest of species that survives, nor the most intelligent, but the one most responsive to change.

—Charles Darwin,
The Origin of Species

Kevin's View

During times of crisis the desire for change becomes much stronger. In investing, a desire to change strategy during a time of crisis may lead to losing more money than just staying the course. The data bears much of this out. There is study after study documenting that investors tend to “Buy High” and “Sell Low”. Many of those studies call for investors to dig in and hold on during turbulent markets. We agree with this conclusion, although with some dissent on what that actually means. To clarify, making large swings in the composition of portfolios in a short amount of time based on the movements of the markets is not a good plan. Changing investment strategy to reflect changes in personal situations or changes in the understanding of the markets on the other hand, is being a good steward of your wealth. In this article I will discuss the two recent changes in our understanding of the markets and the implications of these changes. Please note that much of this material does not come from the recent market volatility, but there is a growing body of work that is just now starting to be accepted.

The first change is simply put; the markets are more risky than most thought. Traditional financial theory states that returns follow a bell-curve. This means most of the time returns will be somewhere around the historical return for an asset class. For example, the historical average return for large cap stocks has been around 10%.¹ We can expect returns will be somewhere in that region, with very few exceptions. Unfortunately, even ignoring our current predicament, this is not true. There has been much more deviation from the bell-curve ideal than anyone expected. Given that knowledge, how do we apply it to the way we manage your accounts? The first step is acknowledging investments we once thought were only moderately risky have much more inherent risk. The next step will be to adjust our allocations to address that risk and your tolerance to it. To help us do that we are starting to use a risk questionnaire with all of our clients to help us better understand your level of risk tolerance.

The second change is the shrinking benefit of diversification. Historically, one of our main tools to help control risk in a portfolio

was to diversify among domestic stocks, domestic bonds, international stocks, commodities, etc. The idea was that different markets moving in different directions would hopefully smooth out returns. That idea worked for many years and worked very well, but the world has changed. There are two primary reasons why diversification no longer provides as much benefit as it once did: globalization and financial engineering. Globalization almost by definition is an enemy of diversification because it is the linking together of the various economies spread across the globe. Economies that are linked together tend to have stock markets that move together. Financial engineering is a field of finance that uses complicated math and financial concepts to produce very complex investment products or strategies. The offshoot of this is these products can link together markets that would otherwise have no interaction. A perfect example of this is failure (or near failure) of many financial institutions because of the sub-prime crisis. The sub-prime crisis on its face was a very manageable problem, but because of the complex products based on sub-prime debt, it has developed into much more. It has become very apparent that no one, least of all the financial engineers themselves, fully understood the risks and linkages they were taking. To be clear, diversification is not completely gone and still is a very valid and important tool for any investor, but finding investments that give us that benefit has become much harder. As we discuss investment options with you in the future, you can expect to see new areas for investment being discussed as we search for that benefit.

As people who love what they do, even in the current market conditions, we are always looking for ways we can better help our clients achieve their goals. In this case we have begun to question some of the core values we have held over the past 30 years. We do not do this lightly and do not believe this is just a fad, but instead new insights on how we can help. We will be discussing these concepts with you in our meetings along with our strategy going forward.

¹ Large cap stocks are defined by the S&P 500 index during the period from 1926 to 2007. Source: Ibbotson.

Did You Know?

In a recent law designed to give some relief due to the markets, Required Minimum Distributions for individuals 70 1/2 or older DO NOT have to be taken in calendar year 2009. This includes any retirement plans such as IRAs and employer sponsored retirement plans.

Randy's Financial Planning Insights

Financial Planning Tips for the New Year

Making New Year's resolutions to improve your overall financial situation is usually a top priority for people. Most folks have the best intentions, but their resolutions fizzle when they realize they do not know where to start. I have compiled a list of several financial planning tips to help make this New Year's resolutions successful.

Create and implement a budget

How do you know where your hard earned dollars are going if you do not have a household budget in place? You need to set parameters for spending and savings to help identify the priorities in your life. A budget is a great tool that needs to be created and implemented to help achieve your individual priorities.

Start a savings plan within your budget

Saving for the future is not possible if you construct a budget to match your current income. You need to allocate 5-10% of your pre-taxed income to a savings account or a money market BEFORE seeing what is left in your budget. If you merely take a chance that you will have money left over at month's end for savings, you are shortchanging yourself and your future.

Spend less than you make

A basic and sound financial planning technique is to always spend less than you earn. This may sound a bit intuitive, yet a very large portion of our society does not figure this out until very late in their lives. With cost cutting measures in place, it is easier to lower your overall spending goal than to earn more money. Typically, everyone can use some sort of reduction in their spending plan.

Pay off debt

Consumer debt such as credit card debt is the single largest barrier to getting ahead financially. Credit cards are very convenient and easy to use in our daily lives. With our best intentions to get the mounting balances paid off, we always end up wasting more of our hard earned dollars on interest charges on the unpaid balance. Best bet, use cash to make purchases.

Contribute to your retirement plan

If you are contributing to your current employer sponsored plan, continue to make the salary deferrals and if possible, increase the contribution. If you are not making contributions, you need to begin. Contact your employer's human resources office to get started. If your employer does not have a plan, arrange to make contributions to an individual retirement account (IRA).

Review your employee benefits

Be sure you are getting the most out of your employer benefits package by using the benefits that are applicable to your situation. By taking advantage of pre-tax benefits, you make the most of your hard-earned dollars to pay for benefits such as medical, dental and life insurance.

Review insurance policy coverage

Insurance is typically a very sensitive issue for most people to address. Even so, it is very important to your overall financial health. When you evaluate your individual situation, you need to review each insurable interest in your life. Each risk can be addressed by one of the following: self-insuring, transferring, avoiding, or reducing the risk. You need to determine the amount of adequate coverage needed so you do not suffer a financial hardship after an event has occurred in your life.

Update your legal documents

When you think about the legal documents you need in place if life throws you a curveball, a will and a medical power of attorney are two of the items that should come to mind. It does not matter the size of estate you have, you need these documents to deliver your wishes in the event of death or incapacity. Even a very simple will is better than letting someone else make the decisions for you. Keep in mind, the government always has a plan for your estate, it just may not be the plan you would implement!

As always, we are here to help you address each and every issue of your financial lives. Feel free to give us a call or we would be glad to discuss any issues at our next meeting.

If you would be wealthy, think of saving as well as getting.

*-Benjamin Franklin,
Poor Richard's Almanac*

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We gladly accept referrals. If you know someone who might benefit from our services during this difficult period of time, please let us know.

Sullivan & Associates Staff

Patrick Sullivan
Financial Advisor
patrick.sullivan@raymondjames.com

Randy Halfpop
Financial Advisor
randy.halfpop@raymondjames.com

Maryann Fulop
Client Service Specialist
maryann.fulop@raymondjames.com

Jane Jacobs
Office Manager
jane.jacobs@raymondjames.com

Emily Marchi
Administrative Assistant
emily.marchi@raymondjames.com

Kevin Sullivan
Financial Advisor
kevin.sullivan@raymondjames.com

Jennifer Malmstrom
Client Service Specialist
jennifer.malmstrom@raymondjames.com

Anthony Weber
Client Service Specialist
anthony.weber@raymondjames.com

Nancy Polwort
Database Administrator
nancy.polwort@raymondjames.com

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SULLIVAN ASSOCIATES

A REGISTERED INVESTMENT ADVISOR
1229 LAKE PLAZA DRIVE
COLORADO SPRINGS, CO 80906