For Clients and Friends of Financial Connections

Quarterly Newsletter, 4th Quarter 2008, 1/19/2009

This has been a memorable year for its positives and negatives. On the positive side:

- Brian and Jennifer welcomed their first child, Robert, into their lives
- Kim and Mike bought a home in Fairfax
- Jill and Bonnie were married before the passage of Proposition 8
- Obama was elected

On the negative side:

- Our founder, Melvin Gladstone, passed away
- The economy and stock market turned upside down

No one anticipated the severity or rapidity of the decline:

- Fannie Mae, Freddie Mac, Bear Stearns, Merrill Lynch, Lehman Brothers, AIG, Washington Mutual, and Wachovia all required rescue with negative repercussions across all types of investments
- GE, Goldman Sachs, and Morgan Stanley required significant amounts of additional capital
- Credit markets became catatonic, creating a new bubble in treasuries. The 3 month T-Bill pays 0.05%; the 10-year Treasury Note yields 2.253% and 30-year Treasury Note yields 2.671%—all historic lows
- All bonds and equity asset classes except government bonds collapsed
- The government provided a guarantee for money market funds and increased the FDIC insurance limit
- The Fed used its balance sheet (all available money) and needed to ask that Congress vote $700 billion to re-liquefy the credit markets and overnight bank lending (see later article)

CONGRATULATIONS TO KIM

We had a chance to witness how the credit crunch affects the housing market as Kim and her husband, Mike, obtained their mortgage. While it wasn't fun for them, it was an interesting microcosm of today's environment.

Please join us in congratulating them on finding their new home in Fairfax. They move in this month.

Capitalism requires confidence and trust in the system, and that is in short supply at the moment. *But over the last fifty years we have experienced ten bear markets declining 20% or more, and <u>every time</u> the market has recovered*.

Yet the recovery will occur in a very different environment. Below are various topics that pertain to the economic, stock, and bond markets.

<u>Oil Prices</u>
The price of oil on July 3, 2008 was $145.29 a barrel. On December 31 it was $44.60 a barrel. The dramatic drop puts more money in everyone's pocket, consumers and businesses alike.

continued inside...

For Clients and Friends...
(continued from front)

Wall Street

Where's Wall Street, you might ask. All the companies that were thought to be "Wall Street" have been bought, have filed for bankruptcy, or became banks.

Coordinated global response by central bankers

Past crises were handled by each country. For the first time in history a coordinated and cooperative global response has been made to provide economic stimulus and financial system stability.

Infrastructure upgrade

Funds targeted to upgrade everything from transit systems, roads, bridges, etc., are part of the Obama stimulus plan. This decision is long overdue. The U.S. spends about 5% on infrastructure, compared to Europe's 10% and Asia's 15%.

Part of the Obama stimulus package includes reworking of the electric grid and green technology. It opens up opportunities for creative thinking and the entrepreneurially inclined. Americans usually excel in this environment.

Corporate survivors

One of the byproducts of recessions is that weak companies go away or are purchased by stronger firms, regardless of the industry. The process is under way in banking and will continue in other industries.

While painful for many, the process allows the remaining firms and economy to become stronger.

The world's reaction

Global investors headed for the United States. A flight to quality led to a recent Treasury-Bill yield of zero.

The dollar increased against all currencies except the yen.

CHECKS FROM COLUMBIA ACORN

If you received a check from Columbia Acorn, it is for a fund you held in 2003 or earlier. It is a settlement with the SEC for a regulatory violation by the mutual fund. If the check was from a non-retirement fund, you can cash it. If it was from a retirement fund, it should be deposited back into the retirement account.

If you have any questions, please give us a call.

continued on next page...

FINANCIAL CONNECTIONS GROUP, INC.

Jill D. Hollander, CFP®, CRPC®, CDFA™, Financial Advisor
Brian Pon, EA, CFP®, Financial Advisor

Financial Connections Group, Inc.
21 Tamal Vista Blvd., #105
Corte Madera, CA 94925
415.924.1091

Berkeley office:
2608 Ninth Street, Suite 302
Berkeley, CA 94710
510.849.4667

EMAIL: client@FinancialConnections.com
WEBSITE: http://www.FinancialConnections.com

For Clients and Friends...
(continued from inside)

The Great Depression vs. our current situation

According to a CNN poll, many Americans believe we are heading for another Great Depression. This is an emotional reaction to a difficult situation. A closer look shows significant differences.

	During the Great Depression		Today	
Economic Growth/Decline	(1931)	-14.7%	(thru 9/08)	0.3%
Unemployment*		24.9%		7 %
Bank failures**		5000+		206

**Unemployment insurance wasn't available during the Depression*
***No FDIC insurance existed, so people lost their money*

If you invested $100 in the S&P in 1928, it declined during the Depression, but by 1935 it was worth $110.18, or a gain of 12%. At the end of 1940 it dropped to $107.37 (a 9% gain), but if you held on to it 20 years, it was worth $ 355.60—an increase of nearly 260%.

In order to participate in the upturn, individuals who anticipate years or decades in retirement have to be invested in stocks. Please see the enclosed graph about opportunities you miss by going into the market after the rally begins.

SUMMARY

The global economy faces serious challenges. And no one can predict which remedies will work or how long they will take to work. The stock market is a leading economic indicator. Almost every bull market started while corporate earnings continued their decline and unemployment continued to rise.

Few of us had experienced the type of risk evident in 2008. So much media attention on the short term eclipses the long term. But a loss is only on paper until you sell. If you are thinking long term, it is important to stay invested in the market, allowing your money an opportunity to increase before you actually sell for withdrawal. We welcome the opportunity to get together with you and discuss how you feel now and what your needs are going forward.

ATTENTION TEACHERS—CHANGES TO YOUR 403(b) Retirement Plan

Effective January 1, teachers and nonprofit organizations can anticipate a change in their retirement savings plans. Like 401(k)s, the corporate counterpart, sponsors for 403(b)s must now meet a fiduciary standard that advises them to find low-cost investment options.

The selections of many 403(b) plans are insurance companies that have multiple layers of expenses (especially if they offer only annuities). In contrast, most 401(k) programs are through mutual fund companies that have lower expenses and no annuities.

We suggest you ask your district or nonprofit if new 403(b) vendors were added or what steps are being taken to review your choices.

CHANGING BEHAVIOR OF CONSUMERS

From 1950 to 1985, consumers saved annually 9% of their disposable income. The savings rate outside of employer retirement plans reached zero this decade. Simultaneously, debt rose to 127% of disposable income from 77% in 1990.

This trend reversed in the third quarter 2008, as consumer debt declined and savings increased. The same is expected for fourth quarter.

With banks and credit card companies reducing home equity lines of credit or not lending at all, consumers will be forced to make adjustments toward living within their means.

Richard Berner of Morgan Stanley says, “The golden age of spending for the American consumer has ended and a new age of thrift likely has begun.” Much of the money for retirement has come from stock market gains, not from savings. As consumers return to savings and the stock market increases again, a stronger foundation for retirement will be created.

As part of our financial planning process, we work with clients on managing their spending. If you are interested, don’t hesitate to give us a call. We have some useful forms that can get you started.

THE FEAR INDEX AND MARKET VOLATILITY

The Chicago Board Options Exchange’s Volatility Index or VIX is frequently called the fear index because it measurers degree of fluctuations (up or down) of the market. As we all know, there have been huge swings from day to day.

The historical average for this index is 20. It peaked in November at 81, hitting an all-time high. At this writing the VIX stands at 46.

From September 15 to November 20, the Dow rose or fell by triple digits 41 trading days out of a total possible 49 trading days. Since September, the S&P has moved more than 5% (up or down) on 18 days. In the previous 53 years there were only 17 such days.

Most of the panic selling resulted in money going into Treasuries (now considered a bubble) or money market funds (some money market funds have actually closed to additional deposits).

This money is now waiting on the sidelines, as people try to time when to get back in. We believe no one can time the market.

NO REQUIRED MINIMUM DISTRIBUTION NECESSARY IN 2009

Congress voted to suspend the required distribution from retirement accounts in 2009. If the change affects you, please let us know if you still would like a distribution this year and for what amount.

Jill D. Hollander Brian Pon

FEDERAL RESERVE AND TREASURY ACTIONS

The Federal Reserve has been taking a number of steps to overcome the credit crunch. We'd like to highlight a few of the decisions.

In an attempt to unfreeze the credit markets, the Fed has become the bank of last resort. It "will employ all available tools to promote the resumption of sustainable economic growth."

These tools include printing money; keeping the rates low so adjustable mortgage rates do not reset higher; and making federally insured CDs look more attractive than money market funds.

In an effort to get the money back into the economy, the Fed will also buy mortgage-related bonds, consumer loans, etc. But the banks aren't lending.

One of the problems with the Treasury Department's TARP program is that it lent the money without legally requiring the banks to use it for loans. Instead, banks are keeping it on their balance sheet for reserves or for they can use it to pay shareholders' dividends. There are no rules requiring a cut or elimination of dividends. We hope the new administration will remedy this.

We are in a deflationary environment where prices are declining (witness retail sale prices over the holidays). But once the money that's put into the system starts being spent, we anticipate moving into an inflationary environment.

The degree of inflation will largely depend on how the Fed handles what happens once its plans start working. "At some point, and without knowing the timing, the Fed is going to have to destroy all that money it is creating," said Alan Blinder, a professor of economics at Princeton and a former vice chairman of the Federal Reserve.

THE MARKETS IN 2008

In September, the credit problems became a credit freeze. Our interpretation of this crisis is that corporate earnings will be lower in the near future. As a result, we moved a percentage of equity mutual funds in portfolios to other alternatives.

There was also no place to hide, as we did in the 2000-2002 market decline. The last decline was mitigated by our diversified approach. Small companies, international companies, and bonds kept our portfolios mostly positive.

This time, only government bonds had a positive return. Treasuries are considered to be overpriced. On the flip side is market performance information and Financial Connections' largest holdings as of December 31, 2008.

This is painful to look at, so do so at your own risk!