



NEXT  
GENERATION  
WEALTH MANAGEMENT

## NG Wealth Management Inc. 2007 Outlook

Yes, it is that time of year when Wall Street's prognosticators expel their annual list of forecasts and predictions for the upcoming year. At Next Generation Wealth Management, our team has been a participant in this type of activity for many years, and even decades - without the hype. This year is no different than in years past.

The real value of our commentary and investment advisory services lies in the adjustments made to portfolios as market conditions warrant. As we are well aware, it is the financial markets themselves that frequently seem to provide both unexpected opportunities and unanticipated risks.

### THE 2007 ECONOMY

Our current economic expansion is over five years old, which is three months longer than the average length of the previous ten economic expansions since the end of WWII. Although the expansions under the Clinton and Reagan administrations lasted 9-10 years, we do not view them as typical.

It is important to recognize the majority of economists do not acknowledge a recession until it is over, and until then, it is called a "soft landing." Cyclical bull markets typically end 6-12 months before the economy slows down. That being said, at NG Wealth, one of the primary areas to monitor is the strength of the the financial markets.

One wildcard for 2007 is the consumer. American corporations, oil producing countries and many emerging nations are flush with cash, but the American consumer continues to have a very low savings rate. In addition, homeowners can no longer use their residences as an ATM. Debt servicing costs are rising, new loan costs are higher than in 2006 and lenders are encouraged to tighten their lending policies. We might have a will to spend, but there may not be a way. Corporations can not drive economic expansion in and of itself.

Our forecast is for the economy to continue to slow despite corporate profits expanding for a while longer. The second half of 2007 will see a slowdown prompting the Federal Reserve to lower interest rates, suggesting further talk of the dreaded "R" word. Strong employment will decline as the stimulus from real estate appreciation and construction employment will no longer prevail.



## THE STOCK MARKET IN 2007

The S&P 500 has yet to reach the extremes existing at most past bull market peaks, but we are becoming increasingly cautious in the near term as the markets are no longer extremely undervalued. As measured from the October 2002 low, the S&P 500 is up in excess of 80%, matching the post WWII median. Historically, overvalued markets can (and have) become radically overvalued, as was the case in 1999-2000. Rest assured, we will be watching this closely in the coming months.

The data in early December suggested that 70 to 80 percent of investment managers were trailing their benchmark. This comes after a long period in which active managers had the benefit of a tailwind (years) for performance relative to their cap-weighted benchmarks. Consistent with our 2006 outlook, we believe the "mega companies" have moved into a leadership position and this trend will likely remain in 2007. As the economy slows, we believe active management will be rewarded and portfolio managers will earn their pay - again. Patience is a virtue, especially on Wall Street.

## 2007 INFLATION

At NG Wealth, it is our opinion that inflation continues to moderate, perhaps to a range of 2-3%. Of course, an unknown is oil prices. If the Mideast geo-political situation deteriorates the price of oil could spike to new highs, causing this outlook to be incorrect.

Even as the U.S. economy moderates in 2007, the rate of change might increase for the Consumer Price Index (CPI). The culprits are wage inflation, a strong employment market, food prices and of course, the price of commodities.

## INTEREST RATES IN 2007

We do not believe the Bernanke Fed will reduce short term interest rates in the first or second quarter of 2007. The economy is slowing. Inflation remains contained, despite being higher than the 2% maximum the Fed likes to see. Consistent with our commentary in 2006, Chairman Bernanke remains data dependent and will remain in this mode for some time. The second half of 2007 is where NG Wealth anticipates a change in policy is probable. The severity of interest rate reductions will depend on employment, a slowing economy and inflation.



A range of 4.00 % to 5.25% on the 10 year U.S. Treasury is likely. A diversified fixed income strategy in 2007 appears to be the most appropriate approach as we monitor today's inverted yield curve.

### OIL PRICES

Over the next ten years, it is entirely possible for the price of crude oil to reach \$100 per barrel as production peaks and emerging country demand continues. The energy dilemma will not be resolved over the next decade, but energy conservation and oil alternatives should assist in decreasing our supply/demand squeeze.

For 2007, it appears as though average crude prices should stabilize, of course, barring any unexpected geopolitical risk (although the markets tend to have a premium on the price per barrel as evidenced by summer 2006). Our guess is a price range of \$50 to \$85 for the year, with an average of mid \$60's.

### ALTERNATIVE INVESTMENTS - HEDGE FUNDS AND LEVERAGED BUYOUT FUNDS

What more can we say, "Be careful..." The number of so-called hedge funds is now 9,400 up from 3,900 in 2000, while the amount of assets has surged to approximately \$1.4 trillion. The hedge fund universe is currently over-populated and over-compensated. Most investors in hedge funds tend to over-estimate return expectations and have done a poor job in examining their risks. How many actually "hedge" anymore?

Yes, the fact that there are so many new hedge fund managers and hedge fund dollars makes it even more difficult to achieve superior returns. Therefore, hedge funds are now expanding into more arcane fields, requiring special management and operating skills that may be beyond the capabilities of hedge fund managers.

By far the fastest growing alternative investment is private equity funds. These funds target existing companies with the objective of buying them to reorganize or enhance financial results. The ultimate objective is to sell them at a large gain, either by a public offering or to another company.

In the past 20 years or so, a few large institutions were successful in this type of investment activity. In the last six years alone, private equity firms have raised over \$800 billion,



including \$200 billion in 2005, with at least that much in 2006. If we assume a four to one leverage ratio within these investments, \$800 billion means as much as \$3.2 trillion can be committed to private equity deals.

**“THERE IS NO ASSET CLASS THAT TOO MUCH MONEY CAN’T DESTROY”**

The above quote is from Barton Biggs, a long-time Wall Street strategist, while speaking to a reporter several weeks ago. The topic was private equity. NG Wealth is in complete agreement with him. While we do believe that alternative investments should be considered for your portfolio, it is specific to each client. In addition, alternative investments need to be viewed as a strategy to reduce portfolio risk and to provide a lower correlation to the financial markets.

Well, here is a summary of our outlook for 2007. In our opinion, Wall Street research is still very conventional and “groupthink,” despite the reforms of New York State Attorney General Eliot Spitzer over the past several years. Mainstream and consensus expectations are just that, and at NG Wealth, we believe you will enjoy our independent, unbiased analysis.

Sincerely,

David A. Massart  
Principal

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