MIKE CHADWICK'S

MONEY MATTERS

ADVISING, EDUCATING & INSPIRING YOU TO A BETTER LIFE

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The Future of Home Prices

The past decade has many Americans believing the common Yankee old time value system that "Your home is your greatest asset and most valuable investment." This is about as true as smoking cigarettes is good for you – and that must be true because decades ago physicians used to prescribe smoking to reduce stress. Little did they know then that while reducing stress it was one of the most powerful carcinogens known to man. Fifty years later and we are supposedly all the wiser thanks to science and modern medicine. Well some of us are, at least for now. In 20 years they'll tell us that the cell phone ear bud gives us cancer. For now we push ahead unabated, ignoring that pain in our temple. ☹

The housing thing has everyone in a quandary – what to do and when to do it. It's been a very interesting few months. I've been telling everyone for the past few years real estate is overvalued and must come down substantially, and it's just beginning to do so in Connecticut, New York and New England in general. We haven't seen massive price declines like they have in some areas, but we eventually will. Prices have come down some, and many people are now declaring this a "buyers market" – that's far from truth – yes they have come down some, but I expect them to come down a LOT more. This will take time. I expect a long slow bleed on home prices over the next few years, not a quick falling out of the floor like we've just lived through in the global stock markets.

From 1995 to 2007 we've seen an advance in home prices globally, not just here in America, like we've never seen before. Prices rose, and rose, and rose, and kept rising until of course the whole thing came collapsing down around us. The reality is home prices rise with inflation, as they have for 100 + years. Karl Case is an economics professor at Wellesley College who is also the

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The Big 3

As if people weren't nervous enough lately, the now likely government intervention or pre-arranged bankruptcy of GM, Ford & Chrysler to prevent Detroit from imploding is now making everyone go from jittery to needing a blood transfusion. Let's look at the reality of this situation and think through some possible outcomes.

It's clear the big three have made a plethora of bad decisions over the past few decades. When they were flush with cash, they blew it on everything known to man and signed United Auto Worker (UAW) contracts that are simply not affordable any longer. They blew $300 billion over the past 10 years and that's simply poor stewardship. The fact that they went to Washington in private jets to beg for cash simply magnifies the stupidity of management all across the board in Detroit. We haven't seen a decade-long string of blunders like that from Toyota & Honda. They've made mistakes, but nothing to this magnitude.

The top two executives (dopes) at GM make over $40 million a year. Nobody is worth that kind of money, nobody. The top 40 at Toyota make the same and I'd argue the top 40 at Toyota deserve 100 times what the top 2 at GM do. Excesses across the board in executive compensation in every industry will come back to reality in the coming years as well.

This past few months has posed problems for automakers across the globe, not just our big three. In the past few months we've had the following car companies reach out to their respective governments to get a handout: BMW (Mini Cooper parent company), Volkswagen (Audi & Bentley parent company), Daimler (Mercedes Benz & Maybach parent company), Renault, Peugeot-Citreon, as well as China's auto manufacturers.

Here is the bottom line in America – the UAW and the dealer networks own the big 3. There are likely 100% to 200% too many dealers for American cars. They'll need to reduce the number of brands they carry and the associated dealer network. Does GM really need Chevrolet, GM, Buick, Oldsmobile, Cadillac, SAAB, Hummer, Pontiac & Saturn? Clearly no, but supporting that many factories and dealers is partially to blame for killing it. Does Ford need Ford, Mercury & Lincoln? Does anyone under 60

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inventor of the Case-Shiller home price indexes. He's studied housing and prices going back to the 1890's and 2.5% - 3.0% per year is the average rate of appreciation in home prices. We're not going to change that with fancy financing, sloppy mortgages or hideous underwriting.

From 1995 to 2006, real estate prices on average tripled, yes tripled. That's an increase of 11.5% annually, clearly not sustainable over the long-term and to my surprise one that lasted longer than I ever thought it would. To come back to the long-term averages, we'll likely have a long period of home prices shrinking, then a bottoming out process, then a slow increase in prices.

The bottom line is home prices are linked to personal incomes and they must come back in line – we all know incomes haven't tripled in the past 10 years so how have home prices gotten so out of control? There were many factors – greed, speculation, emotion, fancy mortgages, sloppy underwriting, stupid consumers, etc. Many of these factors have aggressively reversed course in just the past few months – the crazy mortgages are gone, would-be buyers are now out of the market, inventory is rising and sellers are lining up to sell and get out of their homes. This is especially painful in CT, NY & MA where the population is aging and many older folks are moving out to get to a more hospitable climate and less expensive place to live and many younger people are not settling here because of foolish and unsustainable tax policies.

Many of our real estate professionals are feeling the pain of this reality in a complete lack of real estate transactions, or least a substantial decline in such transactions. The only way to get the transaction volume up, and it may never get up to where it was 18 months ago, is for prices to come way down. We're currently in a waiting game, sellers are holding on for their prices and buyers simply aren't in the game because prices are too high and buyers are waiting for price declines. This will eventually right itself and the government cannot put a floor on real estate prices, regardless of its methods. The most recent government proposal to reduce mortgage rates to 4.5% in an effort to pick up home buying is political semantics. Artificially attempting to change this market will do little to change the ultimate outcomes of where home prices MUST go.

The government's *everyone should own a home* mantra must stop right now. Everyone cannot own a home and the mess we're in is largely a result of failed government policy to transform every consumer into a homeowner. If you don't have a relatively high-paying job or a whole lot of capital, you shouldn't own a home, period. There is no other way to skin that cat. Even if the rent is only a little less than the mortgage payment it isn't a valid comparison. How does someone with little free cash flow and no savings deal with a housing situation when the roof needs to be repaired or the furnace quits in January? They deal with it by getting further into debt by putting charges for home repairs on their credit cards.

Enjoy your home and your family, don't expect to profit from it! ☺☺☺

Real Rates of Return

With the volatility in the markets recently everyone is justifiably concerned with their account values and the seemingly endless plunge they're taking. This isn't going to continue so rest assured that a turnaround should happen soon and we can begin making back the losses. People often think, maybe I should put some money in a "safe" place such as a CD or savings account in times when the markets are getting beat up. This isn't the best move economically, but I can understand the emotional component of the decision. These seemingly safe investments are quite deceptive – they're safe only from the balance ever going down, which they cannot do. They're not safe for protecting your assets, which they're guaranteed not to do. They always, yes always, lose money over time because the biggest issue here is inflation. They don't protect your money from inflation, which is really one of the biggest obstacles over time.

The markets will bounce back in the very short term, not decades like pundits are saying and with that will likely come some inflation. The issue is if you're not beating inflation you're losing money on a guaranteed basis. You're not seeing your account balance shrink, but the amount of goods and services the money buys in the world is shrinking. Let's look at the math of real rates of returns on banking products that seem so safe in various economic environments!

	High Rates Date 1980	Low Rates Date 2002	Average Date 2007
Rate	17.74%	1.36%	4.35%
Taxes	-6.11%	-.37%	-1.87%
Inflation	-11.63%	-2.38%	-4.08%
Bottom Line	-3.13%	-1.39%	-0.60%

The picture suddenly doesn't look so favorable, even though this "guaranteed" investment cannot go down, you're guaranteed to lose purchasing power over time.

Investments in both stocks and bonds today pay dividends at or greater than what bank accounts are offering. The stocks and bonds are so undervalued today, they not only offer dividends, but potential for capital appreciation – even on such seemingly conservative things as municipal bonds, the real question is "why bother with CD's?" ☺

Noteworthy News! ! !

- Congratulations to David Reid on the purchase of his new home! ☺
- Congratulations to Judy & Earl Clark on the adoption of their new dog Winston – he joins the rest of the crew as baby # 6 (these babies are 100+lbs) – if you're a dog this is the place to live! ☺

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Strong Financial Institutions

It seems like the hammer is dropping all around us and one financial firm is failing after the other. Now some of the auto companies may be about to fail or in need of government help to continue to exist. This craziness will stop and not everyone in the world is weak. Many firms are rock solid but they're just not getting the headlines lately. I'm not so sure any more hammers are going to drop. People are so fearful today they're assuming the absolute worst, and of course that is everyone and everything failing. This is absurd as we all know but it's natural human emotional tendency.

The reality is there is a lot of great news across the board that people aren't paying attention to right now and we'll eventually profit from. Aside from that craziness, I've got great news here and locally: we're not going anywhere and we're rock solid as a financial institution. Chadwick Financial Advisors has zero debt, one hundred percent equity and zero chance of having financial problems as a result of latest market turmoil. Savings and little debt are keys to financial success and we practice what we preach. As I try to urge all of you to do, because we're conservative old Yankees here too, this rough economy will only impact us by forcing us to save less. We won't have to change our lives at all, we just can't pack away the same amount of money that we once did because expenses are higher all around.

Our partner firms are also strong and flush with cash, with little or no debt. We don't have anything to worry about with our custodian partners. We have accounts virtually everywhere and none of our partners have any financial trouble either to keep you up at night. Whether your account is with NFS LLC, Schwab, Fidelity, American Funds, Cambridge, Oppenheimer, Pioneer, Franklin Templeton or M&I Trust you have nothing to worry about. ☺

The Big 3 *Continued from page 1*

know that Lincoln is a car and not a dead president?

Now let's move onto the real issue, the UAW. This is mind-bending and is also opening a can of worms that will spread globally. The demands of unions are absolutely out of control. If you are a member of one you love all of the protection and perks afforded you. If you're not you wish you were, of course we all do – who wouldn't want such health care benefits and pension contracts? This system of business is simply out of line with reality and needs to be adjusted. Let's look at the UAW contracts and how they cripple our companies. They demand wages that are above and beyond what the fair market value for the associated skills is. They set minimum pay standards, regardless of job or performance. The incentive is simply to fog the mirror, not do a good job. GM pays an average of $80 an hour for labor and benefits for every worker while Toyota pays $28. They're both in America – Detroit & Texas for GM, Alabama & Texas for Toyota. If you're a machinist making $40/hour and you get hurt and now have to sweep floors you still get $40/hour not $13 that the job should pay. How can that be? It can't! It's currently starting to get exposed and will soon be coming to a very ugly end.

Now we have the jobs bank – if an employee of the big three is laid off after a factory closing or a reduction in hours – the employee can become part of the jobs bank and collect his or her pay, for an average of 85–95% of his total paycheck. This employee isn't working and is lounging around drinking a soda, perhaps a beer, perhaps volunteering to clean a city park. Either way it's absurd. What's the point in reducing jobs, they're paying for nothing to get done.

This same theory is for full employment plants. UAW contracts at many auto plants require workers to get paid even if the plant is shut down. This is why the big 3 have made and still make, but to a much lesser degree, so many junky cars, because they have fixed employment costs that cause them to have to pay the people, so they may as well work – even if it doesn't produce the best cars. This has had a disastrous impact on the quality and reputation of the big 3. I can assure you the workers making Corvettes & Cadillacs are not in full employment plants. When Toyota slows down, it can send workers home without pay. Which it doesn't, it has them working, in class to learn about the new technology for upcoming model cars.

Nobody knows which way it'll shake out in the coming months, but no matter what happens with the auto industry, the country and each one of us will be healthier when this all gets fixed. If they're forced into bankruptcy, the issues are removed overnight and they can get healthy. If they're given help, they'll work through the same issues because they are cancers in the system. Be prepared to see this same problem come up in many areas – state government, town government, federal government, teachers, police, firefighters - they're all union shops faced with the same issues and the gravy train has just slid off the tracks! ☺

Money Quiz

Congratulations to Kevin Chambers on winning last month's quiz. The green fuel that can make us oil independent is…..algae – yes algae. It may not be so gross after all. ☺

This month's challenge is to tell me how many banks failed between 1987 – 1991. This year we've had 22 go down so far. The winner will have lunch/dinner on us at Chili's. 120108 ☺

Insuring Times

The end of the year brings some changes to the insurance arena people should be aware of. This is also a good time to revisit insurance and see if you can either safe a few bucks or increase your coverage with no additional costs.

A new state law makes health insurance for our young people in CT readily available. The rule now states that if your rugrat is 19 and not in college full-time they cannot be on your medical plan. As of 1/1/09 you can keep the kids on your plan until their 26th birthday, regardless of educational status. This is a big benefit for the many young adults who are struggling with how to get medical benefits, soul searching for a career or working for a small firm where there are no benefits. Many small employers don't offer medical and many self-employed don't know where or how to get it in this age range.

Year-end is also an important time to look at employer-provided benefits and various insurance programs. It's the season for open enrollment so if you're not sure what benefits to pick feel free to fax or email your forms, options or paperwork in to us and we'll ensure you pick the best options for you. Your most valuable asset while working is your ability to earn a living so make sure your income is protected at 100% of income on a post-tax basis, including retirement plan contributions. Many people will use a group plan as a basis for coverage and supplement with a personal plan to ensure a complete replacement of income.

Another big and painful risk is a health care catastrophe. If you have your health the rest is gravy, that's no joke. We've all seen someone get sick and need people to come into their home to get care or worst case, have to move to a nursing home. The only way to protect this and maintain control of your life is with a good long term care plan. Think this through, you can't get it if you need it! ☹

Irresponsible Americans

It's clear around the globe that we don't want to assume responsibility for anything. It's painful but true. Look at our legal system – the best the world has to offer but what a joke in many respects within the realms of personal responsibility. People sue over everything and nothing is their fault – for this reason a record numbers of companies are not listing their stocks here and not offering their best products here, simply because they think legal costs shouldn't be the largest expense in a corporate budget. India's income tax system has taken lessons from this mentality of thinking and is now trying to tax corporations beyond it's borders on off-shore transactions. This will play out quite painfully for them in the coming years. Let's hope no one else drinks the cool aid.

Mortgages are no exception and we're now faced with a record number of foreclosures coming down the pike. Banks and government across the country are scrambling to make the wave less damaging, but it's going to happen and there is no stopping it. Just like you can't stop a tsunami, this wave won't go over us without making a life-changing impact. Many mortgages are being "adjusted, rewritten, modified etc." to make them more affordable, but even these loans are seeing foreclosure rates in the double digits after helping the homeowners with modifications. The bottom line is some people cannot afford the homes they're in. Get an apartment! ! ! ☺

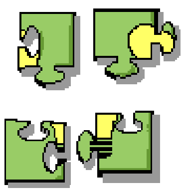
Americans feel that if it doesn't work out they'll just walk away, no harm done and the credit will be back in a few years so we'll do it again. This is the problem here in America, no incentive for proper behavior. This exists because in America we have no recourse loans – if a borrower walks away the bank is out of luck (SOL ! ☺) and just gets the house, which is worth nowhere near the debt amount owed against it and falling quickly.

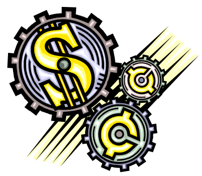
We need to change the system to match the rest of the world – if you default on your mortgage the bank will take your home but it can also go after other assets or even income. This will properly motivate people to behave much more responsibly. People will save first, live below their means and not buy unless they're prepared to deal with inevitable emergencies. This is why in Europe or anywhere else in the world as real estate prices have declined substantially the underlying bonds are not affected at all. The securitization of loans globally is also a joke. The banks that underwrite the loans should be required to keep those loans just as our old school small Yankee banks continue to do around here.

This also causes appropriate behavior because the bank now holds the risk directly, it isn't spreading it around to others who would likely not have scrutinized the risk as the original underwriter did. ☺☺☺

Inspirational Quotes

- Repetition is the mother of mastery, *author unknown.*
- Don't go through life, grow through life, *Eric Butterworth*
- Education is what survives when what has learned has been forgotten, *B.F. Skinner*
- The easy path leads to the hard life, but the hard path leads to the easy life, *Rilke*
- Adversity reveals genius, *Horace*





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

Kids Korner

The things kids learn today so young is insane. My oldest rugrat Hannah is beyond her years and we were recently talking about the stock market, yes the stock market to an eight year old. She loves to make money just like the rest of us and was asking why people were afraid if a real good earnings periods is ahead of us. This is a beautiful thing to hear – the innocence of a child making you see things in a different light! I told her the reasoning was because people are fearful after the recent massive losses and her response was "Dad, you can't live in the past you must move on!" Which of course is dead on, but not what people always think – adults and rugrats alike! Let's all have the magical gift of looking at things through a child's lens sometime this holiday season to put things in perspective. We can't be naive about life, but the fresh viewpoint is priceless! ☺ ☺ ☺

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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, (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

CERTIFIED FINANCIAL PLANNER™ CFP®