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LFA Quarterly Newsletter

Just one year ago, the world's economy looked dark and appeared to be on the edge of collapse. So much doubt had been cast over the prospects for a global economic recovery that markets around the world sold off dramatically. There was a sense of panic and fear as financial Armageddon looked like a real possibility. Today, that deep sense of panic has subsided and a consensus seems to have built that the worst is behind us and that we will return in the not too distant future to some semblance of normalcy. The monetary intervention of Chairman Ben Bernanke and world governments injecting massive amounts of liquidity into the economy appear to have prevented a bad situation from becoming much worse.

On the other hand, the \$787 billion fiscal stimulus appears to have had little impact as it has not yet led to job creation with unemployment breaching 10%. There will ultimately be consequences to pay for effectively printing massive amounts of money. The past few months have seen the U.S. dollar falling and gold prices increasing, suggesting investors are making their concerns known by their investing actions.

There are both positive and negative fundamentals facing our economy now. The positives are the federal stimulus will continue through next year. Chairman Bernanke will likely err on the side of caution wanting to be confident the economy is improving before he starts raising interest rates. The low interest rate environment will help mortgage holders and would-be home buyers. Inventories are at an all time low and will need to be replenished. Lastly, the weaker dollar has helped U.S. exports as overseas economies are gaining some traction. Things are not as bad as they were a year ago. We are in fact getting close to an economic bottom, at least for now.



The negatives are many and will no doubt overshadow the positives for some time. The U.S. commercial real estate market is in a serious slump. Property values have dropped 35% over the past two years and are still falling. Unemployment rates are 10%. This does not include part time workers who cannot secure full time jobs or those

who have given up looking. Job losses are likely to continue for a minimum of another year. Credit availability remains tight as lenders grow more conservative and have increased qualification standards. Many companies are closing accounts or cutting credit limits. It is very difficult to obtain new credit. Small business has been severely affected. The process of obtaining a mortgage loan is frustrating and difficult to say the least. Those of you who have attempted to refinance your home recently have likely experienced this first hand.

Consider the following landscape. Consumer spending represents around 70% of the U.S. economy. Consumer debt (credit cards) and the ability to access home equity appreciation gave consumers additional purchasing power (leverage) to consume more than they could normally afford. This phenomenon and the consumer attitude of spend, spend, spend helped to fuel a bubble that was not sustainable. The U.S. savings rate used to be over 10% in the 1980s. That rate has steadily declined over the past 20 years, turning negative in recent years as Americans spent more than they had. Do you remember all of the credit card offers you used to receive in the mail each month? I have not seen many offers lately in my mailbox. Starting last fall Americans started to save again. The savings rate suddenly increased to 5% last fall demonstrating the strong behavioral change as Americans react to economic turmoil. The Bureau of Economic Analysis is reporting that the personal savings rate reached a 12 year high of 6.9% in May! This is the highest it's been since December 1993.

Another consequence of lower consumption will be further downward pressure on the value of the majority of American's most important asset, their homes. Until recently, Americans saw their homes as a safe place to invest in and build equity for retirement. This strategy is being seriously questioned and may not work well in the future. Purchasing a home for investment purposes will be questioned.



Americans are anxious and are not likely to revert back to their over consumption binge again for quite some time, if ever again. The psychological damage done along with the financial erosion of American's net worth could make this new consumer fiscal responsibility the norm. You will read much more about "the new frugality", and the "paradox of thrift" in the coming months as Americans reevaluate their financial priorities.

It is no surprise to see sales tax revenues decreasing. State sales tax revenues measure retail sales. On average, revenues are down almost 12% according to the Pew Center on State taxes. When people save it means they aren't spending. This hurts the economy creating a ripple effect across all sectors. We are facing a scenario that many have termed "the new normal". The new normal will be characterized by much slower growth going forward.

We do believe that it is a good thing that savings rates have increased. We have been spending more than we have been earning for too long. The new savings rate will no

doubt prolong our road to recovery but when things do recover, it should be genuine growth. We will see if the new savings rate continues. Old habits are difficult to break.

With so much doubt still hanging over the economy, one might reasonably question whether the recent rally in the market is sustainable. We don't know, for example, when job layoffs will end, when home foreclosures will abate, how many more defaults there will be in the commercial real estate market, how many banks will go under, or how many corporations will go bankrupt. Nor do we know how long credit markets will remain impaired, how much more state and local governments will need to cut spending, or how high tax levels are likely to rise. Above all, we don't know how the economy will perform once it is off the life support that these massive injections of federal dollars have provided.

All of the above suggest that the capital markets may have gotten ahead of the underlying economic realities and that a market correction could occur at any time. That is a distinct possibility. However, history suggests that it would only be a temporary setback. At any juncture during a bull market over the last 50 years, one could have pointed to economic problems. They were usually so well documented that the markets had already taken them into account and were looking past them. Moreover, there are now trillions of dollars in cash or cash equivalents that could be used to buy securities once the clouds pass. And by rallying, equities and corporate bonds not only anticipate recovery, but they also help to bring it to fruition.

Paradoxical though it may sound, skepticism has often proved beneficial for the capital markets. As the legendary investor Sir John Templeton once said, "Bull markets are born on pessimism; grow on skepticism, mature on optimism, and die on euphoria." We are deep in the skepticism phase and will remain there until consumer and corporate demand revive.



One must engage an uncertain world with a flexible mind. We financial advisors certainly have our work cut out for us to figure out which factors will govern and how long they might influence trends. We do believe that there will be more uncertainty than certainty over the next 12-18 months as we face nontraditional headwinds.

We at Lifetime Financial Advisors are constantly monitoring the current financial and investment mosaic and are actively thinking outside the box to add value to your investment portfolio. We will continue to be diligent in researching profitable opportunities utilizing our resources. Our main goal is to locate investments that should perform well in this new environment, always asking "what could go wrong and how will it affect our client's portfolios".

We thank you for the trust you have placed in us. We are here to assist you in working toward meeting your financial goals. All of us here at Lifetime Financial Advisors are up to this challenge as we face the new normal and the headwinds of economic uncertainty.

Please give us a call if you have any questions or concerns. We are always happy to speak with you.

Regards,

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