MIKE CHADWICK'S

MONEY MATTERS

ADVISING, EDUCATING & INSPIRING YOU TO A BETTER LIFE

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New Mortgage Rules

The last six months of events in the real estate business have been long coming. We've been telling people for years now that real estate valuations are through the roof and need to deflate to get back in touch with reality. It's happening, but slower than expected. Here in Connecticut we see a lagging trend behind the rest of the nation. What is going on in Boston, California, Florida & Arizona will be here, but likely not for a few years. The banks have taken record losses on mortgage loans that went to foreclosure, and that has forced them to rewrite their mortgage rules to be more stringent: the result has been a dramatic reduction in the availability of credit. It was competition that spurred many companies to ease their loan underwriting rules and that is what ultimately put us in the pickle we're currently in.

Remember the basic financial tenet: don't buy a house as an investment, buy it as a lifestyle decision. Real estate can be an investment if you're buying rental properties, commercial space, raw land etc. But for most of us the single family homes we live in will not make us any money over a lifetime. Some will argue that they only paid $50,000 *x* years ago and the house is worth $350,000 now (in inflated dollars). That sounds fine but is really selective amnesia. Add up what you paid in maintenance, improvements, repairs, taxes and insurance in that property over the past thirty years you've owned it and then tell me how much money you've made: likely +/- 1% will be your overall long-term rate of return. That's what it is always is: I've done these calculations for thousands of people. If the house were an amazing

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Inside This Issue

House vs. Corporation

Money is money and all involved with the economy should treat money equally, but that doesn't happen. Business (Corporation) tends to treat money in ways that are good for capital and shareholders, not wasteful and foolhardy, with the exceptions of excessive executive compensation). Households (mom & pop, the people who head all of the households in America) tend to treat money as a consumption element that is good for lifestyle and nothing else – especially not long-term financial stewardship. This is the mistake made by most consumers, they're not treating the money they earn as a business, they're just using it to live day to day. To be financially successful long-term you need to follow some basic principles that businesses follow: this will lead to long-term financial bliss. Failure to follow such principles will lead to long-term frustration and a slew of other issues that come along with it such as stress, health issues, perhaps divorce of family collapse.

The first financial tenant is to protect your assets. For most of you your most valuable asset is your ability to earn an income, then protect your family and physical assets. Now you should live below your means, don't spend more than you make after all of the living expenses have been met. After you've made this decision you'll find excess money in the checkbook each and every month – this is most easily accomplished by not buying too much house or too fancy cars, etc. As this happens devise an investment strategy to begin saving and investing, pay yourself first as the saying goes. This plan should provide for long-term savings for retirement and college for the rugrats as well as liquid instruments for short term use – cars, emergencies, etc. You need to earn a positive return of at least 3.1% after tax (that's really 0% return inflation

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investment wouldn't banks keep them all? Of course they would and in today's world where millions are getting foreclosed the banks would be scooping them up, but instead the banks are struggling to get out from under them.

Fannie Mae & Freddie Mac buy loans, 'securitize' them, and sell them to investors. But their criteria have recently strengthened: now the borrower must have a minimum FICO credit score of 580. Previously there was no minimum credit score required--they'd take the loan if your credit was 100 (having a credit score of 100 doesn't make you an "A" risk, it makes you untouchable). In credit terms 850 is the top FICO score! ☺

Another change to Fannie & Freddie mortgage rules is a uniform code of appraisals which will be implemented January 1st. This is intended to put a "Chinese wall" between the lender and the appraiser. Lenders will not be allowed to use appraisals from their own employees or from companies they own or control. It is viewed by regulators that the relationships between those two parties gets too tight and appraisers can be pressured into inflating property values to continue to get business from lenders (duh, really?). Appraisers insist that they'd lose their business and licenses if they were to inflate appraisals. I'm sure most appraisers are great people, but as with anything else in our world, one bonehead ruins it for the bulk who are good, so welcome to the new rules.

The subprime arena has already been changed: those loans are not being written at the pace they were just six months ago and many firms have suspended them altogether. Many small regional banks that were pushing these loans are either out of business or close to being out, looking for suitors to buy them up to take them out of their current troubles.

This all translates into a very interesting scenario. Many buyers who shouldn't have been granted a mortgage in the first place are now out of the real estate market entirely. That is okay, not everyone should be a homeowner – many should be renting while they save a down payment, and many more would be better off if they rented instead of owned. For those who should own, it's now more expensive to buy a home, requires better credit, more money down and overall better financial positions. Home prices are falling: the beginning of what I expect to be a long downward spiral locally. Whenever a bubble over-inflates the air has to finally get out – now is the time for that air to leak out of this bubble.

Bubble Mechanics

The bubble my rugrats think about involve blowing air into a wad of gum or dish detergent mixed with water. We hear about investment bubbles endlessly lately, the most recent in real estate. Let's look at how an investment bubble develops.

In the first stage and overlooked or underappreciated asset class produces wonderful returns for some period of time. Next capital flows into this arena as it becomes known for higher returns. After that participants increase leverage (borrow money to invest) and reduce quality standards (lower underwriting standards in mortgages) because they believe current levels of high returns are infinite and deserve such slack. Lastly, the combination of lower quality, higher prices and leverage proves toxic and the majority of participants lose big, especially those who came in during the latter part of the buildup.

As investors we've seen this happen countless times and this time is no different. Hundreds of years ago it was the Tulip craze. In the past 20 years we've seen five bubbles. In the 198's the leveraged buyout junk bond craze ended up with the demise of Drexel Burnham Lambert. It also put Michael Milken in jail for a Ponzi scheme of junk bonds. In the early 1990's commercial real estate was the darling and that led to the S&L collapse and the closing of the Bank of New England and many others. In the mid 90's the Russian bond default triggered the emerging markets debt crisis culminating with the closure of Long Term Capital Management. The late 90's gave us the dot bomb fiasco and the internet meltdown –more companies closed than stayed open and the NASDAQ lost almost 80% of it's value. Today we have the real estate/mortgage dilemma and Bear Sterns is history – it may not be the only casualty of this battle.

The current bubble showed real estate prices dropping across he country in 2007. This is second time on record this has ever happened with the first being in 1941. We need to be realistic in our approach to investing today. Things seem ultra pessimistic in the general media today, but that's not fair. Others argue things are economically wonderful and there are no problems, that's not fair either because some industries and consumers are in tough times. We need to realistically asses our position and move on, calculating the risks and options on both sides of the argument.

By the time the media says we're on our way to recovery, we'll have already had six months of wonderful appreciation so now is the time to make financial moves that will pay off well in the coming years. Call anytime to discuss this further! ☺

Noteworthy News! ! !

- Congratulations to Scott & Jessica Geddes on the birth of their daughter Kali Jade! ☺ Rugrat # 1!
- Congratulations to Liz Wilcox on her new job! ☺
- Congratulations to Rick & Kari Bradshaw on the finally successful adoption of their son Mason from Russia! This was a long, tough road, but certainly worth it! ☺
- Congratulations to Jennifer & Mike Chandonnet on the birth of their first child, Zachery! ☺
- Congratulations to Bob & Cricket Rimbach on the birth of their grandson, Zachery Chandonnet, grandbaby # 4! ☺

The Patriot Act

We often overlook what the government is doing to protect us from terrorism and fraud, but the Patriot Act is a far-reaching set of laws designed to do just that. The Act forces us in the financial industry to become an involuntary part of the police force in monitoring cash flows.

The Act covers many things from holding suspected terrorists without trial, intercepting communications, money laundering and national border security. Where we see its impact directly on a constant basis is in how you are allowed to make deposits to your investment accounts. The Act specifically disallows us to take from you cashier checks in amounts less than $10,000 for deposit into your investment accounts. Why? These checks are not tracked by banks so the fear is terrorists or money launderers will be shuffling the loot around undetected. We'd like to think that it doesn't happen here as we know all of you well – please don't prove my ability to judge character wrong! ☺

I have zero control over this and never mean to cause you any hassle or frustration, but the overall intent of the law is good and I have no means of bypassing it. When you make deposits to your accounts, you never need to send us cashiers checks: we can always accept checks from your personal or business accounts (as long as they're not starter checks, another snag of the Patriot Act).

Please make a note of this for future reference as it saddens me to see you have to work hard to make investments. Investing should be a fun and painless activity you can partake as often as you'd like. You can also save $5 by using a personal or business check instead of a bank cashier check! ☺

House vs. Corp. *Continued from page 1*

adjusted) to truly increase your purchasing power over time. A decade of this process will lead to your household being capitalized and never having financial worries again. While living your life with this mentality you shouldn't have any debts except for mortgages and student loans – good debts. I define good debts as those with low interest rates, fixed rate and preferably tax-deductible debts. Some other debt can be good – a 1.9% car loan or a 0% credit card balance are great debts too. Don't pay good debt off any quicker than required by the terms of the loan. Think about each purchase you make carefully before making it and don't buy things you cannot afford – don't use loans except for big ticket items such as homes, cars, educations. Keep even those purchases moderate, don't buy as much as the lenders will allow you to and don't buy for status. I define status as buying things you cannot afford to impress people you don't care about!

Now you're on your way to fiscal freedom. This is improving your balance sheet (more assets, less debt) exactly as corporate America has done over the past five years. As a result of good fiscal stewardship the corporations have passed record profits to shareholders. This trend will continue over the long-term for well-run companies. Many companies are not well-run and they used leverage to buy assets that we're now finding out are close to worthless. Hedge Funds have used leverage as high as 98.54% - that means they only put in $1.46 of their own money for each $100 in assets they bought – this is massive leverage, never advisable, and is why so many have closed their doors lately.

As we live through the popping of the real estate bubble and this recession (I think we're already there folks) corporations are in much better shape than they were in the last one, but consumers are in worse shape. Corporations have much less debt and much more cash but consumers have much more debt and much less cash.

The economy, business and government will now struggle to shift their focus away from real estate and into infrastructure improvement, updated energy consumption/creation platforms, health care improvements and other pursuits that are more productive than ever more square footage for fewer people on smaller lots! The past 10 years has seen GDP growth between 3-7% from residential housing. Moving forward we'll likely see 2-4% of GDP growth forfeited from housing: this is not a big deal. Most of the world has already been focusing on other, more worthwhile pursuits and global economic growth has been strong.

I expect the same in America as the next few years unwind! ☺

Money Quiz

Last month's quiz was won by Rebecca Rebillard. 28% of Americans save at least 10% of their income. ☺☺ ☺

This month's March Madness related challenge is to tell me what each win the NCAA Basketball tournament is worth to the winning team in $? The winner will enjoy dinner on us at Chili's. BTN 033108

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Taxing Comedy

As April 15th rapidly approaches us, here is some humor at the expense of Uncle Sam and related Federal agencies and employees! ☺

- April 15th is the day you get to deal with two of your favorite federal agencies - the IRS & the US Postal Service – you might as well make a day out of it and go to the Motor Vehicle as well! ☺
- What do you get when you put the & IRS together? TheIRS!
- The IRS has a new slogan – "We've got what it takes to take what you've got!"
- The Post office just recalled their most recent stamps – there was a picture of an IRS agent on one side and consumers weren't sure which side to spit on!
- How are an apple and an IRS agent alike? They both look good hanging from a tree!
- What did the terrorist that hijacked a jumbo jet full of IRS agents do? He threatened to release one every hour if his demands were not met!
- What do you call 25 IRS agents buried up to their chins in cement? Insufficient cement!
- What do you throw to a drowning IRS agent? His coworkers!
- What's brown and looks really good on an IRS agent? A Doberman!

  I don't care who you are, that's funny. I must say the IRS has been a pleasure to work with every time we have to – it takes a while to get a person on the phone, but when you do they're always very professional and helpful – they don't deserve the evil reputation they have!

Fear & Greed

The way successful investors work is to be greedy when others are fearful and fearful when others are greedy. Today the bulk of the population clearly is fearful. This is an opportunity to make some real profits if you can look beyond the news – all of which is painfully depressing of late. The mortgage crisis, like every other financial issue we've had in the history of the world, will pass.

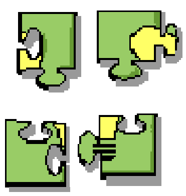
Investors have lived through various economic maladies and issues in the past – many worse than today's issues. These troubles have included: bear markets; wars; double-digit inflation; double-digit unemployment; political scandals; stock market crashes; the Great Depression; NASDAQ bubble; September 11th; oil shortages; Savings & Loan meltdown… the list goes on and on. Even after all of these issues, if you were a consistent equity investor and stayed the course, you made over 10% annually by simply buying into an index, which isn't opportunistic as we are.

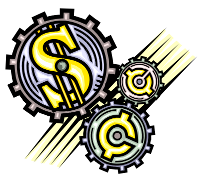
Today's world of fear presents amazing opportunities for us to make profits. Profits are made now, but they're not realized for some time – perhaps months or years when the fear leaves and people again begin thinking clearly and pricing businesses accordingly. Right now the financial sector has been decimated by the current fiasco in the real estate, mortgage and credit markets. As this process continues to unfold, which will likely take up to a year or two, many companies will fold or be swallowed alive just like Bear Sterns. Many other firms will use such opportunities to take additional market share and profitably grow their franchises. On a local level this very thing is happening. F&S Oil closed its doors in Waterbury and most local oil dealers are scrambling to acquire its customers. Some of those oil dealers will be very successful in making their businesses grow exponentially faster than if F&S Oil was still a going concern.

One investor's loss is another's gain and there is no difference between what's happening at a local level in the oil business and what's happening at a global level in big business that trade on the stock exchanges. Are you currently scared or opportunistic? Call to discuss this or anything else anytime! ☺

Inspirational Quotes

- Discontent is the first necessity to progress, *Thomas Edison*
- Action is the foundational key to all success, *Pablo Picasso*
- "I can't do it" never yet accomplished anything; "I will try" has performed wonders, *George P. Burnham*
- Start by doing what is necessary, then what's possible, and suddenly you are doing the impossible, *Francis of Assisi*
- To accomplish great things, we must not only act, but also dream, not only plan, but also believe, *Anatole France*





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

Kids Korner

Who's Change?

Here is a great idea to see the behavior of children change based on what money they are spending. When you go out somewhere give your child some money to go and buy whatever (s)he wants at that particular venue. Tell them the first time out you want your change back and see how much you get. Next time in the same setting at the same place tell them they can keep the change and see how they shop differently. I'm guessing they'll use much less of your money when they can keep the change – see if it works! We're currently in testing here too, I'll let you know how it works out.

Thanks to everyone who came to the Easter egg hunt. We had about 250 people there and everyone had fun. If you have any pictures, please email them to us! ☺ ☺

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