



**RETIREMENT FINANCIAL SERVICES, INC.**  
WEALTH MANAGEMENT AND RETIREMENT SOLUTIONS EXPERTS

**Weekly Commentary**  
**February 2, 2009**

**The Markets**

Our economy has moved from an inflationary environment to a deflationary environment in a remarkably short period. Is that good or bad?

Let's go back to July of last year. Remember that? Oil prices soared to more than \$145 per barrel and unleaded gasoline averaged \$4.11 per gallon across the country, according to AAA. In some places, gas peaked above \$5 per gallon. Even though the economy was slowing down, inflation seemed to be problematic. In fact, inflation, as measured by the consumer price index, had risen 5.6% for the 12 months ending July 2008, according to a report from Principal Global Investors.

Let's fast forward to today. Oil costs less than \$45 per barrel, gasoline averages less than two bucks per gallon across the country, and inflation is effectively non-existent. For the year ending December 2008, inflation rose a barely perceptible 0.1%, according to the Department of Labor. Notice that, in just five months, the annual inflation rate dropped from 5.6% to essentially zero.

Initially, we might think this is a good thing for consumers. We all love lower prices, right? Short term, it might mean a little more money in our pocket as goods and services cost less. But, if it continues, deflation will likely translate into lower wages, less spending (as consumers delay purchases waiting for prices to drop even further), and a continued deterioration in the economy.

The government is clearly aware of the potential problems caused by deflation. That's one reason why they are trying to print our way to prosperity. By stuffing the economy with trillions of dollars, they hope to stimulate spending and stop deflation cold. Will it work? Only time will tell. As money manager Bill Fleckenstein wrote in his January 28 Daily Rap, "In the late 1990s, we tried to speculate our way to prosperity via the stock bubble. And, when that didn't work, we attempted to borrow our way to prosperity during the real-estate bubble." We know both of those strategies failed. Now we're trying a third strategy to "print" our way to prosperity.

Now more than ever we need the old saying, "The third time is the charm" to actually work!

| Returns through 1/30/09      | 1-Week | Y-T-D | 1-Year | 3-Year | 5-Year | 10-Year |
|------------------------------|--------|-------|--------|--------|--------|---------|
| Dow Jones Industrial Average | -1.0   | -8.8  | -37.2  | -9.8   | -5.3   | -1.5    |
| NASDAQ Composite             | -0.1   | -6.4  | -38.8  | -13.8  | -6.5   | -5.2    |
| Standard & Poor's 500        | -0.7   | -8.6  | -40.8  | -13.7  | -6.1   | -4.2    |

Sources: Yahoo! Finance, Barron's. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. Three-, Five-, and 10-year returns are annualized. Assumes dividends are not reinvested.

**ONE REASON WHY IT'S SO HARD TO BE A GOOD INVESTOR** is that the typical investor tends to limit his investing horizon to the recent past, or, at best, to what has occurred in his lifetime. He tends to assume that past performance is a decent predictor of future results, even though our industry plasters the phrase, "Past performance is no guarantee of future results" all over the place.

Perhaps it's human nature to simply extrapolate the most recent results and expect that they'll continue. If fact, physics has taught us that a body in motion stays in motion until acted upon by an outside force. Well, our stock market has no doubt been, "acted upon by an outside force" lately.

When times are good, we tend to think they'll continue to be good. And, the reverse is true, too. When things are bad, we tend to think they'll stay bad. Of course, we know that the economy (and life, for that matter) ebbs and flows. Nothing goes up or down continuously. Things ultimately turn around and balance out. Even though when we're in the midst of a trend, it may be hard to acknowledge that.

So, how do we overcome this natural tendency to extrapolate recent results? How do we gain a larger perspective so we can place unusual events in an historical context and profit from them? Ray Dalio, founder of money management firm Bridgewater Associates and one of the 100 richest Americans, has a good answer to those questions.

Dalio says, "Have a timeless and universal investment perspective, which means to broaden your perspective to understand what happened in long ago times (e.g., in the 1930s) and faraway places (like Japan and Latin America)." He goes on to say that you need an investment process that has, "Worked well in all countries and all time frames in order to continue to work as things change, because it must be based on essential truths that include understanding of how things change over time."

And, in one more telling quote from a recent client letter, Dalio wrote, "People are prone to do those things that worked in the past without thinking hard about why they worked or whether they will work in the future." In other words, the typical (unsuccessful) investor gets a little soft and just keeps on doing what worked well in the recent past *even if the current environment is different from the recent past*. Remember, there are no shortcuts to successful investing.

To be a successful investor, we can't limit our research to what happened during our lifetime, nor can we limit it to what has happened in the U.S. What happened during the Great Depression, and even during the Panic of 1907, may be instructive for us today. Likewise, Japan's 20-year bear market and Latin America's bouts of hyperinflation in the late 1980s and early 1990s may also teach us a few lessons.

Makes you wish you paid a little closer attention during history class!

## **Weekly Focus – Think About It**

"There is a mysterious cycle in human events. To some generations much is given. Of other generations much is expected. This generation of Americans has a rendezvous with destiny."

-- Franklin D. Roosevelt

Best regards,

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- \* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.
- \* The Nasdaq Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.
- \* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.
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