MIKE CHADWICK'S

MONEY MATTERS

ADVISING, EDUCATING & INSPIRING YOU TO A BETTER LIFE

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Financial History 101

There is a great deal of panic and fear across the globe about financial firms today. The reality is that in the history of our world, the banking business swings from periods of low risk and fiscal conservative thinking to high risk high stakes Vegas style banking. We just entered another conservative phase.

What we all know as Citibank today has a long and interesting history. In 1812 a group of merchants in NYC started the City Bank of New York. This startup filled the void left when the first bank in the US closed the year before when Congress allowed their charter to expire. In 1837 the City Bank of New York almost went under in the panic of 1837, but was bailed out by John Jacob Aster, the country's richest man at the time – a fur magnate. Mr. Aster installed his associate, Moses Taylor as a bank executive and it was built back into a sound, conservative monster bank that later bankrolled the Union through the Civil War and later easily withstood the first postwar financial panic of 1873.

From then we've had a pattern that rotates between very conservative practices with big reserves to a very aggressive stance with lots of leverage. Today Citibank is the ultimate successor of the City Bank of New York, and along the way it's consumed, swallowed and taken over many firms in it's path. In 1895 City Bank teamed up with J.P. Morgan to bail out the nearly bankrupt Federal Government. In 1914 it went international after lobbying congress to tweak its charter to allow foreign branches and became the country's biggest bank.

With this growth came again a near collapse of the bank. Big loans to Cuban sugar planters went bad, but the bank was able to repackage the debt and sell securities to the middle class to preserve itself.

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INSIDE THIS ISSUE

A Bullish Signal

We've all heard about the bulls and the bears and I'm not talking about the animals but the types of financial markets in our world. Why are the financial markets referred to as bull and bear markets anyway? The bull market is one that is rising while a bear market is one that is sinking. The origins of the terms are not universally agreed upon, but here are a few explanations. The bear markets origin comes from the saying don't sell the bearskin before you've caught the bear. This is from back in the day when jobbers would kill bears and sell their skins, but many were infamous for selling skins they didn't yet own since the bear hadn't yet been caught and killed. Another explanation is how the animal attacks it's prey, bears typically swipe down with their massive paws and claws to kill their prey, similar to a downward trending market.

The bull market, one that is rising on a consistent basis is characterized by optimism and expectations that positive outcomes will continue for some time. The bull terms origin can be traced to the fitting alter ego of the bear, the way a bull attacks it's target, with an upward approach that is the opposite of the way the bear attacks. Bulls also tend to help in a herd and if a strong bull is going one way, the other animals tend to follow. Just as the bulls charge in Spain each year, the markets charge ahead when people are feeling optimistic.

The last year has been the most powerful bear market most of this generation has seen. Now that we're in the midst of it people are fearful, operating in a realm of emotion and not logic. This isn't the time to be emotional. It's the time to be opportunistic because this environment has created opportunities we likely won't see again for a generation. The key is not to be paralyzed by the current emotion of the day.

The herd mentality that the bear and bull markets symbolize go much further beyond the animal world than most people would ever think. People behave very much the same way animals do, based on the mood of the day and what others are doing around them. This is the main reason people are poor investors, most people have a difficult time fighting the tide and doing their own thing. It's easier to just go with the flow,

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In 1921 City was turned into a financial supermarket, offering much more than traditional banking. When financial assets turned "toxic" (it's amazing how history repeats itself as the assets today are described as toxic) in the 1930's The Glass-Steagall Act of 1933 put an end to the financial supermarket model. City lived on as a smaller, healthy bank.

As the decades passed City remained conservative and Government bonds were the main investment for the bank, until the 1950's when a new aggressive era of growth took over. This growth boom was mostly international and the "y" in City was replaced with the "I" to get what we know now as Citi. In the 1980's Citi was struggling with billions of dollars in bad loans to Latin American clients. Citi survived to fight another day by profits generated from the credit card and U.S. retail banking sides of the business – plus some cash from Saudi Arabia. Is this process beginning to sound familiar?

In 1988 Citi "merged" with The Travelers and The Glass-Steagall Act was repealed by Congress creating the largest financial superstore in the world. Fast forward to 2009 and Citi has had life support injections to the tune of $45Billion from the dim bulbs in Washington. The newest challenge for lawmakers will be to create laws to prevent the madness we've seen in the past six months and to preserve the entrepreneurial system that is America. Will it put a new Chinese wall such as Glass-Steagall back in place where each type of business must stay within its core competency and not go into ancillary businesses? It may come to that. AIG wouldn't be on life support had it not been for its "financial products" unit in London trading credit default swaps that were off balance sheet items.

The reality is the banking dilemma we have today isn't new and we've been here before. The global landscape we have today is new, where virtually each and every country is intertwined economically and politically. The balance must come between keeping the banking sector healthy, making risk reasonable, tying executive compensation to long-term financial results of company performance and avoid at all costs a repeat of the excesses that caused this fiasco.

The economic, political or financial systems aren't perfect and never will be. Now that we're so deep in the fear cycle today people cannot see what down the road. We will shortly come to a place where the global financial system stabilizes and volatility is back to normal levels. Hopefully the governments of the world will agree to reasonable rules that put financial interests of corporate leaders in line with the rest of us and severely punish those who get out of line.

The recently changed FASB 157 or "mark to market accounting rules", which we've been harping on for over a year now make this a whole new ballgame. Companies will now have some leniency in valuing assets that they plan on holding for a long time, and should experience amazing write-ups in the coming years. Many of the write-downs we've witnessed over the past few years were warranted, but many were not. This easing of the rules for financial firms will show amazing write-ups where the write-downs weren't justified. ☺

Pressure Cooker

Jobs are a hot asset these days with so many people losing them. Stress to do a good job at work and show your value and willingness to do whatever needs to be done has never been higher. Unemployment hit 8.5% today, April 3rd 2009, the highest level in decades. In the investment business there is no difference in stress, especially in these illogical markets, but some firms are making things just outrageous for their employees. Since investments go in cycles, most firms judge a money manager over a 4-5 + year period to see if (s)he did a fine job or a poor job of handling the resources they were so graciously entrusted with. Some firms don't share that wisdom and the annual or quarterly number is the gauge by which employees are measured and also by which they may keep or lose their job.

Firms where the investment manager or management team owns the business obviously have nothing to worry about since they aren't going to fire themselves. ☺ That ownership structure is the minority of firms and employees in the money management business out there. Some of the giants of the investment world are putting the money managers under unrealistic expectations, forcing them to worry about short-term performance to attempt to reach a certain quarterly or annual goal to keep their job. As if we don't have enough to sift through today just sorting through all of the information and opportunities that have presented themselves in the past year or so, now some must worry about their quarterly performance figures to ensure employment. That is nuts! When going for these short-term performance metrics to preserve their jobs, they are often forced to do what will hurt long-term performance and ultimately hurt shareholders. Since investments change in value so frequently most investment buy and sell decisions are made on a 3-5 year time horizon if such management pressures don't exist. As long as things pan out in that 3-5 year time frame, everyone is happy.

Hoping for returns on a quarter by quarter or annual basis just isn't reality, especially in extremely volatile times like today. Firms that are placing unrealistic expectations on management will hurt shareholders over the long-term in an effort to show short-term positive results. 2008 was a blood bath of a year in the investment business; almost everyone had losses last year. Good for 2008 would be not getting hammered and losing 20%-50% of your balance. The few positive performance aspects of 2008 were US Treasuries, futures, and ultra-conservative bond portfolios.

For the rest of the planet who lost substantially in 2008, now fund giant Fidelity is ousting a lot of managers who had a bad year last year. If 2008 is the measuring stick, I think most of the investment business will be out of a job. This is very important for shareholders to know about and watch because it shows how short-sighted a firm can be. Not the best decision, but a very important metric to know about. ☺

Noteworthy News! ! !

- Congratulations to Rich Croteau on the purchase of his new home in Raleigh, NC! He's now close to his grandbabies full time! ☺
- Our congratulations to the Leight family on the birth of baby Noah Ryan! ☺ Elaine's first grandbaby – do you think the baby will get spoiled? ☺

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Write Down Folly

The past year will go down in financial history without question. The write downs effecting companies are not all created equal, some write downs cause structural problems to a firm while others are simply one time accounting issues that aren't all that material in the long run. For many firms, the write downs they've had to take in the past year make them appear to be no longer profitable and the market has discounted them as if they're going under. This is the furthest thing from the truth. Let's take a simple business like a restaurant chain. Most have taken write downs in the past year for the value of their real estate and good will. If the chain makes $1.00/share they're worth about $15.00 based on historical standards. They continue to feed people and continue to be profitable. Since the write downs were much larger than their annual earnings, maybe $2-$3/share, they seem to be running a current deficit this year and are bad businesses. This isn't true as the write downs of this nature are likely one time events and once we pass into the next fiscal year, earnings won't have any more negative issues attached to them dragging them down. Even if earnings are lower than they were in 2007 once they come out in 2009 due to the recession, they're likely going to be positive. Let's say the business earns .80 cents a share in 2010 and at historical price levels, the company is worth $12.00/share. If such shares can be now had for $1.00 - $5.00, which is where many of these firms now are, they represent extreme opportunity – to multiply your money up to tenfold! ☺

Many firms have been sold off to such a degree the market assumes they're going to go out of business. Most businesses will survive this chaotic time. For those who know where to be invested and how to tell the difference, there is a mint to be made. If the write downs are indeed structural and will cause the firm to cease operations, that's a whole different ball game. Detroit's issues are real and won't go away without major restructuring, which seems to be unfolding. Bond holders, taxpayers and shareholders are likely to be left holding a partially empty bad on these deals, here write downs are real and not temporary. ☹

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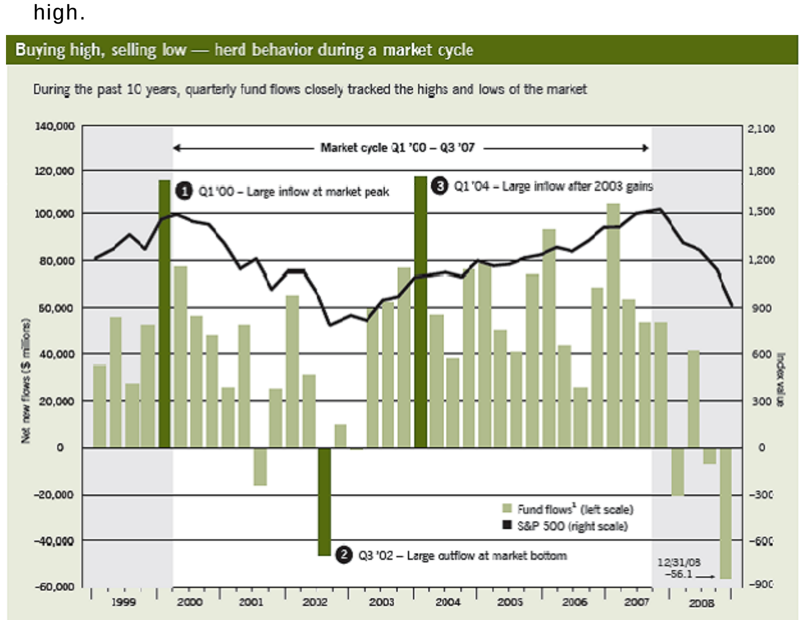
but the flow may not be very profitable over the long-term.

This is proven in how the general public behaves with their financial decisions and when. Studies prove that even though the general market, as measured by the S&P 500, grows substantially over time, the average investor misses most of the gains. Over a 17 year period ending in March 2002, in the midst of the last bear market the market averaged a wonderful gain, but the average investor didn't even earn a third of what the market produced! Here is the data:

Data	Annualized Return 1984 - 2002
S & P 500 Index	14.3%
Average Retail Investor	4.2%

This data is compiled from Dalbar & The Bogle Financial Markets Research Center. The logical question is why the huge discrepancy. This is due to timing – people often buy when things seem safe, not when the markets are at low levels, and actually are safe, like they are today. When they're low, people tend to sell because they're fearful even though markets are safe, people act emotionally not logically.

Further proving the behavior of the average investor we see fund flows when the market is strong vs. fund flows when the market is weak. We all know to make money on investing you must buy low and sell high. The reality is most people buy high and sell low, losing money or at least not making anywhere near what is possible because of poor behavior that harms outcomes. This is what earns the average investor 4% return over time while the market cooks along at triple that pace. Today we're very low and people are net selling investments. The pain in the trend continues. ☹ Look at this chart and see people put more money in money markets when the stock market is low and less when it's high.



Money Quiz

Eric Larson won last month's quiz. To be in the top 1% of US Taxpayers an individual must earn $388,806. Eric wins lunch/dinner on us at Chili's. ☺

This month's challenge is to tell me what nervous folks do. Tell me how much Americans have added to savings accounts from 1/1/09 – 3/9/09, a time when markets are at least 50% off their highs? The winner will enjoy lunch/dinner on us at Chili's. 033009:6☺

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Banking Guidelines

The dim bulbs in Washington are currently putting the 19 largest banks in the nation through a "stress test" to see how they'll fare assuming the worst possible economic situation. I think we've already lived through an awful economic situation and things are likely on the mend now. The results of this test will be out late this month or early in May. This is a great idea, even though many banks have already gone through their own internal stress tests, and most of them are performing just fine. Even the big boys, thought to be in the most trouble, are profitable in January & February this year. It would have made a lot more sense to do this months ago, when it seemed like all financial firms were under pressure and the bond market was permanently broken. Many banks are now repaying the TARP program to get the government out of their lives.

The rules and regulations are complicated and full in loopholes. The system ensures that during tough times, like now, banks need enough reserves so that they can survive worst case scenarios. The system also has allowed everyone to get into everyone else's business, with regulators not communicating. Will this cause a new set of laws to once again separate financial firms? It may and it may make sense to do it. The current capital reserve model prohibits the banks from lending when under economic pressure and asset valuations are artificially down. The recently eased accounting rules, FASB 157, will provide a whole lot more freedom for banks, insurers and other financial firms to use in valuing assets. These asset valuations under the old rules were mostly much too artificially depressed, especially since there is virtually no market for many of the current assets with the "toxic" label. Even these supposed toxic assets will have buyers once a market is created, and the challenge will be to talk holders into selling, because virtually everyone knows the assets are worth more than current appraisals suggest. Let's see how it plays out! ☺

Too Much Too Often

People are paying too much attention to the financial news and their associated appraisals lately with the media having nothing else to talk about. Of course the value of your assets is indeed very important but the price movements today are simply out of control and people are judging success and failure every other day. Lately prices are fluctuating by 20%-50% daily and that's just not reality over the long run. When you make investments in stocks or bonds or mutual funds or ETFs they're typically in some way related to a business. Stocks are ownership in business and bonds are loans to a business or other entity. When making these decisions don't think about stocks or bonds, think about the businesses that underly these assets. If you happen to own a business you approach your business totally differently simply because you don't know the value of it on a real-time basis.

Let's look at the investment process through the eyes of a local business person and try to adjust your lens to take this view. This example will use the local auto repair shop. The owner of the business owns the tools, building, lifts, furniture, parts inventory, bank accounts, etc. She is also liable for the bills such as mortgages, loan payments, taxes, environmental issues and utilities, etc. The business has a value but to get it you must hire a firm to appraise the business. If you buy a business you're buying the whole business and will get this appraisal done or request the seller to get it done. This will cost anywhere from a few thousand dollars to tens of thousands of dollars depending on the size and complexity of the business. The reality is most business people don't know what their business is worth on a daily basis nor do they care. They can guesstimate the values, but there is no real certainty there. Similar to every one of us with our homes, we can guess the value based on what the home next door or down the road sold for, but nothing is for sure. People don't often get the business or the house appraised. Typically there are only a few life triggering events that will cause the appraisal – the purchase or sale, the refinancing, estate planning or gifting and tax assessments. Otherwise, values are a moot point because the business keeps on keeping on and life continues.

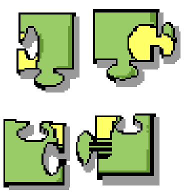
When it comes to investments on paper it's a whole different ball game. People check the values every month when the statements come in, each week, day or hour online. They look too often at the values of the assets they own. There's nothing wrong with looking at the values of the assets, as long as you don't act emotionally out of the data, especially in an environment like we have today where emotions are running high. Most people hold financial assets for their whole lives, this may be 10, 20 or 80 years. The value of the assets day to day just doesn't matter as long as what you own are solid firms that will pass through the tough times we're currently in. These tough times also present opportunities because the market is emotional in the short-term and logical in the long run. Many firms have been beaten down to levels where you can now make 5 – 10 times your money over time if you know where to invest.

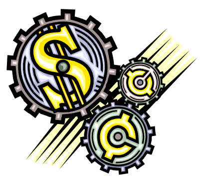
Think about this in terms of a road trip. If you were to travel from Connecticut to California by car and I asked you to tell me how many miles the trip was, you'd likely say sure. What if I handed you a ruler and asked you to use that as your measuring device? You'd think I was a sick pup and tell me to go pound sand and deservedly so. This insanity of measuring a cross country trip with a ruler is no different than measuring the value of a business each month, week, day or hour when you'll own that business for decades.

It's all perspective. The lens you look through dictates your success in the process. ☺ ☺ ☺

Inspirational Quotes

- *Hell hath no fury like a bureaucrat scorned,* Milton Friedman
- *When you are through changing, you are through,* Bruce Barton
- *Small opportunities are often the beginning of great enterprises,* Demosthenis
- *The quarrels of lovers are the renewal of love,* Jean Racine
- *There is no beauty but the beauty of action,* proverb





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

Kids Korner

Thanks to all who came to the Easter egg hunt in March, we had around 300 people searching for 12,000 eggs and they cleaned up the entire yard in about 30 minutes. I typically only find one or two eggs all year long so great job to all the hunters! ☺ The bunny store was also cleaned out in minutes after the hunters collected their loot! We look forward to a bigger party next year. Keep your eyes open for the details that'll be forthcoming in January.

Make sure your kids know how to make change when making a purchase. We play a game where I ask the rugrats if I pay for an item with a $20 bill and the item cost $7.14, how much change am I due? They love the game, can do the math in their head, and will always know how to make correct change if they ever have a job in a cashiering role. They also know how much to expect in change when they're making purchases. Priceless! ☺ ☺ ☺

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, (860) 489 8880, (800) 843 4513
Facsimile = (860) 673 5177 or (860) 482 5300

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Mike Chadwick's Money Matters

15 New Britain Avenue
Unionville, CT 06085
(860) 673 1942

199 Main Street
Torrington, CT 06790
(860) 489 8880

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