MIKE CHADWICK'S

MONEY MATTERS

ADVISING, EDUCATING & INSPIRING YOU TO A BETTER LIFE

Volume 6, Issue 8 Advising, educating and inspiring you to a better life August 2008

Drop Your Shorts!

Now don't take me literally and tell your rugrat to moon someone from the school bus. I'm talking about short sales of stock here. Short selling involves borrowing shares of stock, immediately selling those shares at the current market prices, and then, hopefully, buying the stock at a later date at a lower price. The difference in sale vs. buy price is your profit, or loss, depending on which way the stock price has moved since the original short sale. The lender expects the shares to be returned by a specified date, and is compensated during the lending period. The biggest risk to investors involved in short selling is they are selling shares they have borrowed and must replace them later at a price that cannot be known in advance.

There are two types of short sale. The first is known as 'covered' ('against the box') and the other is 'naked.' Covered short sales means you already own the stock that you're going to short, but you don't want to liquidate your own shares (in case the price goes up), so you borrow somebody else's shares instead. The benefit of this strategy is that you already own the shares that you are obligated to return to the lender: they are sitting in your own account (i.e. 'the box'). Otherwise you could find yourself in the position of being obligated to return shares to the lender but you may not be able to buy them in the open market. This results in the other type of short sale known as 'naked': you do not own the shares that you sold short, nor have you arranged to borrow or buy the shares for delivery to the lender at the specified date.

There are firms that specialize in short sales and profit handsomely from such activity. For most large, publicly-traded stocks there is typically a small percentage of short interest in the stock: most investors are in 'long' positions (they buy shares today and hope the price will go up in the future, not down).

Continued on page 2, Drop Your Shorts

Inside This Issue

Retirement Math

Most people think that math is math -- addition, subtraction, multiplication, division… it's all the same and works out no matter how you do it, as long as it's performed in the proper order. For basic math problems that is true, but for taking a pile of money and turning it into an income stream, it is the furthest thing from the truth. Retirement math doesn't work like that at all – there are a whole different set of rules for retirement math that must be taught and observed.

The first rule of retirement math is to protect your principal! If you're in retirement and taking a weekly, monthly or quarterly income from your assets losing a large percentage of your account in a short time can cost you your future. Let's look at the math of losing and making money, starting with a $100,000 lump sum in the beginning.

Original Investment	% Loss	Value of Account	Gain Needed to Breakeven
$100,000	-7%	$93,000	7.53%
$100,000	-10%	$90,000	11.11%
$100,000	-15%	$85,000	17.65%
$100,000	-20%	$80,000	25.00%
$100,000	-25%	$75,000	33.33%
$100,000	-40%	$60,000	66.67%
$100,000	-50%	$50,000	100.00%
$100,000	-70%	$30,000	233.33%
$100,000	-90%	$10,000	900.00%

Continued on page 3, Retirement Math

Drop Your Shorts *Continued from page 1*

The financial system needs short sales to maintain a system of checks and balances together where "irrational exuberance" is kept to a minimum. In theory anyway, even with short selling traders tend to get both too optimistic driving prices too high and then too pessimistic, driving prices too low.

Behind the scenes, the Broker/Dealer of the firm you're trading account is held at is required to either borrow the shares of stock being shorted from another account or enter into an agreement to borrow those shares. The investor sees none of this as (s)he presses buttons to buy and sell or short shares of stock. There is an exception to the short rule for Broker/Dealers that allows them to skip this step if they "reasonably believe" the shares can be borrowed. This is where the current SEC belief is that short sellers are manipulating the markets in financial stocks and running "distort and short" trades. A distort and short trade is a series of trades that are designed to run a stock price down, quickly and far. These are valid legal trades typically made by large institutional traders and hedge funds. The fear is that stock prices will be pushed too low because of this hole in the rules.

The SEC now believes that because people's wills are fragile in today's environment, the potential for this rule to be exploited, and the need to make things fair across the board, they've decided to limit short selling in 19 "special" financial firms. You can still short these firms, but you cannot do a naked short without the shares already borrowed or have a contract to borrow the shares. Here is the list of the 19 financial firms believed to be sacred and the country they are from:

Firm Name	Country of Corporate Headquarters
Bank of America	USA
Barclays	U.K.
Citigroup	USA
Credit Suisse	Switzerland
Deutsche Bank	Germany
Allianz Holding	Germany
Goldman Sachs	USA
Royal Bank of Scotland	U.K.
HSBC Holdings	U.K.
J.P. Morgan Chase	USA
Lehman Brothers	USA
Merrill Lynch	USA
Mizuho Financial	Japan
Morgan Stanley	USA
UBS	Switzerland
Freddie Mac	USA
Fannie Mae	USA
BNP Paribas Securities	France
Daiwa Securities	Japan

Many bankers associations now fear that short sellers will begin targeting banks not covered in the new rules. Short sellers will always be here and they play a vital role in the markets. If the stock isn't overpriced, short sellers won't be looking at it. The key here is not to own businesses so overpriced that short sellers are circling as vultures would a carcass in the jungle! ☺

The US Home Fallacy

As a country we need to change the mentality of seemingly forced home ownership. It seems as though everyone in the country believes we should all own homes, regardless of our economic position. About 65% of the U.S. population are home owners -- the highest level ever and over 10% higher than just ten years ago. The reality of the situation is that we should not all own homes, and a larger and larger piece of the population doesn't want to own a home any longer. For older people, single parents, those that are not "handy" home ownership is often a burden. It's easier to just pay the rent and when something breaks, call the landlord and they handle a new furnace, new roof or new windows.

The country is currently hardwired to give everyone a home – this is absolute stupidity! The argument is that a mortgage is often just a tad more than renting. I agree with that on the surface but the second something goes wrong, homeownership now costs thousands or tens of thousands of dollars when renting costs a phone call. If you can barely afford the rent, you certainly cannot afford the home.

Lenders have relaxed underwriting standards in recent years and the government has incentivized behaviors that we're all paying for now. The current real estate mess will likely take 5 years to unwind as the inventory of homes is far in excess of what we'll need for a long time. The government is guilty here. When FDIC has taken over banks in the past it was responsible for writing $550 million of sub-prime loans at over 12%, all with FDIC employees okaying the transactions. The past and current bailouts of the sub-prime mortgages are just delaying the inevitable. Those who cannot afford a home unless everything is going just right may not lose their home today, but they'll lose it in a few years when something else "comes up."

Fannie Mae & Freddie Mac are working vigorously to postpone many foreclosures. New loan servicing agreements allow Fannie & Freddie to pay correspondent firms (banks or loan servicing companies) $800 to avoid foreclosures, up from $400. Freddie & Fannie have also increased the amount they pay for correspondents to arrange short sales of homes to $2,200 from $1,100. If borrowers default on loans, Freddie & Fannie have to pay the investors. These firms used to buy investors' problem loans after they became 120 days past due – now they can wait 24 months before doing so! They're also offering $15,000 loans to help people who have fallen behind on mortgages – let's give more debt to someone who cannot afford their current debt! ☹ (who comes up with these ideas? – they're getting paid for this!).

These measures mostly won't prevent the upcoming foreclosures, but they certainly can postpone them, which will just cause the wound to slow bleed for more years prior to healing. I'd rather see it gush out now and begin healing immediately but that isn't how government works today, especially in an election year. ☺

Noteworthy News! ! !

- Our condolences to Lee Rho on the passing of her father, a wonderful man, father, grandfather, husband and friend.
- Congratulations to Fran Cassullo on his recent retirement! ☺

~~~

Depression Suppression

Pundits are comparing the economic environment today to that of the Great Depression – what a joke! The government intervention today won't allow too much to go wrong, they won't even let those who should lose their homes lose their homes. The reality is things are quite good and the economy amazingly strong.

Here is what was going on in the late roaring 1920's and early 1930's that was the reality of the Great Depression. In 1933 unemployment was 25% of the population and it averaged 18% for the decade of the 1930's. It is currently at 5.7% - a far cry from what would be called depression levels. From 1929 – 1933 40% of U.S. banks failed. Today we have less than ten bank failures year to date with over 8,500 recognized banks: that equates to a bank failure ratio of less than .01% -- that's less than 1/10th of a percent – another joke. During the Great Depression wholesale prices dropped 33%, today we see prices rising on everything except homes and vehicles that are fuel inefficient.

Today's economy is strong, despite the grenades that have been thrown at it. We have record high energy prices, housing implosion, mortgage failures, issues with construction, real estate, airlines and mortgage banking to go along with global politics and nut cases running some volatile countries. Despite all of these issues, corporate profits continue to rank at historical highs of $1.5 trillion annually. The real culprit of the great depression was a passive Federal Reserve, today's Fed under Chairman Bernanke is anything but reserved – they're shooting with all bullets and aren't afraid to use more.

There is nothing to fear and hopefully when the dust settles the Fed will raise rates about 2% to where they should have been all along: that would have prevented a lot of the current mess. ☺

Retirement Math

Continued from page 1

As you can see, the difference in what you have to earn to recoup a loss is very different than what most people believe to be true. People assume that if you lose 10% of your account you need to make 10% to get back to where you started. Let's look at an example. If you start with $100,000 and then lose 10% ($10,000) now you have only $90,000. If you subsequently earn 10%, or $9,000, on that $90,000 you now have $99,000. As you can see you would need to earn 11.1111% on the $90,000 to offset your 10% loss on your original investment. Small losses are recaptured relatively easily and quickly. Not so for larger losses.

We are firm believers in never losing a lot of your capital and creating income streams from a lump sum of capital is one of our specialties. When using your capital to generate income, the percentage you withdraw annually will determine the long-term success rate of your strategy. If you're taking 4% or less the strategy is bulletproof. If you take 5 - 6% of your capital the likelihood of success is around 85%. Some people believe they can safely withdraw 10% of their account balances. I'd never suggest you use such a high withdrawal rate because you will almost certainly quickly deplete your portfolio. The idea is to have the money last at least as long as you do ☺. Let us look at some common portfolio income strategies:

- Maintaining a conservative, diversified portfolio of stocks, bonds, currencies, commodities and cash will allow you to always own an asset class that can be sold at a profit to provide income. This portfolio should never experience losses of over 20% in a single year and income should come from assets that are strong, not weak ones. Never sell good investments when they're down, the long term ramifications of that are too painful.
- Keeping enough cash on hand (not invested) to cover a few years' living expenses is an option. This cash could be held in one or more liquid vehicles such as a money market mutual fund, a bank savings account, or U.S. treasury bills and used to pay current living expenses. The cash reserve would be replenished every few years. Maintaining this type of cash reserve gives you time to invest more aggressively while not worrying about short-term cash needs.
- Bond ladders: owning bonds with staggered maturity dates spanning several years can provide you with the income you require over several years. This is an old school strategy that is inferior to others available today.
- Immediate annuities: as you all know I'm no fan of annuities but you can take a small pile of money and turn it into an income stream and if the insurer gives you a good rate (4-5% in today's market) it isn't too bad of a vehicle. This will also buy you time so you can allow your portfolio to grow and weather any storms prior to having to pull money out. ☺
~~~

Money Quiz

Last month's quiz wasn't won, despite a plethora of attempts. The average mortgage debt on a home today that is not paid off is $191,917. ☺☺☺

This month's challenge is to tell me how many acres does the average Chinese farm till? The average American farm tills 441 acres. The winner will enjoy dinner on us at Chili's. CFP6

~ ~ ~

Non-Tradeable Securities

Most people think all securities are readily be bought and sold anytime with the push of a button as long as the markets are open. That's true for the most part but a lot more goes on in the background to make that happen. In the background we must ensure there is a market for each security, someone to buy it from you or sell it to you, ensure you get the best price, then you may push the button and Wham, you've just bought or sold some securities. The SEC (Securities and Exchange Commission) has created a new program to help facilitate the destruction of non-transferable securities as this is a new area of fraud. If you have a security that is worthless and cannot be traded it is now required to be destroyed. I hope you don't have any of these but chances are you know a few people who do. ☹ The rules for determining if a security is no longer tradeable include the following:

- If a security has no known transfer agent services and have not been for six or more years
- There is no known market for the security
- The position is therefore known as "non transferable"

If you have such a security in your account here, we'll automatically take care of it for you. If you're holding securities and you're unsure, call us anytime and we'll research the status of your security – what it is worth, if there is a market, if it should be destroyed, etc. It is important to know when a security becomes worthless as you can typically take a tax write off for the transaction. To take this tax deduction you'll need to have a specific date and value of the transaction. We find that many times, people forgo the tax savings on such a transaction just because they have no idea It's happening! ☺

FDIC Dice

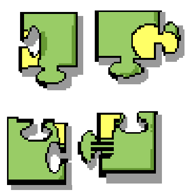
FDIC stands for the Federal Deposit Insurance Corporation – the government entity responsible for overseeing banks and ensuring that if one goes under, the transition happens smoothly. The FDIC also insures bank deposits of participating institutions for up to $100,000 per account registration. When a bank goes under, as Indymac did a few weeks back, the FDIC doesn't come in and hand out checks and close the bank, it takes over the management of the bank and works to sell the banks assets and liabilities to another bank. This process is mostly done behind closed doors and rarely gets any attention. If this happens in a town you live or work in chances are you won't even know it's happening unless you're part of the police force, the local hotel or the pizza restaurant, all of which see big increases in business and a lot suits running in and out of meetings.

The Indymac failure had people lined up down the road, which is not typical for FDIC bank takeovers. If you're a depositor in the bank that is FDIC insured with less than $100,000 in your account you have absolutely nothing to fear, even if the bank is taken over by the FDIC. The fact that consumers were lined up down the road when Indymac was taken over by the FDIC shows how poorly people understand our financial system. I'm guessing none of those in line had over $100,000 in their account. When a bank goes under, there is no need to move your account. The bank will continue to operate just as it always had with new management and will eventually be sold to a competitor, where it will again be financially healthy. Your checks will still work, your ATM & credit cards will function as they always have. Indymac was the big headline bank to go under so far this year, there have been 8 so far and 2 more after Indymac, but none of them made headline status because people weren't standing in long lines down the road – no exciting or ridiculous headlines no new coverage. Expect many more to go under in the coming months and years – the FDIC has tripled the size of its staff in recent months, asking retiree's to come out of retirement to help with the case load and they're expecting around 100 banks to fail in 2008.

The FDIC has also issued new rules for large banks – those with $2 billion in assets and 250,000 depositor accounts. These firms will now have to standardize information reporting to FDIC & to put in systems to automatically hold very large deposit accounts. These new changes are effective August 18th, 2008. The FDIC is also looking at changing how sweep accounts are handled in failures, they may end up not being insured.

Throw the dice – use the bank! ☺

Inspirational Quotes

- *Doing is a quantum leap from imagining*, Barbara Sher
- *Be less curious about people and more curious about ideas*, Marie Curie
- *You cannot get ahead while you are getting even*, Dick Armey
- *Sooner or later, those who win are those who think they can*, Paul Tournier
- *By three methods we may learn wisdom: First, by reflection, which is noblest; Second, by imitation, which is easiest; and third by experience, which is the bitterest*, Confucius
-  

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

Kids Korner

Helping to hurt, that is what many parents are doing today. We all want our childrens' lives to be better than ours, easier than ours and make them happier people. This strategy can backfire in that it creates a generation of kids who feel entitlement to everything and have no work ethic whatsoever. Think about it in terms of our health. To stay fit we all know we must eat well and sweat – we can't take a pill to feel well and be healthy. The same lesson is true for our children – they need to know the value of a dollar, how the economic reality is in our world and be prepared to make tough decisions. You and I make tough decisions everyday – our kids should make the same and learn the skill early in life. The best lessons in life and the best life experiences are often also the most difficult. If we keep our kids living in Candyland where there are no problems, issues or decisions, what are we really doing to them? Challenge them, give them structure and make them make the tough decisions.

~ ~ ~

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

If anyone you care about would benefit from receiving this newsletter, tell us who they are and they will be included on our mailing list. They'll certainly appreciate you thinking about them and having their best interests at heart.

Name____

Address______________________________________

City ____________________State__________Zip Code__________

Name____

Address______________________________________

City ____________________State__________Zip Code__________

Visit us online = www.fiscalwisdom.com

Call us anytime at (800) 843 - 4513

Please think of us whenever you or someone you care for needs the following:

- Stock option analysis, diversification
- Pensions - qualified and non qualified
- Family Protection Strategies
- Retirement Income Plans
- Investments & Investment Advice
- Business Protection & Succession
- Retirement Plans
- College Funding 1.6
- Tax Savings Strategies
- College Financial Aid Strategies
- Required Minimum Distributions
- Debt & Cash Flow Management
- Employment contract negotiations
- Settlement option analysis
- Financial Advice - hourly or annual retainer
- Fee based investment management
- In depth portfolio & risk analysis
- Estate & Income Tax Planning
- Distribution of Assets – IRA, 401(k), etc.
- Retirement Income–Guaranteed or variable
- Income Replacement Techniques
- Widow/Widower Assistance
- Nursing Home Asset Protection Strategies
- Long Term Care Issues & Strategies
- Key employee retention strategies
- 401(k) & Retirement Plan Rollovers
- Philanthropic gifting & charitable planning
- Trust, inheritance and foundation planning

Mike Chadwick's Money Matters

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

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