



Kintyre Investment Letter

Third Quarter 2007

SUMMARY: →

Quarterly Market Commentary

The subprime-fueled liquidity crunch in the third quarter cascaded into broader risk avoidance by investors, hedge funds, and other financial market players. With the Fed's rate cut, things have settled down but they have not returned to normal.

The other major problem is the housing market, where excess supply, declining prices, and tighter credit are feeding each other. With the housing ATM out of cash, the economy is faced with the possibility of a material slowdown in consumer spending—a key driver of economic growth.

The Kintyre Investment Letter is mailed quarterly to our clients and friends. The intent of this publication is to share our investment thinking and provide general advice to the public. Please contact us for advice specific to your situation.

The market volatility, credit crunch, housing market collapse, and hedge fund debacles make it hard to believe the overall stock market was in the black during the third quarter; but it was, with the S&P 500 gaining 2%. Moreover, through September the index is up 9.1% on the year. While the numbers for the overall stock market were quite satisfactory over both periods, there was a wide degree of variation across asset classes. Value benchmarks were in the red for the quarter, with smaller-caps doing worst. Growth benchmarks did quite a bit better, and for the year growth stocks are ahead of value by a wide margin after seven consecutive years of underperformance. International stocks gained over 4% in the quarter, extending their run of impressive returns. With the exception of high-yield bonds, fixed-income asset classes had a solid quarter, with investment-grade bonds climbing almost 3%, and emerging-market short-term bonds returning almost 5%.

Looking ahead, the driving factor for returns over the next year will likely be the health of the U.S. economy and its impact on the rest of the world. The credit crunch and continued deterioration in the housing market, which drove this summer's volatility, make a recession more likely than it was earlier in the year; but it is not a foregone conclusion.

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Kintyre News

Annie was a speaker in October at the NAPFA Northeast/Mid-Atlantic Conference, held in Hartford, CT. The topic of Annie's presentation was Technology in Financial Planning. Conference attendance is one of the ways that financial planners keep up with the latest planning techniques, and meet the CFP and NAPFA continuing education requirements. At this conference, Annie attended presentations on compliance and audit requirements, and best practices for retirement and estate planning.

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Quarterly Market Commentary (continued)

So where does this uncertain outlook leave us? Economic predictions are not accurate enough to serve as a basis for investment decisions. Therefore, we are more confident in our valuation work as a basis for decisions, but this can not be done in a vacuum. We know the economy could fall into recession, but it could also avoid recession and surprise on the upside with the aid of Fed easing, a weaker dollar that stimulates exports, and global growth driven by emerging markets. Getting defensive in our portfolio allocations could result in missing out on returns that could be captured during, potentially, a few more years of economic growth. On the other hand, we recognize that stocks could drop 10% to 20% if we experience a cyclical bear market.

What we do first in setting our portfolio allocations is draw upon our basic building blocks of diversification, such as using investment-grade bonds to protect against recession. Our historical, common-sense framework helps us understand how asset classes perform in a variety of environments, including cyclical bear markets. Moreover, that framework allows us to understand the factors—liquidity, interest rates, starting valuations, and earnings, for example—that drive the performance of each asset class from one cycle to another. Not every cycle is the same.

Next, we consider our maximum loss thresholds, which allow us to accept a certain amount of near-term risk in exchange for some flexibility to capture long-term return. We “stress test” each portfolio strategy against different possible scenarios so that we can assess the amount of downside one-year risk we think each portfolio would be exposed to. If this scenario analysis suggests that we are taking on too much short-term risk relative to the potential long-term return benefit, we will adjust the portfolio allocation accordingly.

This disciplined approach allows us to capture long-term returns that are driven by factors in which we have the highest confidence (valuations), while still keeping risk in line with each portfolio’s profile.

Today, this process leads us to leave our portfolio allocations right where we have been. For quite some time we’ve believed most equity asset classes to be in a fairly priced range—suggesting that over the long run we will make more money in equities than we would in more defensive asset classes (e.g., bonds). And, we’ve been rewarded for taking that view. But we also recognize that, as always, there are troubling risks. Equity-type asset classes have not been priced at levels that were low enough to ignore these risks and entice us into more aggressive positions. And we have been concerned about the likelihood that corporate earnings growth will slow from its historically high recent levels. So we’ve stayed relatively neutral in terms of our risk exposure, though we have a bit more exposure to recession risk than we would in a normal scenario. Our analysis supports a continued balance between the return opportunity from equities and hedging of these risks so we will continue to maintain a middle ground. However, as the economic expansion continues to mature we will reassess the degree to which we want to hedge against the possibility of recession.

We know there will always be uncertainty in the markets, but what remains consistent for us is this framework for how we make consistent and disciplined investment decisions.



Credit Card Theft

What are your rights if your card is lost or stolen?

You reach for your credit card and it isn't there! Don't panic: your losses are limited whether the card fell out of your pocket or was stolen by a thief. You're also protected if your credit card number was used without your permission over the phone, on the Internet, or by mail. If your credit card is illegally used, your liability is limited to a maximum of \$50. Although debit cards are governed by a different federal regulation, your maximum liability is still limited in most cases. As long as you tell your bank about your missing card in a timely manner, your liability for unauthorized use is generally limited to \$50. However, this amount can increase if you are slow to notify your bank about the missing card.

What should you do if your credit card is lost or stolen?

Call the card issuer immediately

If you discover that your credit card or charge card is missing, or if you discover unauthorized charges on your card statement (indicating that your card number may have been used without your knowledge), call the card issuer immediately. Most card companies provide 24-hour customer service for such emergencies, but you have to know the number. If your card has been stolen, you won't be able to flip it over and dial the toll-free number printed on the back. It's important to keep this information in a safe place. You'll need to provide your account number when you call, so make sure you have recorded this information as well.

Follow up with a letter

Many card issuers will require you to follow up your phone call with a letter. This letter should include your name and account number, the date you realized your card was missing or discovered the unauthorized charges on your statement, and the date you first reported the loss. Write down the name of the customer service representative who takes your phone report and include that in your letter as well.

Don't use your account

Most card issuers will freeze your credit card account as soon as you report your card or account number lost or stolen, in order to prevent further loss. This means that you (and anyone else who is named as an authorized user) won't be able to use the account. The card issuer will usually issue a new card and account number immediately.

How is your liability established if your credit card is lost or stolen?

If you report the loss before the card is used, you have no responsibility for any unauthorized charges. If your cards are used before you report them missing, the most you will owe is \$50 per card. You'll never owe more than \$50, even if the thief uses your card at an ATM to access your cash advance.

If you discover that a friend or family member has stolen your card, you have a choice to make. Reporting the stolen card limits your liability to \$50, but it may mean identifying your friend or family member as the thief, because you must provide any information necessary to assist the card issuer in investigating the loss. You may decide it's better to pay for the unauthorized charges rather than giving your friend or family member a criminal record.

What should you do if your ATM or debit card is missing?

Notify your bank

If you discover that your ATM or debit card has been lost or stolen, or if you notice unauthorized transactions on your bank statement, notify your bank immediately. You should call your bank first, since this is the quickest way to notify it. However, you should follow up with a letter so that you have a record of your notice.



Stop using your card

As with a credit card, most banks will deactivate your ATM or debit card as soon as you report it missing in order to prevent further loss. They will generally issue you a new card right away.

What is your liability for a lost or stolen ATM or debit card?

Your liability for unauthorized transactions using your ATM or debit card depends on how quickly you notify your bank of the loss. Guidelines for determining your liability are as follows:

Within two days of discovering card missing

Your liability is limited to no more than \$50 if you notify your bank within two days of the time you discover your card is missing.

More than two days after discovering card missing but less than 60 days after unauthorized transactions appear on bank statement

Your liability is limited to no more than \$500 if you notify your bank more than two days after discovering your card is missing but less than 60 days after the unauthorized transaction appears on your bank statement.

More than 60 days after unauthorized transactions appear on bank statement

If you wait more than 60 days after receiving a periodic statement showing unauthorized transactions, your liability is unlimited. This means you could lose everything in your account and possibly more if your account is attached to an overdraft line of credit.

Unauthorized use of account number without actual card

If a thief finds out your debit card number without actually taking the card, this information can be used to shop by phone, mail, or on the Internet. You would probably not know your card is being used fraudulently until the transactions appear on your bank statement. Your liability for this type of unauthorized transaction is limited to \$50, as long as you report the fraud within 60 days of the time the information first appears on your bank statement. Failure to report fraudulent use within this time frame can increase your liability significantly.

As long as your liability is limited, why bother protecting your cards?

You generally don't pay for unauthorized usage of your credit or debit cards and credit card thieves are seldom caught, so who is left holding the bag? In most cases, the card issuers are stuck with the loss. Or are they? Credit card companies are usually quite profitable, even though they suffer large losses from credit card theft. What this really means is that the card issuers pass their losses on to you in the form of increased interest rates and fees.

Kintyre Financial Advisors, LLC is a fee-only financial planning and investment management firm. Kintyre is completely independent and accepts no commissions. We adhere to a fiduciary standard, and work entirely on your behalf.

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