MIKE CHADWICK'S
MONEY MATTERS
ADVISING, EDUCATING & INSPIRING YOU TO A BETTER LIFE

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Interested Appreciation

In the world of finance interest is a common term. People often focus on their rate of return but don't really know how that rate of return is actually being generated. At the simplest level you can deposit your hard earned money in a savings account, which has a stated interest rate (typically an insultingly low rate, but a stated rate nonetheless). Let's say the bank is offering 2% on savings. That is a rate they just pull out of the air, one just high enough to lure depositors to give them their hard earned money. Make no mistake, the bank does not leave your money in the safe, they put it to work. The banks usually lend money to consumers and businesses in the form of personal, car, credit card, mortgage and lines of credit loans. For a bank loans are assets and customer deposits are liabilities because they're making money on the loans but paying paltry interest on the deposits. The bank is only good for a checking account and loans, any use of the bank above and beyond that is hurting you economically.

The traditional savings account interest rate is very low because the average consumer isn't too sophisticated and will accept that low rate. The institutional investor is sophisticated and will not accept the paltry rate, so the banks have other avenues to get their hands on assets. These routes require the bank to pay more interest, but

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Inside This Issue

Investing vs. Speculation

Investing is something we do for people to improve their outcomes, speculation is something you do at the casino or in the lottery, expecting to walk away empty handed, but willing to pay for the experience. I don't know anyone who is happy about losing half of their hard-earned assets from 1999 – 2002! The very difference is betting versus investing. The financial world has a tool we refer to as "appraisals" and that allows us to value various assets for what they're actually worth. This is very similar to having an appraisal done on your home when you go to buy or refinance your home. The appraiser "values" the home and assigns a price tag to it, in his or her opinion. This price is good in today's market but will likely change 3 months, 3 years and 3 decades out – but it's good today. Realize three different appraisals will come up with three different values, all likely close but none identical.

With investments we get paid to take on inescapable risks – risks that stick around no matter what you do with respect to diversification and asset selection. Risk and return are indeed related and we don't like risk so we will often take very little of it in to preserve your hard-earned capital. Market risk is just the risk of the market—any market, wherever it is, for stocks, commodities, real estate, etc. No market is free of market risk. There are other risks depending on where you go to invest – if you're investing internationally you have political and currency risk. If you're investing in just one particular investment you have specific selection risk.

The relationship between risk and reward remains a constant – if you buy treasuries there is no risk and you'll earn 5%. If you buy stocks there is risk but you can earn a lot more over time: you can also lose money.

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when the financial playing field is leveled, they need to pay up for additional capital. The bank will offer brokered CD's, just like the CD's you see in the bank's lobby, but at much higher interest rates so institutions like us can get CD's for you at a better rate because we won't accept the lobby rates. The other avenue for the bank to raise capital is with commercial paper. This a popular term lately as the recent credit crunch has had many running scared. Commercial paper is a way for banks and large institutions to get money on a very short term basis for a stated interest rate. Banks and big business rely heavily on commercial paper to come up with money to finance their operations – sometimes the day to day activities, sometimes for investment purposes. Here is an example of how commercial paper works: Citibank needs $500,000,000 for the next 120 days and requests that money from GE, agreeing to pay 5% for the transaction. GE agrees and the deal is done. GE had the money in the checking account and wasn't going to use it, so this is a good use of its capital. Chances are, when the 120 days is up, Citibank will just roll that "loan" over to another firm to keep the money rolling. Notice that they're paying a pretty good interest rate for a short period of time. If a company is in good financial shape, they can get money relatively cheaply. If a sub-prime mortgage firm wanted to borrow some money, they may find that in today's economic world there is nobody willing to lend money to them, or if they are the interest rate would be 25%.

The commercial paper market is also what drives money market mutual funds. Inside your brokerage accounts you'll see something like "Prime Fund" "Core fund" "Cash Reserves" or "Money Fund" which is a cash type account that pays a much better rate of return than the banks money market. Now the various money markets are hovering between 4.5% and 5.5% depending on your balances. These money market mutual funds do not offer FDIC insurance as does a banks FDIC insured money market, but they often pay many more times the rate of return. These are typically very safe vehicles and we haven't seen any real problems with them. In recent months as the credit crunch has hit, one firm stopped redemptions from their money market fund – that firm is Sentinal. You may be able to use a money market mutual fund as you bank account if your bank or credit union can offer the service. Each day the bank or credit union "sweeps" money from checking into the money market fund you specify and now you earn whatever that fund pays, perhaps 4.5% - 5.5%.

How is the simple rate of return paid by a savings account compared to other investment vehicles? The interest of non savings investments needs to be calculated by adding up or subtracting all of the moving parts. Let's start with a bond, remember a bond is a loan. If you buy a bond (lend someone or something money) at $1,000 and they agree to pay you 7%, that is one component of the return. If when the agreement is over you get back your full $1,000 then it is the whole return. If you get back less, say $975, then 7% interest must be added to the 2.5% loss ($1,000-$975) you incurred on the value of the bond, giving you a net return of 4.5%. If you got back more than you lent, then 7% would be added to the gain. If you got back more on your bond, say $1,040, then the equation would be 7% return plus 4% capital appreciation = 11% total return. Stocks work the same way, if you buy Altria today, it has a yield of 4.44%, if the stock price stays at $67.52 for a year, you'll have earned a fix 4.44%. If the stock price goes up 10%, you'll have earned 10% in appreciation, plus the 4.44% dividend for a total return of 14.44%. If the stock depreciates by 10%, you'll have had a 4.44% positive, offset by a 10% loss, netting your return to -6.56%. ☹

Dividends are a very important part of total return in investments. Of the 500 stocks in the S&P 500 (an unmanaged market index that you cannot buy) right now 388 of them pay dividends. Last year, dividends made up 13.8% of total return for the S&P 500. In 2005, dividends made up 38.9% of the total return of the S&P 500. In the crazy stock market environment of the 1990's, dividends only made up 7% of investors' returns, so they discounted the value of dividends. Over the long haul dividends have accounted for more than half of total return. Twenty-five years ago the S&P 500's average dividend was 6.21%, now it is a mere 1.74%.

Here is a long haul fact that you need to really pay attention to: From January 1972 to July 2007 dividend-paying stocks generated a total return of 10.2% annually. During the same time period non-dividend paying stocks generated a total return of 2.4% annually. The 2007 view that dividends are unimportant is absolute insanity. Today's tax law favors dividends. Dividends provide strength and safety when things get volatile and dividends have provided superior returns over the long run when compared to non-dividend alternatives. Over the past five years investment in dividend-paying stocks has grown over three fold. There was $85 billion in dividend funds assets in 2002, today there is over $300 billion there. Do you see a trend? ☺☺☺

Noteworthy News! ! !

- Congratulations to Ziggy & Virginia Maciokas on the birth of their 4th grandbaby, Ava Joy! (What a joy, no pun intended) ☺
- Congratulations to the Cheney family on the birth of their daughter Nadia! She joins big baby brother Max. ☺
- Congratulations to Donna & Robert Ferrante on their recent marriage! The beginning of a happy life together. ☺
- Congratulations to Donna Finn on her new business, Donna Finn's Music Studio! ☺
- Congratulations to Jennifer Cassella and Jason Pace on their recent engagement! ☺
- Congratulations to John & Michele Ciesco on the purchase of their new home! ☺
- Congratulations to David Reid on his new business, The Traveling Music Teacher! ☺
- Congratulations to Dr. Hynes & Danielle Birmingham on the purchase of their new home! ☺

Voicemail Meltdown

For a few days in early September we had a problem with our voicemail system – it had massive heart failure and completely melted down. The system breakdown caused an unfortunate loss of stored voice mail messages that turned out to be irrecoverable. As you know, we always return your calls as soon as humanly possible, often times faster than you expected. ☺ This time I know that many people called and left a message for us and never received a return phone call to address their concerns. Please realize this was not done intentionally and was completely out of our control. If you did place a call to us and didn't get a return phone call it was because of our voicemail system meltdown. Please call or email us again and we'll be happy to address whatever is on your mind. ☺

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The size of a firm has a lot to do with the risk as well. Larger firms are more stable and less risky, so they often generate lower returns than smaller, less established operations.

Today's world is a global one where almost each and every country is interdependent on other countries for something. We're reliant on many countries for petroleum products and many countries are reliant on us for food. Many countries are dependent on many others to provide the plethora of goods and services that they consume.

When you invest the idea is to earn interest on that investment or buy assets that you expect to appreciate. People can understand this in terms of their homes. Here is a common example – I bought my house in 1960 for $29,000 and today it's worth $500,000 – what a great investment. When we do the math on this so-called investment it's not bad on the face, but when we take into account all of the costs of homeownership over the years, it becomes a very different story, typically -1% to +1% return on residential real estate. If you're buying investment property it's a whole different ball game, often a very attractive one if you can buy it right. Buying it right is the key, whether you're buying homes, antiques, muscle cars or stocks. The appraisal remains a key tool to make it all happen.

In open and liquid markets things are typically priced so they'll sell well and there is an orderly market of buys and sells. If you're able to buy something at a discount to value, it's because there is risk. Krispy Kreme shares recently traded at $3.43, and just four short years ago they were trading for $48.90 a share. Something went wrong! The market is constantly factoring into the price of a stock the management's ability to make prudent decisions, assessing the products or services the company offers, and guessing at how successful the firm will be in implementing its business plan-in short, how successful they are likely to be. This isn't necessarily the end for Krispy Kreme. It can be turned around, but this is certainly a risky venture.

Insight that allows one to look into the future and make an accurate appraisal, comparing that to the current market valuation, and then buying when substantial discounts can be had—that is the art of investing. Speculation is scratch off tickets, lotto and going to the casino! Where is your future? ☺☺ ☺

Money Quiz

Last month's quiz was won by Todd O'Keefe! ☺ Two-thirds (66%) of recyclable beverage containers are not recycled. Todd & Susan will enjoy dinner on us at Still River Café in Eastford, CT.

This month's challenge is to tell me about kid's dreams – the 20 highest paid major league baseball players earned $16.6 million last year. How much did the 20 highest paid hedge fund managers earn? he winner is going to dinner on us at any one of a few select fine dining establishments. BTN 091007

Title Insurance Insight

Title insurance is something you must have when you buy a home and finance that home with a mortgage. If you're paying cash nobody will force you to have title insurance, but it may be a worthwhile investment. Many hate title insurance, seeing it as a necessary evil that just increases expenses and makes attorneys more money. Title insurance is a very important tool if there is ever a question as to who really owns your house – you or some Indian tribe kicked off the land 300 years ago. The title insurers issue policies essentially guaranteeing a homebuyer is the rightful owner of a property.

Title insurance is an interesting indicator in offering clues about the stress points in the nation's housing economy. Title insurance claims can be triggered by many events; foreclosure, contractors not getting paid on work done to a property, pre-foreclosure, etc. Title insurance claims are up 52% from last year--a staggering number. The other indicator is that title searches typically happen 2-4 weeks ahead of a mortgage closing, giving the attorneys ample time to determine if the title is clean or has problems. The big title insurance companies are showing a severe slowing of new business. For the past three months the declines have been, in reverse chronological order, 9.3%, 8%, 6%. That's a 23.3% decline in just 3 months! This should be a pretty good indicator of what new mortgages should look like in the coming months, down dramatically. ☹

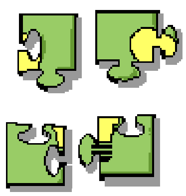
Traveling

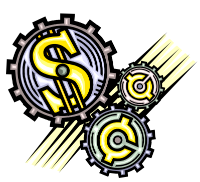
This isn't about visiting exotic physical destinations on Earth, it's about traveling through economic cultures. I see many people who started life as average, perhaps poor - and worked very, very hard and grew wealthy over many decades of blood sweat and tears. These folks had a transition of life to the higher reaches of financial success in America. I refer to these people as "acquirers" because they worked hard and earned their wealth over a long time. These people tend to see the journey through life as they raise through the economic rungs as a pleasurable, stressful or sometimes shocking transformation. This transition allows some people to experience comfort while others experience frustration. Some folks deal with this by seeking out and purchasing the most costly possessions to announce their success to the world. Others maintain a conservative lifestyle, despite their riches, and live under the radar screen. Some cherish their wealth but feel no material connection to it, it's simply a tool to reduce anxiety. Those who grew up poor or average and made their money as adults developed most of their personality as "average" children before the wealth arrived. These folks were raised with adversity and limits and learned responsibility initiative and perseverance, all of which helped lead them to where they are.

Compare this to those who grew up wealthy and eventually inherited a large estate, I call these folks the "inheritors." They feel that wealth was there before they were and their personality was developed as a child who grew up rich. Many of these people didn't have the same stresses and challenges the acquirers did because the family money was there to bail them out and they were not exposed to the same stresses. They have since built very different personality traits, strengths and coping mechanisms as they were exposed to different issues. They didn't grow up stress-free as many believe, but had different stresses, typically not economic ones. These folks have the same challenges as the acquirers do in dealing with economic and family issues today, but have such a different background and developed set of tools, how do they successfully give their children the skills necessary to cope with wealth and society? Do you talk to your children and grandchildren about money? Eventually, it's going to be their responsibility to deal with the family estate. If you don't talk to the kids about this now and on an on-going basis, you'll eventually have to hire a trustee to make the decisions for them to preserve what you have. If you'd like help in opening these doors, starting or furthering these talks, call anytime. ☺ ☺ ☺

Inspirational Quotes

- What you are will show in what you do! *Thomas A. Edison*
- Knowledge is the life of the mind, *Abu Bakr*
- The best way to predict the future is to create it, *Peter Drucker*
- All I ask is the chance to prove that money can't make me happy, *Joe E. Lewis*
- You never lose by loving. You always lose by holding back, *Barbara de Angelis*
- Love means to commit yourself without guarantee, *Anne Campbell*
- All is connected….no one thing can change by itself, *Paul Hawken*
- The artist vocation is to send light into the human heart, *George Sand*





We can piece the puzzle together and make your money work for you. ☺

Kids Korner

Tips to teach our youth about money

What economic stresses have your children had to deal with, if any? Many people grew up poor and try as hard as possible to shield their children from the same traumatic experiences, sometimes to a fault. The kids need exposure to economic challenges, stresses and realities to build the strengths and coping mechanisms necessary to deal with them. If you insulate the kids too much from economic realities, you're actually creating an environment where they will never be independent in this arena. It typically doesn't occur to people until long after the children grow up, but then it's too late. By that time they're thinking I shouldn't have raised our kids in this rich town, or I should have made them make different decisions, or I shouldn't have bailed them out of that situation. Whatever the case may be, it's never to late to start injecting some reality inot the children's lives about what it is really like in life. The earlier they develop these skills, the longer they'll have to hone them and the better they'll ultimately be for it. ☺☺☺

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Company Directory

Mike = mike@fiscalwisdom.com, phone extension 202
Eric = eric@fiscalwisdom.com, phone extension 208
Nancy = nancy@fiscalwisdom.com, phone extension 201
Maureen = maureen@fiscalwisdom.com, phone ext. 206
Betsy = betsy@fiscalwisdom.com, phone extension 203
Telephone = (860) 673 1942 or (860) 489 8880 or (800) 843 4513
Facsimile = (860) 673 5177 or (860) 482 5300

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Mike Chadwick's Money Matters

199 Main Street
Torrington, CT
06790
860 489 8880

15 New Britain Avenue
Unionville, CT
06085
860 673 1942

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