

## Market Comment

The first half of this decade has been defined by many negatives and tests to our beliefs and morale. Peace has been rocked by terror, and corporate morality has been tested by a few that were motivated by greed and personal interests. Looking back, it seems that we have been relentlessly bombarded by one negative event after another. They

say that one's character is measured by how they deal with adversity. Terror is no longer accepted and hopefully the majority of the world will act to quell those who put no value on human lives. The greed in our corporations here at home is being dealt with by our justice system as evidenced by the recent convictions of executives at Adelphia and Tyco. America's core values are still strong.

These core values and free market economies have the potential to drive the U.S. to economic growth unmatched in our past. It is said that more wealth will be created in the next 25 years than in the last 2,500 years. There are more than 50 million people in this country alone between the ages of 40 and 55, which are in the high production and high spending periods of their lives. While our labor force is moving away from the manufacturing sector, which is moving to low cost labor nations, job growth remains strong. In the next decade, it is reported that more than 3 million jobs will be available in

biotechnology, 1.5 million jobs in health services, and over a million in high tech manufacturing.

History is repeating itself again as it relates to economic growth. Six times in the twentieth century the stock market declined more than 40%. In all six declines, the market has come back to new highs and the economy has shown high rates of growth for the following five year period. Growth this year is strong and is expected to follow last years 4% gain, which was the strongest in twenty years. Rising interest rates will slow our growth somewhat, but slow, steady growth produces longer expansions than quick, explosive growth periods. Managed growth with low inflation produces real measurable results. The U.S. economy produces nearly one third of the world's wealth with less than 5% of the world's total population.

Oil is again in the news being debated on its impact on corporate profits and our pocketbooks. At record levels, the negative view is that the cost of fuel will force consumers to cut back on spending and manufacturers to raise prices, thereby raising inflation and choking the economy. Much has been written about the scarcity of fossil fuels and the impending end of oil as a fuel source. Recent information by the Intergovernmental Panel on Climate Change has noted that "fossil fuels are still very abundant and that only 1.5% of the total physical resource base of the

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earth's crust has been discovered. After 2% annual increases in demand for the past decade, it is interesting that the latest estimate of the world's crude oil reserves is the highest ever, with over 1,000 billion barrels of proven oil reserves waiting to be drilled and produced". With prices at \$60 a barrel for oil, other fuel alternatives become very viable. Fuel cells, Hydrogen, solar and nuclear power alternatives are all being developed and hybrid autos are already on the road. Toyota and General Motors plan to have Hydrogen fueled autos by 2010. Oil prices will be in the news, because the media feels we need to worry about them, but we hear prices will settle closer to \$45 per barrel.

Trade will also open up with many other countries as capitalism spreads and free trade expands. Tariffs are being lowered around the world and the ensuing trade will lead to more prosperous nations and people. The Wall Street Journal has been monitoring 160 countries for ten years on ten economic freedom variables. For example, if countries are lowering taxes and tariffs, they are moving toward freedom. If they are raising taxes, etc, they are moving away from freedom and prosperity. In the mid 1980's there were 17 countries in the world judged to be free economically. In 2005, 74 countries are judged to be free economically. The world, with its stops and starts, is headed toward capitalism.

While the future looks bright, there are many issues that still need to be addressed as the baby boomers retire and re-write the definition of "seniors" in this country. The increase of personal saving will be the answer to most problems plaguing our Social Security and Medicare shortfalls expected. Detractors to personal savings in this country are the current Income Tax, Estate Tax, and Alternative Minimum Tax. Abolishing the Alternative Minimum Tax and Death Tax and completely rewriting the Income Tax to something like a flat tax will shelter savings from double and triple taxation and encourage investing.

Skyrocketing health care costs also need to be high on the priority list. Through tax reform, we must limit non-economic malpractice damages. These insurance rates are ballooning and doctors are merely giving up their practices to avoid the malpractice insurance costs. States should follow Texas' recent cap of \$250,000 for such damages.

Strong leadership, coupled with the backing of the American people will be needed to make these necessary changes and do what is right to continue the prosperity we have all enjoyed. The values and dreams upon which this nation was built will need to remain at the forefront of the decision making processes.

If history holds true, the second half of this decade looks to have potential to be one of our best economically.

## The Real Estate Sector

The Real Estate phenomenon in the United States has been remarkable over the past five years. Consider the San Diego area averaged 18.9% per year growth since 2000. Other notables include Miami at 15.6%, Los Angeles 17.3%, and New York City 13.8%. This leaves us asking why and what should we expect going forward.

First, keep in mind the national average annual return for home prices from 1980 to 2000 is 4.4%. However, that figure jumps to 10.5% from 2000 to 2005. Certainly, this seems to be out of the ordinary. One reason involves the historically low interest rates we are experiencing. With rates so low for so long, borrowers are able to afford more house with reasonable monthly payments.

Another catalyst is the growing popularity of Interest-Only mortgages. These let you payoff the interest only for a specified period, then convert to a traditional mortgage from there on out. However, once the interest only period ends payments are significantly higher since you must also start paying down the principle. Real

estate investors utilize these often to keep monthly payments low allowing them to purchase more properties.

Lastly, the demand for new and existing homes is at all time highs. Over 2 million jobs have been added since our most recent recession and many people view real estate investing as the next best thing. Certainly, when there is such great demand sellers are able to charge a premium for their homes.

Signs on the horizon are indicating a slowdown. Interest rates have been hiked up by the Fed eight straight times and are expected to continue rising as inflation continues to rise. As mortgage rates rise with interest rates borrowers will become more limited to what they can afford. Consider right now that only 11% of families in the nation's hottest markets can afford an average house with a traditional mortgage.

Further, the hottest markets are showing declines in homes sold over the past eight of nine months while home listings have increased by 27%, signaling a rush to jump into the real estate frenzy as demand is softening.

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## Market Summary Year to Date

<b>Dow Industrials</b>	<b>-4.56%</b>
<b>Dow Transportation</b>	<b>-10.59%</b>
<b>S&amp;P 500 Index</b>	<b>-1.75%</b>
<b>NASDAQ Composite</b>	<b>-5.99%</b>
<b>Russell 2000</b>	<b>-3.57%</b>
<b>International</b>	<b>-1.66%</b>

Eventually, borrowers will simply be priced out of the market altogether and sellers forced to reduce what they are asking or sit on the property and wait for a rebound in years to come. Keep in mind the national real estate market is relatively stable while regional markets go through periods of substantial growth and then stagnation.

The frenzy surrounding real estate investing is not much different than what occurred in the late nineties with the Dot.coms and day traders. Each time the popular trend surrounded a very hot sector over a relatively short period of time. Investors become convinced they can participate in these sectors with limited knowledge compared to the seasoned pros. Unfortunately, those rushing to be part of the game in the end may get caught holding the bag as the experienced experts walk away with cash in hand. Eventually, these hot sectors return to their long term average, as has happened repeatedly in the past. Be careful if you decide to venture into the real estate market and be sure to protect your investment as much as possible.

## AMT Reform Up for Debate

Beginning in 1969, Congress enacted the Alternative Minimum Tax (AMT) as a second tax system designed for the very wealthy taxpayers who were able to dodge paying taxes, legitimately, through various loopholes and deductions. Under the AMT, many tax breaks within the regular system are not allowed including state and local tax deductions. The taxpayer is responsible for paying the higher of the two systems.

The major problem with the AMT is that the exemption levels, currently \$58,000 for married couples and \$40,250 for single taxpayers, have never been indexed to inflation. Therefore, more and more taxpayers are subject to the AMT. This year roughly 3 million people will pay the AMT, and that number is expected to grow to 35 million by 2010.

Senate hearings are under way with regards to the AMT in preparation for the President's next tax reform. A report is due out in July with recommendations on how to make a simpler and fairer tax system. Already the debate is heating up as Senators, Republican and Democratic alike, are calling for the AMT to be abolished. However, that's not so easy as the AMT becomes a larger source of government revenue each year. Consider estimates that the AMT will generate additional income tax revenue of \$20 billion for 2005.

The tax experts agree that any reform will require difficult decisions because the lost revenues will need to be recouped from somewhere else. One remedy is to wipe out the current federal income tax system altogether for a national sales tax. This idea has gained growing support from Congressional leaders and taxpayer groups. Other possibilities include higher income tax rates or eliminating the state and local tax deduction for all taxpayers. Regardless, it appears there is major tax reform on the horizon and we will keep you apprised of the developments as they occur.

## FYI

It is a good practice to **review the beneficiaries of your life insurance** policies and retirement accounts from time to time. This can help to avoid potential estate planning pitfalls and insure your assets are distributed as to your wishes. Give us a call if you need assistance or wish to discuss the best way to setup your beneficiaries.

Due to the increasing need for assistance in selecting **senior living facilities** we have developed a packet of information for facilities located in the Westlake area. It can serve as a good starting point with information on facilities, issues to consider, and definitions of commonly used terms. The packet is available on our website in PDF format or a copy can be provided to you upon request.

On **Friday, September 23, 2005**, we hope you will "Cruise On In" to the St. Clarence Pavilion in North Olmsted, Ohio, to celebrate **Lesjak Planning Corp's 25th Anniversary**. We'll start the evening with a casual dinner and then, get ready to kick off those shoes ... back by popular demand from our 20th Anniversary Dinner Party...The Remember When Band! We hope you will join us for this fun filled evening. Keep an eye out for details to follow near the middle of August.

**For clients with Charles Schwab accounts**, you will soon be able to receive your monthly statements electronically. If you are interested in receiving your statements and trade confirmations by e-mail instead of by regular mail, please let us know by calling us with your e-mail address or send an e-mail to [karen@lesjakplanning.com](mailto:karen@lesjakplanning.com). Once we receive responses from enough clients we can begin the setup process with Charles Schwab. At that point, you will receive an email from Charles Schwab with instructions on how to begin your activation process. We hope for this to begin sometime this summer. If you have any questions, please call our office and ask for Karen.

The **LPC Charity Golf Outing 2005 was a smashing success**. Clients, friends and sponsors enjoyed a wonderful day of golf and companionship. Thanks to all those who participated and the sponsors we were able to present a \$5,000 check to Matthew's Lending Library. Pictures are currently posted on our website at [www.LesjakPlanning.com](http://www.LesjakPlanning.com).

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