FINANCIAL CONNECTIONS
GROUP INCORPORATED

## *For Clients and Friends of Financial Connections*

**Quarterly Newsletter, 4th Quarter 2011 1/20/2012**

Enclosed are your reports for 2011 including the Realized Gains/Loss Report on wheat colored paper that should be given to your tax professional along with the 1099 that comes from TD Ameritrade.

If you fell asleep January 1, 2011, and woke up December 31, 2011, you would think we had a boring year. For those twelve months, the S&P 500 rose 0.04 *points (or 0% return)*. When you add dividends, the S&P 500 gained a 2% return for 2011.

You would have slept through a very busy year:

- Triple-digit swings of 104 trading days on the Dow
- A spread between highs and lows of 3.9% *per day* on the S&P 500 in August
- Fretting about government default because of political bickering
- Downgrade of the U.S credit rating
- European Union's distress (International developed country index was - 12%; emerging market index - 19%) (see insert)
- Arab uprisings with regime changes in Egypt, Tunisia, and Libya
- Continued tensions over nuclear programs in Iran
- The Japanese tsunami tragedy and nuclear meltdown
- Regime change in unpredictable North Korea

You would have missed other sensational headlines:

- U.S. unemployment rate declined from its high of 10% down to 8.6% in December—its lowest level in three years
- Factory output rose
- Consumer spending was strong
- U.S. was a net energy exporter (the first time in decades)
- Corporate profits continued their upward trend

The flight to quality reduced interest rates even further, making government bonds the best performer in 2011.

Usually, markets are driven by earnings and interest rates. Last year, political risk had the biggest impact.

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### ***Clients of Financial Connections***
*(Continued from front page)*

U.S. Deficits

No one will argue that the deficits need to be reduced. The issue is how to do it. Dr. David Kelly, Chief Strategist for JP Morgan, discussed his concern with how the deficit is cut.

Deficits are often discussed as a percentage of Gross Domestic Product (GDP). It was 8.7% the last fiscal year (government fiscal year is October 1 to September 30) and he anticipates 2012 to be 7.1%.

He is worried there will be a sharp decline in fiscal 2013 to 4.7% of GDP if the Bush tax cuts, payroll tax, AMT, and Medicare adjustments all expire in 2012. When there is a sharp drop to the deficit versus a gradual one, there is a huge drag on the economy because of the combination of increased taxes and spending cuts. Unemployment would also rise.

A gradual decline allows the economy to slow and absorb the changes as opposed to a potential recession with a suddenly slowed economy.

2012

Although there are some attractively valued investments, we still anticipate continued volatility in 2012 with so many issues in the U.S. and Europe unresolved.

If you would prefer to dampen volatility and give up some potential growth by reallocating a portion of your portfolio, please give us a call to discuss your investments.

**FINANCIAL CONNECTIONS GROUP, INC.**



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## DO A FAVOR FOR YOUR LOVED ONES

In a client's Christmas letter, she outlined the difficulty of dealing with her ailing father. Terry gave us permission to tell you her story.

*My father's mental health deteriorated so significantly I had to admit him to a senior center for dementia care. There was a lot of angst and drama leading up to the decision and the process that followed to execute the decision. Once he was in the center, his house had to be closed up for the short term until it could be emptied of all of his possessions, put on the market and sold.*

*These few sentences don't begin to do justice to the amount of physical and mental energy required to make this happen. And it doesn't speak to how fortunate I feel as a result of the way things happened. I had outstanding support from the rest of the family. I had help from friends and my father's neighbors.*

*My father had the foresight to add me to his financial accounts years ago, so when I needed to execute the Power of Attorney and become successor trustee, the transition went smoothly. And he had most of his wishes spelled out and in legally executable form.*

*While it was a difficult year, it could have been so much worse were it not for all that love and support—and the right legal foundation. For all you procrastinators out there—take steps to ensure your loved ones know and can honor your wishes.*

Financial Connections is happy to help you with this endeavor. Please give us a call.

## MAKING YOUR MENTAL MUSCLES STRONGER

According to new research, memory that involves solving problems and reasoning can be improved by using a type of brain exercise. Daily training can improve your cognitive functioning. Below are some examples you might consider.

- Puzzles such as Rubik's cube, Sudoku, KenKen, crosswords, word finds
- Select four words at random. Set a timer for five-minutes and perform another task such as reading. When the timer chimes, recite the words out loud
- At the end of your day, recall what you did that day in as much detail as possible. Once you feel accomplished in this task, add remembering yesterday in detail

Sample brain exercises can be found at:

http://dual-n-back.com/nback.html
http://brainworkshop.sourceforge.net/
http://brainage.com

## NEW COST BASIS REPORTING FOR 1099s

Beginning in 2011, custodians such as TD Ameritrade are required to report cost basis information to the IRS. The requirements are being phased in, so 1099s in 2011 include only cost basis for stocks, and investments that trade like stocks, purchased and sold in 2011.

Financial Connections Group has provided you with this information in the past and asked you to use it when preparing your taxes. However, now that the IRS considers the custodian to be the authoritative source of cost basis information, you will need to pay closer attention to TD Ameritrade's data.

For any other 2011 cost basis, refer to your realized gains and losses report from Financial Connections Group when preparing your taxes.

## WELCOME LESLIE H. MILLER

Leslie joined Financial Connections Group last November. For more than 20 years she was a financial advisor working with individuals, families, and businesses. Earlier, Leslie worked in the wealth management department of a bank and has been an underwriter of municipal bond insurance.

Leslie is a native of Marin and very active in the community.
She volunteers as:

Director, Girl Scouts of Northern California
Director, Marin Symphony Association
Financial Women's Association of San Francisco,
of which she is a past president

Please join us in welcoming her to our firm.

Jill D. Hollander

Brian Pon

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# EUROPE'S DIFFICULTIES—MORE THAN DEBT

To give a complete review of the European situation would take at least a novella. Instead, we've tried to highlight some of the financial and non-financial issues that interweave money, infrastructure, and social systems.

Post World War II

Financial aid flowed overseas to rebuild Europe. Many European countries grew rapidly as they set up health care, pensions, lengthy unemployment insurance, job guarantees, etc., for their populations. By U.S. standards, these benefits were generous.

These and other benefits eventually became institutionalized in the labor force. The work rules made it difficult for companies to close unproductive businesses in favor of funding newer and more productive ones.

A unique characteristic of our American culture is to acknowledge the right to fail and try again. Steve Jobs, for example, had several companies that did not succeed before Apple's recent run. Flexibility is required to grow and weather crises. One of the reasons the U.S. economy tends to bounce back sooner after a crisis (like the Great Recession) and adapt more readily is part of our national consciousness. Businesses were destroyed, workers displaced, but slowly we are making our way back.

It is a hardship when individuals lose their job. But frequently with re-training, employees find a job in a new type of business (as in the move from manufacturing to service industry employment). If companies can't cease to exist and workers can't be laid off, this flexibility and competitive advantage is lost.

In Europe, such a scenario is unknown. At a conference in October, Jill heard an international mutual fund manager say that the "joke" was let's get a job in Belgium and get fired. If you are fired in Belgium, your severance package includes wages for several years!

Eurozone

This union of countries was launched in 1999 to improve trade and strengthen economies—to be more competitive as a trading block. The sum of the whole was to exceed its parts. Countries were required to follow specific financial guidelines (i.e., maximum 3% deficit of GDP) that were never enforced.

Most countries gave up their currencies in favor of the euro, with the European Central Bank as the equivalent to our Fed.

The southern European countries with the new currency were able to borrow at lower interest rates than their previous sovereign currency (think of Greece, Italy, Spain).

Northern Europe (think of Germany and France) could export its surplus to southern Europe, and its banks could lend southern Europe the money to buy the exports.

This plan worked until the debt became so large that it collapsed the system. The Global Financial Crisis of 2008 was the beginning of the end, and the Greek crisis serves as the most recent catalyst.

## Response to the crisis

Northern European banks lent large amounts of money to southern banks and governments. With the value of the bonds declining, banks' financial positions are precarious. (Europe's Web of Debt: http://www.nytimes.com/interactive/2010/05/02/weekinreview/02marsh.html)

Many experts believe the European Central Bank (ECB) should be doing what the Fed did; buy the debt and keep the banks solvent. The Fed's action is given a large share of the credit for bringing the U.S. back from the brink of the Great Recession. The ECB has not done as much to alleviate the situation.

The political response has been just as dismal. Germany has the strongest economy and a trade surplus. German editorials question why the Germans should work longer to pay for Greek retirements and "lavish" benefits while the Greeks don't even pay their taxes. Conversely, Greek political cartoons depict Germany saying they finally won WW II.

## Future

There is no clear resolution to the crisis in Europe. Recession, dissolution of the eurozone, expulsion of certain members, and bank failures are just a few potential outcomes.

For the countries in trouble, leaving the European Union would be no panacea. They would likely see a collapse of the banking system in a depression-style run on the banks. Their sovereign debt would be devalued substantially. Greeks are already being arrested with suitcases of cash. Athens is out of safety deposit boxes.

Germany, on the other side, would be the strongest. But its currency could be so strong as to inhibit exports. Its banking system would also be suspect, since it holds large loans of other countries' banks.

The ECB has been dragging its feet throughout the crisis. As U.S. banks and money market funds refuse to take the risk of owning European debt, the ECB might finally be forced to be a more active participant. There is some consensus that at a minimum, the ECB has to absorb government debt.

Former German Chancellor Gerhard Schroeder (1998-2005) recently called for the creation of the "United States of Europe." In an interview with *Der Spiegel,* he said, "The current crisis makes it relentlessly clear that we cannot have a common currency zone without a common fiscal economic and social policy. We will have to give up national sovereignty."