NORTHERN FINANCIAL ADVISORS, INC.
TAX PLANNING AND PREP | FINANCIAL PLANNING | INVESTMENT COUNSELING

Quarterly Capsule

CREATING THE FUTURE TOGETHER

ALL IN THE FAMILY- NEWS ABOUT YOUR NORTHERN TEAM

KARIN ANDERSON is busier than ever. She recently flew to Florida in her role as team leader for our database conversion. We want to increase our capacity to respond to and support you with faster response times. She continues on track toward her CFP designation and still finds the wherewithal to put in a full day as Sean's mom.

CHRISTINE ISHAM may be the role model for Karin, juggling work and family like a true artist. Her recent travels took her to Chicago for two days of Strategic Coach work, Florida for four days of financial planning continuing education and is back from Chicago where she, ***DALI NENADOV*** and ***LAKHAUN MCKINLEY*** did due diligence on a new mutual fund family. And, as Dr. Laura would say, Christine is her kids' mom, all the time!

DAVID LENTZ is still Christine's full time partner and you could have found him on the same itinerary as Christine. In between all of his work commitments, around here, we catch tidbits of his daughter's progress in Washington, DC (Rachel) and on campus at the University of Michigan (Lisa). You'll be happy to know both are doing just fine.

MICK PORTER has settled in well. Mick kept a full schedule during our tax preparation season. The computer savvy group did great with the online collaboration and surprisingly, so did a variety of not-so-computer literate clients. He did all this and I learned he's right in the thick of raising his kids with minds of their own!

ROSANNA NORWOOD just took off as the tax season started! Does she know something we don't? It turns out she took her whole family—including (or should I say, especially)—the grandchildren to Disney World in Florida. She came back brown but didn't particularly look rested, if you know what I mean.

GARY MURPHY and Stacey are awed and delighted to announce the birth of their first child, a son, Brayden Patrick Murphy, born April 4th at 4:01 PM! The little guy weighed in at 7 pounds, 5 ounces and was 21 inches tall. It turns out that this is the absolutely best physical makeup to insure a long life of outstanding golf! Mother and child are at home doing great. Give Gary a hearty handshake and your very best wishes for the blessings of a lifetime of superb health, a great heart with a loving spirit and a long and joyful life!

MICHAEL RUDY went away for some mysterious weekend retreat somewhere just outside of Ottawa, Canada and came back just beaming. Is there a new companion in his life? Could her name be Madelainne? Is he mad about Mad?

MICHAEL WILLIAM REYES Joins the Northern team this quarter as its first intern. Wanting to make a career change from his work in the bio-tech field, Mike attended

Oakland University and recently completed the educational requirements for his Certified Financial Planner designation. He's his dog's dad and "Scooby" are regulars on the downtown Ferndale circuit. At Northern, we'll give him opportunities to get practical, hands-on experience that will fill out the requirements for his CFP. In the meantime, we'll both have an opportunity to discover if we have a good-enough fit to make a more enduring relationship.

LENNETTE PRICE has moved on in her work path/journey. Lennette gave a lot of herself while with us, always willing to pitch in no matter what the project. With Gary's coaching, she became our go-to person for Schwab. I'm sure you share our best wishes for all good success as she moves forward on her path.

LUCILLE FLINT has been graciously and effectivey been pinch hitting for us in the Receptionist role and we surely appreciate her. She's doing a fabulous job for us. Still ***RECEPTIONIST*** where are you? We have steadily looking to find a way to give Lucille some time for her annual summer engagements and have interviewed a number of candidates for the Client Relations Coordinator position. In spite of a major effort, we still haven't found the right person So, if you know someone who is bright, great with people, extraordinary communications skills, a capacity to juggle and multi-task and a self-starter to boot, would you let Christine or David know? Thanks.

NEWS BITS

THE WINTER PARTY BECOMES A SUMMER OUTING: After so many of you expressed an interest in moving the Winter Client Appreciation Parties—that tended to come at a time that was rushed and cold—to summer, which can be laid back and warm. We've made arrangements to host this year's Client Appreciation Party at Meadowbrook Hall on the Oakland University campus. You'll have a chance to take a tour of the great mansion, relax to the fun sounds of a Dixieland jazz band and have a swell dinner. Christine will speak: you'll learn some interesting new things about money and she'll be able to write the whole thing off. A magician is expected to arrive and make all of it disappear. The date is August 19th. An RSVP will be needed, so keep an eye out for our invitation. It's in the mail (or soon will be). Start looking for it in July.

THE NATIONAL ASSOCIATION OF PERSONAL FINANCIAL PLANNERS (NAPFA), the premier fee-only professional financial planning association in the world held its annual convention in Florida recently. Oil prices seem to be enough of a concern that a number of general and breakout sessions were devoted to the topic. Perhaps the clearest explanations of the dynamics between domestic and global markets came from Dr. "Woody" Brock of Strategic Economic Decisions (http://www.sedinc.com/brock.htm). Brock said you can expect oil prices to be highly volatile in large part just because the supply/demand curve does not have much elasticity, that is, the oil supply cannot easily be ramped up or down in response to the amount of demand in the world. John Rutledge, another independent economist argued persuasively that we needn't worry about either the domestic deficit or the balance of trade deficit. His view is that as the Gross National Product grows, it's only natural for deficits to grow as well. Find Dr. Rutledge and his company at http://www.rutledgecapital.com/index.html. Our old friend, Bert Whitehead of Cambridge Connection , presented a breakout session on the role of real estate in asset allocation. What was interesting to this writer was that as I listened to people like Rutledge and Brock, I could hear in their massive mathematical constructions and structures, the simple, enduring principles that Bert has been teaching to all of us for years. You can find Bert at http://www.bertwhitehead.com/.

E-STATEMENTS FROM SCHWAB - Would you like to get less mail from Schwab? How about an easier storage system for these statements? Would a more timely delivery of your account information help? How about lowered commissions? Schwab promises all this with their new "E-Delivery" program. The critical factor is your email address and we need to sign you up for the service. We can arrange this for you if would you send us an email to info@nfa1040.com from the email address at which you'd prefer to receive your E-Deliveries. Would you type in *Schwab email* in the subject line so we can add them to our list to submit to Schwab?

OPERATIONS & INNOVATIONS

PROCESSES TAKE FRONT ROW – CENTER

You can't make much real process if you're always re-inventing the wheel. Most start-up companies respond to calls from customers for service by creating new processes in the moment. Some of these responses come from the entrepreneur's experience; some get built right on the spot to satisfy an urgent need.

One of John D. Rockefeller's passions was his attention to detail, and in particular, finding ways to standardize processes that would lower costs and increase productivity. This is what we have set as our focus for this year.

Already this year we have two major projects underway here at Northern. As mentioned in passing, Karin is spearheading efforts to convert our database into a new program that holds the potential to significantly advance our capacity to work with you with increased speed and accuracy. Karin, Christine, David and Mickey all attended a one day seminar on using this new database known as *Junxure*.

We also took some time after the tax season to review our tax season from an operations point of view. Over the past three years, we've been building specific modules—some which work better than others—that we want to now integrate. We have ideas on which structures, policies, procedures, work-flow and human resource management utilization will make the tax season less taxing for clients and team members. In the end, we are looking to create a written master plan that can serve as our compass as each tax season comes and goes.

So, processes are taking front row-center in our commitment to deliver a more consistent financial advisory service.

YOUR PERSONAL FINANCES

RISING INTEREST RATES – WHAT DOES IT MEAN FOR YOU?

BY: MICK D. PORTER, CERTIFIED FINANCIAL PLANNER

Interest rates have been on the rise. Since the middle of 2004, the Federal Reserve has been on a gradual course of increasing the Fed Funds rate. So just how will that impact you?

Let us consider the impact of rising rates on the pieces of your portfolio. As you may recall from your last investment appointment, our Functional Asset Allocation approach considers the importance of three key areas of your portfolio: fixed income, real estate, and equities.

Fixed Income includes your cash, bonds, certificates of deposit (CDs), bond mutual funds and other debt investments. For your cash and other short-term fixed income investments, a rise in rates simply means you earn more interest. You've probably noticed your money market rates and savings accounts rates increasing. For longer-term bonds and CDs, you've probably noticed a *decrease* in their value. The reason for the decrease stems from the inverse relationship between bond prices and interest rates. As interest rates rise, bond prices go down and as interest rates go down, bond prices go up. Should you sell all your long-term bonds and CDs?

No! Although the current price of your CD or bond may have declined, you will still receive the full proceeds at maturity and you still continue to collect the interest payments along the way. Your fixed income investments provide stability and cash flow, and the function of this piece of your portfolio is a hedge against deflation. By earning a fixed interest rate on your investments, you'll have more dollars tomorrow than you have today.

Real Estate is another important piece of your portfolio. With your investment in real estate, you not only have a place to hang your hat but you also have an important investment. Over time, real estate prices generally rise. And by maintaining a mortgage, you not only get a nice tax deduction buy you also leverage the appreciation. So what about that mortgage?

If you have a fixed-rate mortgage, a rise in interest rates will not have an impact on your monthly payment. The same would be true for a fixed-rate home equity loan. But if you have an adjustable-rate mortgage or a home equity line of credit, you should be aware of how interest rate hikes can affect your payments.

Having said that, keep in mind that the Federal Reserve sets short-term interest rates – the rates at which banks loan each other money and the rates at which the Federal Reserve loans money to banks. Longer term rates and mortgage rates are determined in the marketplace. In fact, we saw an increase in mortgage rates *before* the Fed began its current path of rate increases in mid-2004, and mortgage rates have been relatively stable since (see www.hsh.com/forgetfed.html for a graph). Since equity lines of credit are often tied to the Prime Rate or other short-term rates, you most likely have seen an increase in your interest rate and payment.

The function of real estate in your portfolio is to hedge against inflation. Real estate prices typically rise more quickly during higher inflationary times. Fixed-rate mortgages add the extra comfort of long-term, low-cost financing. If you have an adjustable-rate mortgage, anticipate rising mortgage rates, and you expect to remain in your house for more than five or ten years, you might want to consider a fixed-rate loan. Be sure to review the structure of your mortgage(s) at your next appointment.

Equities are a key ingredient for reaching your financial goals. The function of equities in your portfolio is to provide long-term growth. So what happens to stocks when interest rates rise?

That's a good question. Many good questions have several answers. Higher interest rates mean borrowing costs for businesses become more expensive and that added expense could reduce profits. Lower profits are bad news for stocks. On the other hand, a rise in rates causes a decline in bond prices which may make stocks more attractive relative to bonds. A rate hike may signal to investors that the Fed believes the economy is really strong and lower rates are no longer needed to get the economy moving. The outlook is good and the stock market rallies. On the other hand, investors may perceive that a rate hike is a sign that the Fed is worried about inflation and inflation means higher prices for goods and services. Higher prices could decrease sales and stocks could decline. So, are rising rates good or bad for stocks?

Who knows? It's outside our control. It's not our goal to predict the future. Instead, our job is to focus on what is inside our control. How much are you saving? How much risk are you taking with your investments? What upcoming expenses do we need to plan for? What are your goals?

Being guided by our goals and keeping with key principles of diversification and asset allocation, you will enjoy a comfortable ride on your journey to financial freedom. If stocks go down, your equity percentage will be too low which means we will reallocate some money from fixed income to equities (buy low). If stocks go up, your equity position will become too high and we will reallocate some money from equities to fixed income (sell high). We have a plan for either scenario.

Diversification works and adhering to our strategy of functional asset allocation is important not only during cycles of rising rates, but during all economic conditions.

YOUR PERSONAL FINANCES – ECONOMICS

BUZZWORD. . .STAGFLATION

BY DALI NENADOV, FINANCIAL PLANNING ASSOCIATE

Recently concerns over stagflation (low economic growth accompanied by high inflation) have started to appear in the media. Many of the financial television channels and major newspapers have recently covered this issue. The concerns are valid since the high oil prices, which were present in the last period of stagflation during the 1970, and relatively low economic growth, are happening at the same time. Regionally the stagflation effects will be felt even more than nationally since the unemployment rate in Michigan is higher than the national average of approximately 5.3% due to the heavy exposure to manufacturing in the state. Coming out of a stagflation period is difficult since the Federal Reserve will have to balance the increase of rates, used to control inflation with the fact that economic growth and employment will be adversely effected by higher interest rates.

What does this mean to the NFA client? Prepare for higher prices for most consumer products. Also, make sure that you have enough liquidity to weather any emergencies. Equities and real estate may go down in value and may not be very liquid during this period. Although these sectors may perform poorly, precious metals and international funds will likely do well. As always, having a diversified portfolio will position you to buy additional shares of equity (stocks) mutual funds cheap and protect you from having drastic swings in the value of your portfolio. Above all, do not lose any sleep over these stories. If you have a well diversified portfolio, and since you are one of our clients you should, the long term outlook is good. None of the experts can predict that stagflation will take place for sure so their predictions are just that. Take these stories in stride and remember: Save at least 10% of your income, fully fund your retirement accounts, be adequately housed with the right amount of leverage (helpful during inflationary periods), have a tax efficient portfolio and finally diversify your investments. Follow these few steps and you will prosper.

PERSONAL FINANCES - REAL ESTATE – HOW MUCH EQUITY SHOULD YOU HAVE IN YOUR HOUSE?

Early on, at the Financial Life Cycle level of "Early Accumulation," we start preaching the gospel of "Buy a home." I wish we could say that we're being sentimental, that everyone should have the experience of "Home, Sweet Home." We are interested in pressing our clients on this because we think of your first home purchase as filling out your asset class mix. Real estate, and in this case, your home, is an asset class. For most people it's their largest asset and the basis for your largest debt. In Germany, Christine once told me, you have to pay cash to buy a home; they didn't (and maybe still don't) offer home mortgages.

We usually like our clients to buy a home that is 2 to 2.5 times their gross income. We like our clients to generally have 20% down though in reality and especially with the new creative financing that is available, we might recommend a young person buying a house with only 5% down. Just like with saving, getting started early lets time work on your side. As you pay off your mortgage and as your income goes up, we will often recommend that our clients "buy up" so they keep that 2 to 2.5 times income relationship. Looked on this way, you can see that what we are looking for is to use "good debt" most effectively while making sure the proper balance exists between asset classes.

But there is a conversation that comes up but perhaps not as frequently as it should: *How much equity should you keep in your home?* Should you strive to pay off your mortgage and pay your house off completely? During the 1950s this was the dream of every young couple. Having seen their parents and friends of their parents loose their homes to foreclosure around the Great Depression, the idea of owning your home, free and clear, had a lot of appeal. So, many of our clients who are on the brink of paying off their homes generally show a reluctance to having a conversation about refinancing their home and taking equity out for other purposes.

During the recent hay-day of dropping interest rates, it was all too common that many of our clients refinanced their homes to lower interest rates and took out equity to pay off car loans or pay tuition for the kids or in some instances, just to take a cruise around the world. Not many of our clients, strapped for cash at a particular moment, resisted taking out enough cash to fund their Roth IRAs. So, at least as a precedent, clients know that this can be done and it also makes good economic and investment sense.

What about now? Well, you know, peace of mind comes in many shades of gray. America is somewhat unique in the world where homes can be bought on credit. We call this "good debt." There's a lot to be said for not ever paying off your home—ever! But each client has a unique situation and requires a unique answer. What's important here is that you bring up this topic and explore it in your tax and investment meetings. We're still about helping you realize your best dreams, including that great American dream, owning your own home.