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SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

April 2009

And, the *'Leon Trotsky'* Award goes to…………………………………………….

You're probably wondering what the Leon Trotsky award refers to. I'll going to keep you in suspense for a few moments. But, I think you'll agree with the choice. Before I get there however, there are several issues which are now, or will soon be affecting all of us - especially retirees.

Just about everyone in America today feels poorer than a year ago. In fact, we have lost $13 trillion of wealth for the year 2008 alone. Unemployment is scary. Forget what the government tells you about the rate being just over 8%. When you add in the under-employment number of 8 million Americans (the ones who want a full time job but can only find part-time work) the **REAL** figure is a staggering 15.5%.

Stock market sentiment is not so hot either. According to Investment Company Institute, there was a $63.82 billion outflow from the market in September last year. In October, an unbelievable $127.55 billion went onto the side lines. By any measure this is the 2nd worst correction of the Dow going all the way back to 1896. The worst? You guessed it…the Great Depression.

Dividends, for retirees, are frequently a life-line. In 2008, $40.6 billion were cut by U.S. companies. In the first **two months** of 2009… $40.7 billion have already been cut. The futures market expects this trend to continue with a further 24% drop for 2010. This does not auger well for total returns seeing as dividends represent roughly 33% of share price gains going back to the 1920's.

I don't mean to be piling on with bad/sad news, but I'm trying to be pragmatic in interpreting the news. The American Institute for Economic Research put out a paper on March 2nd stating that the projected cost of our *unfunded* liabilities for Social Security & Medicare over the next 75 years is $43 trillion. To put this number in perspective, the Federal budget for 2008 was $3 trillion. Where will this money come from?

You'd have to be vacationing on Jupiter or Saturn not to know about the *magnitude* of the spending initiatives our government is taking on…our behalf. As of this writing, we're up to $7 trillion and counting. (The amount pledged is actually $14 trillion). Considering that our entire U.S. economy runs at about $14 trillion annually, we'd have to say that that's quite a bit of money, even by Washington standards.

How do we finance all this debt? In the good old days, our symbiotic relationship with China worked perfectly. They produced a bunch of stuff and then loaned us the money to pay for what they made. But with our severe economic downturn, China's exports have taken a beating. In February alone their exports fell a jaw dropping 25.7%. This has caused them to close more than a few factories. More than 20 million Chinese workers have been displaced.

O.K. so, is there any good news out there? Well, actually, there is some. According to the National Association of Realtors, housing affordability is now at levels last seen in 1970. February existing home sales were up 5.1%. House prices actually rose from December to January by 1.7% (It's not much, but it's pointing in the right direction).

Durable Goods Orders were up 3.4% in February. They were forecast to be down -2.5%. We have had tremendous action in mergers & acquisitions. Pfizer bought Wyeth. Merck bought

Schering. Roche bought Genentech. Gilead is set to acquire CV Therapeutics. IBM wants to buy Sun. Coca-Cola wanted to buy China Huiyuan...but were stopped by Chinese anti-monopoly laws. In all, there has been close to $1trillion in M&A in the first 10 weeks of 2009. The point here is simply: **there are many undervalued companies out there.**

Finally, because company earnings are very abstract right now in relation to analyst's estimates, we look to book value to get a sense of where the value can be found. At its peak, the S&P 500 was trading at a value of 5 times book. Today we are at 1.4 times. If and when we get to about 1:1 you'll know we're at the bottom. The way I see it, stocks will have a hard time falling out of the basement!!! This is not the time to get out – all the bad news has already been baked into the cake.

There is so much negativity in the economy that it is feeding upon itself. We are in a crisis of confidence. Until we cheer up as a nation and start buying again, we'll be stuck in a quagmire. Problems are real, but they can be solved.

Every American is outraged at some of the excesses of Wall Street. But, it is worth noting however, that the problems were created by the few...not the many. It isn't prudent to tar our entire economic engine with the brush used to tar the culprits. Harsh words coming out of Washington make the financial markets wonder if it is still O.K. to make money. Mr Obama so much as said it wasn't: ("there will be a time and a place for profits, now is not the time"). If Wall Street and our capitalist system cannot make money here, they will go elsewhere.

Our government has a few more tricks up their collective sleeves. Let's start with a proposed $3.5 trillion budget. To help pay for many new initiatives, some taxes are due to go up. The top two marginal rates would go from 33% to 35% and 36% to 39.6%. Dividends & Capital Gains tax would rise to 20%. To help pay for the needed $634 billion for health care reform, it is currently being proposed to restrict itemized deductions on home mortgages and charitable deductions. Now granted, these changes would most affect the top wage earners, but we should keep three things in mind here:

1. These targeted individuals typically are our small business owners and entrepreneurs…the economic engine under the hood.
2. In a March 16 report by IBD, they wrote that the wealthiest 9% of taxpayers provide more than 50% of charitable giving. Reducing their donations, they report, may provide low-income Americans with better health care and slightly less food.
3. Reducing mortgage interest would sucker punch an already devastated housing market.

It would seem that the intention out of Washington is to raise taxes & raise production at the same time. If this is accomplished, not only will I be ecstatic, I'll be out there looking for the first flying pigs!

Our U.S. dollar printing presses are running overtime right now. As a nation we are in debt for over $11trillion (and adding to it). Our children and grandchildren will be paying off this IOU.

It appears likely that we are going to try and inflate our way out of debt. By debasing our currency, we can repay what we owe with a future dollar worth much less than today. This is also why the Chinese, who hold $1trillion of U.S. Treasury's are more than a little nervous.

Since last September, the Federal Reserve has more than doubled its balance sheet. Inflation, although not yet here, is coming. This will ravage those on fixed incomes. As our dollar falls, commodity prices will rise because they are traded in U.S. $. There is a silver lining here. So much liquidity in the economy WILL eventually supply the desired stimulus and we could see a quick & significant rise in the stock market and a fall in rates for corporate bonds.

Interest rates have basically gone to '0'. On the surface one would think this is good, but as Warren Buffet and others have observed, we may be in the midst of creating another bubble…this time in the Treasury market. If it bursts, treasury prices will drop like a stone. Foreign investors would stop financing our growing trade & budget deficits. This would eventually drive up interest rates. Higher rates will hurt us all.

There is one other bubble out there in the banking industry which makes me very nervous. There are only two banks, that I'm aware of, that have basically 'marked to market' everything on their balance sheets…everyone else's balance sheet is filled with assets they can't sell. In the meantime, consumer credit card debt has ballooned to $1trillion. This is unsecured debt on the bank's books. As unemployment rises, so too do late payments.

According to Innovest Strategic Value Advisors, banks are expected to charge off close to $100 billion of credit card debt in 2009. Then we have rising defaults on the Home Equity Lines of Credits. This amount could rival the credit card problem. Don't be tempted to try and bottom-pick the financials. As I mentioned there are only 2 banks that look decent. They are the best horses in the glue factory.

O.K. so now back to Leon Trotsky and his award. The Bolshevik revolutionary was quoted as saying: "everyone has the right to be wrong, but Comrade X abuses the privilege". In this case the award goes to the entire U.S. Congress. The way they keep changing rules and proposing knee-jerk amendments, they may prolong the recovery and keep cooperation from the private sector in a very tentative position.

I'm as horrified as the next person with the excesses that we have recently witnessed inside companies taking our taxpayer help. Some have bordered on illegal. However, a recent cartoon in Barron's magazine said it best: "Congress' criticism of excessive pay for failure sounds like the pot calling the kettle black."

The TARP money approved by Congress originally had a few strings attached. By the time our lawmakers finished changing the rules, again and again, the string turned into a ball of yarn. This is creating an unhealthy situation with the banks wanting to give the money back!

Lately our Washington bureaucrats have come up with the idea of changing the tax code in order to recoup bonus money that was paid out to a few individuals using TARP funds. We all want to recover this money, but changing rules after the fact does not foster trust.

Congress and Treasury want to remove toxic assets off the books of our financial institutions with the help of the private sector (investment banks, community banks, hedge funds, venture capitalists, etc). This will never happen if private money thinks that rules could change mid-stream. Will Wall Street come to the rescue? I am an optimist by nature and am surely hoping that the public & private sectors can work synergistically. We'll have to wait and see. I am concerned however. There are three issues that have to come together **IF** the plan is going to work:

1. The banks have to agree on a price that they're willing to sell at.
2. The private sector has to agree on a price that they're willing to buy at.
3. The private sector has to have the confidence that Congress will not change the rules at the end of the game.

These are **3…BIG… IF'S…**

So, this leads us to several remedies to help protect what we have in such an uncertain environment.

1. If we believe that all this printing of money will reduce the value of the dollar and lead to inflation – **BUY TIPS** (Treasury Inflation Protected Securities)
2. A weak dollar will prove to be a profit oasis for companies getting more than half their earnings overseas **– BUY THEM.**
3. With health care reform coming, managed care providers and insurance companies will take significant profit hits – **AVOID THEM.**
4. Select companies making health care supplies & treatments will see a profit boost – **CHOOSE CAREFULLY.**
5. Health care providers who serve to reduce health care costs have substantial profit potential…like generic drugs. **–LOAD UP.**
6. Some <u>*investment grade*</u> corporate bonds have been the 'proverbial baby thrown out

with the bath water'. Certain issues can generate returns in excess of 12%/year. **GET PROFESSIONAL HELP HERE.**

7. When picking stocks follow the basketball rule: don't look at the hands; look at the hips. They will tell you the direction of the next move. **IF *INSTITUTIONAL* INVESTORS ARE SELLING THE STOCK…STAY AWAY!**
8. While we're waiting for a market rebound, try to generate some safe income from your portfolio. **SELL PUTS OR COVERED CALLS.**
9. Keep your eye on the stock market moving averages. When the shorter average crosses over its next longer average, that's a bullish sign. **30 DAY CROSSES 90 DAY; 90 CROSSES 180; 180 CROSSES 360.**
10. **BUY COMPANIES TRADING ABOVE THEIR 200 DAY MOVING AVERAGE**

I read a very interesting article recently which analyzed the gains in the market following the worst 12 month declines. In the 12 months which followed, these 10 worst markets were up between 30.6% to 59.4%. As you can see, there is hope!

Also, looking back at the Great Depression when the stock market fell **86%,** there were periods that did extremely well. During the 1930's decade, for example, stocks had four major surges lasting close to ten months and produced gains between 62% AND 132%. You have to be able to take advantage of these periods. Know your buy & sell target prices…and don't forget the practice of annual rebalancing.

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