Lassus Wherley ...a view from the top

Building Better Futures

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What Are They Thinking? Part II

Quarterly Reports

I made a decision to delay the processing and review of quarterly reports for the quarter ending 9/30/2008 in order for us to focus our time on reviewing portfolios and continue to be available to our clients in light of the current market uncertainty. We will get these out to you within the next 2 weeks. Thank you for your patience.

What 's Been Happening???????

There is no way to reduce what happened last week to a few words but I am going to try. We have continued to see hedge funds that are being forced to sell. We are also seeing mutual funds that have higher redemptions having to sell holdings to raise cash. I will talk about the headline makers below but I spent much of the week trying to figure out why this market had a different feel than prior bear markets. It occurred to me that the biggest difference between the early 90s and now is the media. We not only have 24 hour news in our face constantly, but there are all these talking heads that are held out as "experts" on everything. I flashed back to the early 90s when Bill Griffith began the CNBC "Money Club" show. We went on air and talked about things that were educational and we took questions about real financial planning problems. Today............the guests are all heads of trading firms and stock pickers and people who tell you to time the market. Today the shows are entertainment not education. Unfortunately, people have become addicted to these shows. I remember having conversations with clients in 2002 where I told them to turn off the TV.

Some of us have to stay immersed in these headline shows because it is part of what we do. However, I can tell you that I have to turn it off at times. The constant hammering from these folks pushes your stress level up the scale very rapidly and increases feelings of panic. The reality is that there are only so many things we can control and those are the things we have to focus on. We each have emotions and feelings that we constantly try to balance with the rational or reasoning side of ourselves. During times like this the emotion or fear can overwhelm the reason.

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I was speaking to one of our clients and feeling very bad about the market being down. The client stopped me and asked a question. The question was, "did you **make** the markets go down?" My response, of course, was no. But it brought home to me how easy it is, even for professionals, to get pulled into the emotional side of what is happening.

WE ARE CONCERNED, not just about the markets, but about the impact on you, our clients. We are concerned about the emotional stress that this environment is creating for you and the financial stress due to the decrease in wealth we are all experiencing. That is why we have literally gone through every portfolio several times over the past few weeks including this weekend. We have begun moving out of several mutual funds that have underperformed and added several funds that we believe will perform better going forward.

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A few people we have spoken to have said they saw this huge downturn coming a long time ago. I think we all know that when you go through a strong bull market sooner or later you will go back the other way. However, there is no way that anyone could have convinced me or many other professionals that it would go this far and certainly not this quickly. Someone asked me, if I had seen it coming, what would I have done differently. The answer is I'm not sure if I would have believed it if my crystal ball had told me. The only thing I might have done differently, just in case, was to increase cash for those who might have specific near-term needs.

The Headline Makers

US Treasury Secretary Henry Paulson and Federal Reserve Chairman Ben Bernanke are incredibly bright individuals and I am convinced they will get it right but they both need to take communications courses before they make any more announcements. Secretary Paulson talks about action in very vague and generic terms which has not instilled confidence. We know the details exist and that he is moving forward to provide a trading platform for creative mortgage paper on the bank's books and for commercial paper. We also know he is going to inject capital directly into the banking system but he needs to share more of the information. Chairman Bernanke is increasing the liquidity in the system and has reduced cost by lowering interest rates but continues to end every announcement in a very negative way. I don't think these folks get the impact that a few words from them have on people and the markets. As we are ready to go-to-press more details are being released so information on that will come in the next release.

And then there is Cramer. There was a great article in the NY Post written by John Crudele. A client who knows we aren't fans sent us a copy. Here are a few quotes from the article.

"Jim Cramer had a big helping of crow for breakfast yesterday. The loudmouth host of CNBC's "Mad Money" frantically told investors before Wall Street opened yesterday (this was last week) to take their money out of the stock market. But he forgot to apologize for telling them the exact opposite for the past year……… Cramer's stock market calls have been spoofed in You Tube videos and are fodder for bloggers."

"Lest we forget," wrote one blogger, "Cramer announced the end of the housing crisis some time ago (I've got street creds, he said). He also predicted 14,500 for the Dow in '07. The man is a shameless advertisement for his own products, books, TV show, etc." Wrote another: "I have studied Jim Cramer's main recommendations for one year. Conclusion: He is absolutely the best contrarian indicator I have come across in over 25 years of investing." " In other words, bet against Cramer."

Here are some of the questions I have received this past week.

Question: *Should I reduce the risk in my asset allocation based on what is happening in the markets?* **Answer:** Possibly, but not until the world becomes more sane. The worst possible time to make changes in the asset allocation of a portfolio is when the world is in chaos. So……..as the markets stabilize and begin to act a little more reasonably we will work with anyone who believes we need to review their asset allocation.

Question: *Why are my bond funds going down? I thought they were supposed to be safe.* **Answer:** One of the biggest issues we are facing with both corporate bonds and municipal bonds is a lack of confidence. What this has caused in the short-term is rising interest rates on everything but Treasuries. This is a short-term problem that will be resolved over time as the bank credit issue is corrected. Remember that bond values are controlled by several factors including the interest rate demanded by buyers of these bonds and the current economic climate. With buyers demanding higher interest rates, the value of the bonds has gone down.

Question: *Am I crazy to want to add money to this market?* **Answer:** No. There's an old saying "when there is blood on the streets is the time to buy". We are beginning to edge new money back into the market and will be reviewing for rebalancing over the next few weeks to move dollars out of asset classes such as bonds that have done better and moving dollars to those that have fallen in value. This means we are "buying low" and "selling high". It is emotionally difficult but it is the way to make money in the financial markets.

Question: *I keep hearing discussions about the LIBOR and how important it is. What is it and why is it important?* **Answer:** LIBOR (London Interbank Offered Rate) is the measurement of the interest rate that banks charge one another as opposed to the Fed Funds Rate which is the interest rate the Federal Reserve charges banks for money they borrow. LIBOR is important because it is one of the ways we measure the amount of trust between banks.

One of our clients gave us a great example of how Lehman's failure impacted the trust banks have relied on in dealing with one another. Think about going to the drive-in at McDonalds or your favorite fast food place. You drive up to the first window and order and prepay for your hamburger. Then you drive to the second window to pickup your hamburger. How many times would you go back if when you got to the second window there was no hamburger. When the Treasury Secretary chose to rescue Bear Stearns but let Lehman fail, we encountered the world of unintended consequences. No one realized how interconnected Lehman was with the system. I think history will point to Lehman's failure as one of the primary triggers of the cascading freeze in the credit system.

Lack of trust is the issue causing banks to not want to deal with one another. One bank is concerned that the other bank won't deliver and they will be left holding the bag. As we see more action taken by the Treasury and the Federal Reserve the frozen credit market will break free. Once that happens dollars will once again flow to where they are needed and can be loaned out to small businesses and individuals to get this economy moving again. So…….watch for LIBOR to begin to come down as the Treasury interest rate begins to go up. We need these two rates to be closer to one another and that will be the signal that money is starting to move and the credit freeze is finally melting.

Question: *I'm in my 80's do I really need to be in equity funds at this point? And how can I be a long-term investor?* Answer: The reality is that inflation isn't going away and many of us spend more than our invested assets can comfortably support. We have always used a rule of thumb of 3%. In order to take 3% out of your accounts over time you need to target a return of approx. 8%. This return will allow you to preserve principal. Unfortunately, many people spend more than the 3% and some spend up to 8% and higher. When you are taking out dollars at a high level you have a choice of accepting a very low return with no inflation protection from fixed income meaning that you will run out of money at some point or…….. targeting a higher return over time and at least having the opportunity to keep pace with inflation if not the spending.

It also means accepting higher risk which can lead to losses as we have seen. I have spent considerable time reviewing asset allocations for folks that are retired, and looking at their actual returns over the last 20 years. A higher targeted return has allowed many to stretch their dollars many more years than investing more conservatively would have allowed. The other side of that equation is we are now paying a price for all of those years of better returns that have supported higher spending.

It is a very difficult balance between low returns where you know you will have to spend principal on a monthly basis or higher targeted returns where in some periods of time you give up principal value. There is no right or wrong answer but it is something that may need to be reviewed whenever circumstances, objectives or concerns change.

The other part of this equation is that many clients are investing not just for themselves but for their families so that when you talk about long-term it is really about the life expectancy of the individual and their children or sometimes grandchildren.

So………..asset allocations are based upon the individual's situation and must be reviewed periodically to determine if changes need to be made. We will continue to review allocations based on your individual situation and concerns. If you are taking out significant amounts of money, it may be time to review your overall investment program but it is also time to review your spending. Please remember that we plan to age 100 and we expect many of you to be around to that age so based on that, even at 80, you will probably still be around to enjoy the move back up and recovery of these markets.

Someone said that his life expectancy was only 85. That may be true but the definition of the life expectancy tables is that 50% of the people will die before age 85 and 50% will die after. And………...every year you live extends your life expectancy. I took a test online not too long ago that looked at lifestyle and many other things and the results came back and told me my life expectancy was 98. So………..we continue to see most of our clients as **long-term investors**.

As we go to press with this issue we have completed a day with a 10% rally in the financial markets. It certainly doesn't tell me the problems are over because we know they aren't. It does tell me that we are moving in the right direction. The Treasury Secretary has begun to publish specific details on plans to stabilize and fix some of the more difficult issues in the financial system and we are seeing some daylight in what has been a very dark time.

I don't expect it to be straight up from here and I am sure we will be challenged through many more days before this is over. The key is that by staying invested you get the benefit of the upward movement after having suffered through the downward pain.

Please let us know if you have specific questions concerning your situation.

Diahann