

January 14th, 2008

Here is our 4th Quarter 2007 newsletter.

Can You Take a "Do Over" for Your Retirement?

In my newsletter in July of 2007 I stated that once you have taken your first Social Security retirement check, you can't change your mind. Since then I have learned that may not be true. The Social Security Administration has a form SSA-521 "Request for Withdrawal of Application" where you can indeed change your mind. The bad news is that you have to give back the funds you have received. The good news is that you do not have to pay any interest on the funds.

You can find my previous newsletter and the form on the Documents page of my website at www.CompFinancial.com to see if you should consider doing so. If you took your benefit before your normal retirement date, you should definitely reconsider. Other good candidates are married couples where the older spouse has a higher retirement benefit than the younger spouse. As part of a financial plan, I can run the numbers and show the benefit it may have for you and your family.

Should You Do a Rollover?

The requirements for moving funds out of your company retirement plan into an IRA are often misunderstood. Many believe you have to do a Rollover to accomplish this. There are actually two common methods the IRS recognizes that you can use to move retirement assets.

The first is a true "Rollover". With this method you move the funds from one plan then take control of the funds yourself before transferring the funds to a second plan. With a Rollover there is a 60 day time limit for you to complete the transfer; otherwise it is treated as a taxable distribution with possible penalties. A Rollover is also subject to tax withholding. A Rollover is also limited to only one every 12 months.

The second method is a "Trustee-to-Trustee" transfer. With this method you do not take custody of the funds. This second method has several advantages over doing a Rollover. There is no time limit, no tax withholding and there is no limit on how many you can do over any time period. In short, if you can do a "Trustee-to-Trustee" transfer, do it.

Another little known fact is you may be able to do one of the above transfers while still employed with the company. Some company retirement plans will let participants transfer funds into their own IRA while still employed by the firm using what is called an “in-service withdrawal”. You should consider this, especially if the investment choices in your company plan are limited or if you are paying high fees.

Market Review

For the most part, with respect to the ranking of investment returns, the fourth quarter of 2007 was consistent with the rest of the year. In general, commodity prices moved sharply higher, as they did over the full year. Emerging-markets equities and currencies continued their advance (there is an embedded commodity play in some of these markets). Developed country foreign equities declined but they still significantly outperformed the U.S. equity market for the year. Value continued to under perform growth in the fourth quarter and was in the red on the year. Growth stocks delivered decent positive returns for the full year. Small-caps continued to lag large-caps and were also in the red for the year. REITs’ collapse intensified, as they dropped almost 13% in the fourth quarter alone. As recession fears increased, bonds performed well in the quarter and ended up with a solid 7% return for the year, ahead of the U.S. stock market.

December Benchmark Returns (Preliminary)			
	Dec.	4Q	YTD
Large-Cap Benchmarks			
Vanguard 500 Index	-0.7%	-3.4%	5.4%
Russell 1000 Growth iShares	-0.4%	-0.8%	11.6%
Russell 1000 Value iShares	-1.0%	-5.8%	-0.3%
Mid-Cap Benchmarks			
Russell Midcap iShares	-0.3%	-3.6%	5.4%
Russell Midcap Growth iShares	0.2%	-1.7%	11.2%
Russell Midcap Value iShares	-1.1%	-6.0%	-1.6%
Small-Cap Benchmarks			
Russell 2000 iShares	-0.1%	-4.6%	-1.5%
Russell 2000 Growth iShares	0.6%	-2.1%	6.9%
Russell 2000 Value iShares	-0.8%	-7.3%	-9.9%
Other Benchmarks			
Vanguard Total Int'l Stock Index	-2.3%	-1.2%	15.5%
Vanguard REIT Index	-5.1%	-12.9%	-16.5%
Vanguard Total Bond Mkt Index	0.2%	3.1%	6.9%
Merrill Lynch High-Yield Bonds	0.3%	-1.1%	2.2%
Citigroup World Govt. Bond Index	-0.5%	3.9%	10.9%
DJ-AIGCI (Commodity Futures)	4.6%	4.7%	16.2%
JPMorgan ELMI +	0.6%	4.4%	16.0%

Another story in the markets for 2007 was the huge divergence in returns across sectors. The S&P 500 gained only 3.5% for the year. Leading sectors were Energy at 33% and Materials at 20%. The two sectors that brought the average down were Consumer Discretionary, mostly from homebuilders at down 15% and Financials down 21%. Energy has had a huge run, with the weighting in the S&P 500 going from 5% in 2003 to almost 13% currently.

Our Portfolios

Our portfolios performed well for the quarter and the year. Our most aggressive portfolios (All Equity) lost 1.6% for the quarter compared to a loss of 3.6% for the benchmark. For the year our All Equity portfolios returned 9.1% vs. 4.3% for the benchmark. For the quarter our more conservative Equity-Tilted portfolios returned -0.7% vs. -2.1% for the benchmark and for the year returned 8.4% vs. 4.9% for the benchmark. Note almost one half of the excess return over the benchmarks occurred in the 4th quarter when the market started their downturn.

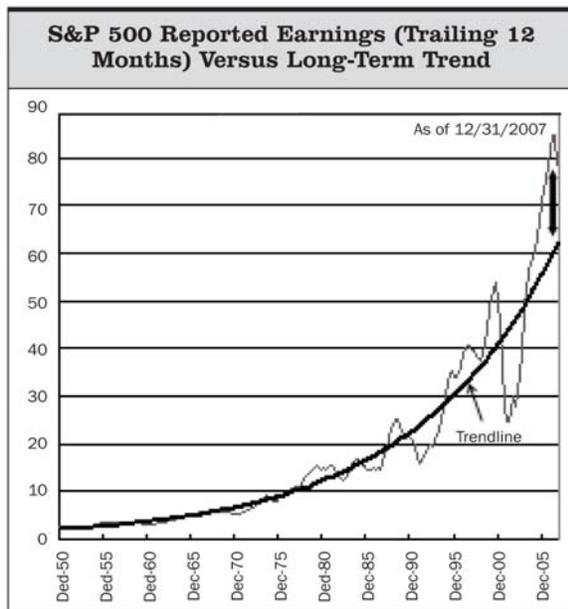
Our returns have been primarily enhanced by our allocations to foreign stocks, commodity futures and emerging-markets local currency short-term bonds. We also started building

some cash in money market funds in November with the distributions of capital gains and dividends from our funds and with the sale of Harbor Capital Appreciation.

At the fund level, 2007 returns ranged from 32% for Bridgeway Aggressive Investors II to down 14% for Oakmark Select. Oakmark Select lost 13% in the 4th quarter alone with the primary reason being their large holding in Washington Mutual. While a number of investors may flee the fund due to their weak performance over the last couple of years, we will stick with them recognizing their strong long-term performance.

Outlook for 2008

A year ago in our newsletter we indicated we thought the housing market would continue to be soft but the consumer would hold up well enough to prevent a recession in 2007. For 2008 the outlook looks like continued weakening of the economy, at least thru the first half of the year. While we may be able to avoid a recession, we're at least going to have an "earnings recession" with corporate profit growth falling or perhaps even turning negative. Looking at the chart of S&P 500 Reported Earnings we can see earnings have risen well above the long-term trend the last couple of years. The simple fact that earnings always eventually revert back to the mean tells us we could have a 15% drop in earnings before we even get back to the mean trend.



Earnings are way above their long-term trend, mostly due to very high profit margins.

For the stock market, while nobody can predict the unpredictable, clients should understand that the possibility of rough times could lie ahead. In the face of this possibility we have made some changes to our portfolios in the last nine months with the addition on our long-short fund last spring and our recent cash allocation. While our main focus is always our long-term goals, we also try to maintain adequate risk protection over a one-year time horizon based on the one-year loss threshold for each portfolio and the risk tolerance of each investor. If the current turmoil in the credit markets and/or an economic downturn triggers a severe sell-off, we are likely to see opportunities created at the asset class and fund level. At a stock-picking level several of our fund managers have commented they are seeing more opportunities to add value than they have seen in some time. This is especially the case for some of the large financial firms selling far below what their fair value would be if, after the credit crisis abates, their earnings return to normalized levels. Our valuation work suggests that (on the surface) stocks look fairly valued and on some measures undervalued based on current earnings levels. The problem is earnings are falling and nobody knows where they will land.

For the bond market, Investment-grade bonds are the primary way we hedge against recession risk and though Treasury yields are quite low now, some slices of the investment-grade market offer more attractive yields. For example, a significant yield pick-up is available in the agency bond sector. Longer-term return potential is limited given today's yield levels with returns likely to fall between 4% and 6% (annualized) over the next five years. This makes bonds unlikely to be able to keep pace with stocks except in a most bearish scenario. Concerning high yield, our portfolios have very little allocation and we will continue to avoid until spreads widen further. High-yield defaults are likely to rise going forward.

The housing market will continue to be weak. Fortune magazine had a good article in their November 7th issue titled "How Low Can This Go". The article posted at http://money.cnn.com/2007/11/06/real_estate/home_prices.fortune/index.htm has a link to "this table" which shows what average house prices could do over the next five years in 54 areas around the country. Their projections are based on the fact that housing over the long run is priced at a price-to-rent ratio, similar to a stock price to earnings ratio (P/E). If one simply takes current rents and uses the average P/R ratio over the past 15 years (14), the average price for all markets surveyed drops by 28%. The data is as of the end of June, 2007. Using a projected rise in rents over the same five year period at 12%, prices need to drop about 16%. The table shows there is a wide difference in the project price drop from location to location. Denver's drop is only 5.6%: Phoenix's drop is 23.5%. In general it looks like those markets that had the biggest price rise will have the biggest drop.

For those interested in Durango, Dr. Luke Miller at Fort Lewis College has applied the same methodology to come up with a projection for Durango. He will release his analysis in the January 16th addition of the Durango Herald. The P/R ratio for Durango has averaged 21 over the long term: it's currently 35, which would suggest a possible 40% fall in prices. Luke believes rents should go up over the next five years at 10% per year, resulting in a price drop over five years at about 5%. In 2007 the median single family home price in La Plata County dropped about 10% to \$340,000.

In summary, for housing investors, prices should continue to decline and will take a long time to recover. The good news is that rents should improve throughout the correction as the level of home ownership decreases.

We look forward to discussing your current financial situation. Thank you for your business. If you know anyone else who would value our services, please let us know. With their permission, we would be happy to call and introduce ourselves.

Sincerely,

Stan Johnson, CFP(R)
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Certified Financial Planner
Registered Investment Advisor