

## Mispriced Risk

The last few years have been historic in many ways in the financial world. The biggest thing we see is risk is grossly mispriced. We have market participants not getting paid for taking monster risks which is typical of a financial bubble.

This is happening across the spectrum, last month we wrote a story about how many bonds that normally trade at \$100 are now trading at \$120 - \$125 each and if held to maturity, guarantee the holder a substantial loss on what is commonly a very "safe" investment. We need to redefine safe today since all assets have the illusion of safety in them as many have gone up big time in the past few years.

Let's look across the pond to Portugal as an example of what I mean here when I talk about risk being mispriced. The country has had its fair share of issues in the past few years and they're still working to get their house in order. Things appear great on the surface, but under the covers not so much. Here is how the net debt of the country has grown over the past decade.



We clearly see the trend that debt levels continue to rise each year. In 2011 when Europe seemed to be coming unglued, debt levels were at 94% of GDP. Today they're at 129% of GDP. With so much more debt to deal with, the country is a far riskier place than it was just a few years ago.

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## Small Business Succession

Most small businesses cannot survive one intergenerational transfer. For those who do, even fewer survive multiple intergenerational transfers. We work with a plethora of small businesses and see this on a daily basis. On the news lately front and center is the Market Basket fiasco. How ironic the company name includes the word basket as I've heard many people describe this as a "basket case" but it's not uncommon for things to unfold this way in business.

For those who are unfamiliar with the story, Market Basket is a regional grocery chain mostly in northern New England. There have been family "issues" for a long time and this summer they decided to try and fix these issues. The fix was to fire the longtime CEO, replace him and try to take over the company from the longtime family who held just under the majority of shares. There has been bad blood between family members for a long time, years ago there was a lawsuit for 500M for wrongs committed by one side of the family against the other. Sad how this all plays out in business. You'd think these people would find a way to get along and feel lucky and blessed for the success they've had in business. This isn't a tiny company, it's big by any measure but these very things go on almost every day in local businesses we deal with. We know of several of them right now with similar issues within.

Here is how this plays out after they fire the longtime CEO they call Artie T. The company did this and simultaneously did a horrific job of communicating to the employees what was going on. When the news of the firing came out, many employees who loved and were loyal to Artie T. just walked off the job, refusing to work. This became crippling for the company as they basically shut down the logistics operations of the company while havoc was going on outside the stores around the region. While the outside havoc was happening, virtually nothing was going on inside the walls of the stores. Not only were they unable to get food to stock the shelves, the customers also had a revolt so to speak.

An interesting twist of events happened when local unions tried to come into the mix and talk the employees into becoming part of the union. The overwhelming response was no way, why do we need a union, we've brought this company to its knees without paying anyone a nickel. The employees were unified and used social networking and other modern technology tools to come together and stop business as it had once been doing.

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## Mispriced Risk (cont'd from pg. 1)

Much more debt and a slow economy would logically result in a riskier place to do business. A riskier place to do business would no doubt carry with it riskier investments. Riskier investments would no doubt demand a much higher interest rate to compensate for the additional risks.

Not so much! Now let's look at the actual bond yields for the country of Portugal to see how much investors are getting paid to lend money to that country over time. This is the 10 year Portuguese government bond as our example here. Thanks to Bloomberg for the chart.



Why is this happening you ask as we all do? The risk is clearly higher than it was a few years ago, yet the cost of borrowing for the country has gone from 16% annually to just over 3% annually. You'd think they were doing such a great job with the country's finances. The politicians should leave the elected office and run as CFO for Apple or any other company who is very financially stable.

The driver here for this behavior are central banks. They've pledged to do "whatever it takes" a few years ago to keep countries alive, regardless of how badly they're behaving financially. Portugal is currently running a current account deficit of about 5% of GDP. This means the country is spending 5% more than it takes in this year. Next year the debt to GDP will likely go from the current 129% to about 134%. This is not a good trajectory yet the costs of borrowing continue to decline. This is Orwellian in many ways but we need to look over the fences and realize what is happening.

Central banks are printing like mad, they're offering all kinds of schemes to make people believe in what they're doing. Some of the schemes range from QE (bond buying) to hypothecated borrowings, reverse repo facilities and the like. The bottom line on all of these gyrations and exercises is that it really doesn't diminish the risks of the investment. Although current prices make these seem like very safe and stable investments, they're nowhere near close to that. This is happening across the globe and across the risk spectrum. Move with caution in this environment, things are not what they appear to be in any way.

## Where is the volume?

We're (Sammy & I) always cranking up the music and Cup often says turn it down. Our canned response is "if it's too loud, you're too old" and someday I'll be part of that too old crowd, but not just yet.

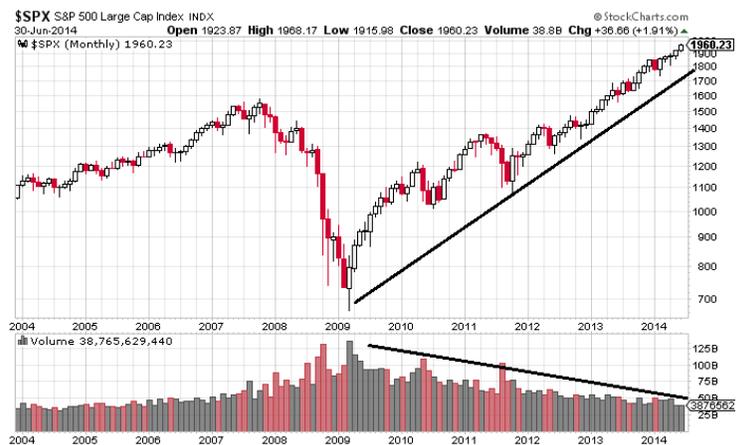
This volume we're speaking about here isn't the volume of the music, but of the activity in the trading on stock markets in America. We're seeing markets go high on negligible volume. This is an interesting study we want to share with you so you can see just how much volume has fallen off a cliff in the trading arena we all live in.

Here is a spreadsheet of the volume

Trading Volume, S&P 500, June of Each Year, 2009 - 2014		
Year	Volume (Shares Per Month)	Year-Over-Year % Change
June 2009	93,147,496,448	
June 2010	91,971,043,328	-1.3%
June 2011	63,674,499,072	-30.8%
June 2012	59,703,365,632	-6.2%
June 2013	51,560,980,480	-13.6%
June 2014	38,765,629,440	-24.8%

Data source: [www.StockCharts.com](http://www.StockCharts.com), last accessed July 1, 2014

Before the last few years, whenever markets have gone up they've gone up on increased volume, typically massive increases in volume as everyone jumps in and pushes prices higher. This time we're seeing prices go up but volumes aren't there. Here is a graph of the same data with the S&P 500 added in. Things haven't gone as they have in the past now for 4 years. How long can this carry on?



How are prices moving up if there is negligible volume? We don't have the answer to that question, but we suspect corporate buybacks as well as QE both have major influence on the systems for the time being. Note the corporations are not good at buying their stock back at the right time. Think about it, if they were smart they would have been buying it back in the depths of 2009 when prices were cheap. No, they're buying it back now that we're in bubble territory. Human psychology will never change, the big question is can we be strong enough to avoid the herd mentality?

I can, can you?

### Noteworthy News!!!

- Congratulations to Paul & Chris Piantek on the purchase of their new home! ☺
- Congratulations to Wayne Prescott on his new job in Region 6! ☺
- Congratulations to Marian Flores on her new job with the Waterbury Schools! ☺

### Question & Answer

Ask any financial question and we'll answer it here!

*Q: Do electric cars provide true green energy or just switch the source?*

Great question and not one with a clear answer. If your car is a traditional one and you burn gas or diesel they're obviously in the "dirty" category. Electric vehicles are considered "green" by all involved in their movement and they certainly have impressive MPG estimates. Being a car nut I do have a liking for the Tesla model S. It's a slick luxury sedan and has an impressive almost 3 figure MPG rating. The cost of running a Model S if you're driving about 12,000 miles per year in CT is only about \$28.00 per month. That money you'll spend on the electric charging as this car doesn't take gasoline at all, it's not a hybrid it's truly all electric. I have yet to drive one, but when I do I'll share the experience. I cannot justify the current price, but if they become mainstream it'll come way down.

Since you're paying for electricity as your energy source instead of an oil or diesel, does that make it green? That all depends on where your electric utility generates their power from. In America here is how our energy is sourced across the country:

Coal – 39%

Natural Gas – 27%

Nuclear – 19%

Hydropower – 7%

Renewables – 6%

Petroleum – 1%

Other gasses – 1%

This list isn't all "green" energy for sure. I would classify the natural gas, hydro and renewables as truly green energy. We have a movement to make electric generation greener but it'll take decades. The bottom line is electric vehicles are not all green, but they're better than the alternative and far less costly as the Tesla proves. We'll have to see how long term reliability and longevity play out. Right now it's a bit too early for mainstream adoption. Today it's more of a tech junkie experiment, and that's only for the rich tech junkies! ☺

Fast forward a few months and the new organization that had planned on taking over the company has now decided that it is in everyone's best interest to sell the company back to Artie T. and his family. The deal is in the works, Artie T. is back in the driver's seat and the employees have come running back to work. The stores are now full of goods to sell (mostly, not 100% but getting there) and customers are back in the aisles.

This experience with a very public war between family members in a closely held business will likely go down in the history books and be used as a common teaching example of how to properly plan for business succession. We often tell clients who own small businesses there are many things they must be concerned with outside of just doing business. If the business is successful and helping many families provide for themselves, there is tremendous importance in making sure the business carry's on no matter what happens. Too many people are depending on the business to have it fold over poor planning.

Here are the big issues we see facing businesses today that all business owners, boards of directors and families need to think about. What happens if a business leader is incapacitated, dies or for some other reason is unable to carry on with his or her duties? A plan must be in place to accommodate that very thing as it happens too often. We've had this happen to businesses we deal with twice in the past few years and that is a very small sampling of just a few hundred businesses.

Many businesses not only have important leaders, but sometimes salespeople are the rainmakers in some organizations. If the rainmaker is gone what happens to the organization? It often struggles if it can survive. Think of corporate leaders, top salespeople, key executives or any other very important person in an organization. Plans need to be made for each of these people as they're all very important to the survival and hopefully thriving of an organization.

For those who have ownership in the firm, a succession plan needs to be developed so the company can carry on in the event of an untimely death or disability of an owner. Not only should plans be in place for such an event, but funding mechanisms should also be in place to help with funding of such a purchase at the worst possible time.

For larger firms where values are sizable the people with ownership need to coordinate such succession plans with solid estate plans so the death of an owner doesn't result in a forced sale of the company or a portion of the company to pay for estate taxes imposed by the IRS. We've seen this go down as well, people thinking this will never happen to them after explaining the rules and a subsequent death, then the family having to struggle to pay off a huge estate tax bill. We've seen this very issue bury companies as well and when that happens, unless the company is sold for a fair price, the assets are not there to pay the taxes due. The income certainly isn't there as the business was the source of the income so once the machine is gone the ability to use it for income is also MIA. There is a lot of meat on the bone in business planning, if you'd like to talk about this reach out to us anytime.

## Money Quiz



This month's challenge is on the black gold. How much oil do we produce domestically each day in 2014? . Last month's quiz wasn't won! ☹️ The 22 largest banks in America control 62% of the assets! This is 0.35% of the banks controlling 62% of the assets in the country. Time for baby banks perhaps? Winner goes to Ruby Tuesday on us! 08/04/14: 05

## Student Loans!

We're all putting our kids back on the busses and shipping them back to college this season so it's an opportune time to discuss student loans. This has been a problem for years, but is now getting to the point of crazy.

Student loan debt is now over \$1T (that's Trillion) dollars with no end in sight. The problem seems to be anything government is involved in, sponsors or subsidizes in any way quickly gets out of hand. I cannot think of one government body doing well financially. They're all fiscally problematic as they run without the application of common sense. Of the \$1T in borrowed money, the government sponsors about \$864 billion of it while the other \$150 billion are private loans.

You cannot only blame the government, the choices people are making for the "experience" are their own and once made, must be paid for. It is still possible to get a very reasonably priced education through a few years at a local community college and then transferring to a local state school as a commuter student. Through this method, you can still get a bachelor's degree for about \$20 - \$30k depending on what part of the country you live in.

Not everyone wants that and the getting away and living on your own is an important part of developing into an adult for some people. If this is your path it's going to cost more simply because you're supporting two homes for the college life, the one you've always lived in plus the dorm.

Here are the stats on how families deal with the exponentially rising costs of higher education today.

- 20 million people attend college in America every year
- 12 million, or 60% of those, borrow money annually to help cover the costs
- 37 million people in America have outstanding student loan debt – 14% of borrowers are behind on payments ☹️
- Average balance is \$28,700
- Average balance for a physician is \$175,000

## Wikipedia 2

In a prior issue we discussed the amazing success of Wikipedia. Authors from all around the world have made an online resource that is fabulous. Here are a number of entries I found so comical I needed to share them with you. ☺️

Obsessive Compulsive Disorder (O.C.D is getting really upset that there is no period after the D in the first part of this sentence.

Latte is a brewed beverage made by adding five dollars to a cup of coffee

Signature is a written representation of the only known cursive letters an adult knows anymore

Mirror at his point is likely the most photographed object in the world

A conference call is a phone call between multiple business people who want to waste each other's time but cannot do it in person

Ringo Starr, born Richard Starkey, is a British drummer who achieved fame as the least famous member of the Beatles.

Pompeii is an ancient Roman city known for its breathtaking and, every millennium or so, life taking views of Mt. Vesuvius

What is and what is not a toilet kind of depends on how drunk you are

A soul patch is a lot like a Hitler mustache, but below the lower lip and worn by people much worse than Hitler

Sweatpants are a non-verbal means of indicating that you would like your order to go

Resume is a written summary of all of the professional accomplishment a person has made up

Tequila is a Mexican liquor typically consumed just prior or in order to forget a huge mistake.

Greece is Europe's Detroit

Sphinx is a mythical creature with the head of limestone, a body of limestone and wings of limestone

Yoga Pants are a type of flexible form fitting pant designed for the practice of yoga and used for pretty much everything but the practice of yoga

April Fool's Day is an informal holiday during which people lie to each other for amusement instead of to get ahead

A DJ is pretty much just a person who knows how to make an iTunes playlist

Beverage coaster is an article upon which beverages are placed in order to protect the beverage drinker from one of his wife's lectures about how long the table has been in her family.

## Inspirational Quotes

- We are all in the gutter, but some of us are looking at the stars, Oscar Wilde
- Limitations only live in our minds, but if we use our imaginations, our possibilities become limitless, Jamie Paolinetti
- You need a mind open to possibility, conditioned to love the creative spirit we all have inside ourselves, Gianni
- Be nice to nerds, chances are you'll end up working for one, Bill Gates
- Kind words can be short and easy to speak, but their echoes are truly endless, Mother Teresa
- A little nonsense now and then is cherished by the wisest men, Roald Dahl
- When you confront a problem you begin to solve it, Rudy Guiliani
- Fools rush in where angels fear to tread, Alexander Pope



**We can piece the puzzle together and make your money work for you!**

## Kids Korner

Are our children being good stewards of the resources we provide for them? I had a conversation recently with a client and they explained how their daughter wanted to buy Uggs. I didn't know what these were but apparently they're very expensive boots or shoes. Some of these can cost \$250.00 for a pair. The kid is feeling social pressure because some kids in school have a dozen pair of these and she had none. I cannot justify that kind of money for shoe and to have our society pressure the kids to follow suit is the perfect time for a conversation. Talk to the kids, explain that regardless of social norms or pressures, spending that kind of money may not be the best stewardship of our resources. They respond when you explain logic. They need to get this early or it'll own them lifelong.

**Don't make excuses; make things happen; make changes; make history, author unknown!**

**Connecticut Directory (860) 673.1942**

Mike [mike@fiscalwisdom.com](mailto:mike@fiscalwisdom.com)  
 Michele [michele@fiscalwisdom.com](mailto:michele@fiscalwisdom.com)  
 Andrea [andrea@fiscalwisdom.com](mailto:andrea@fiscalwisdom.com)  
 Nick [nick@fiscalwisdom.com](mailto:nick@fiscalwisdom.com)  
 Betsy [betsy@fiscalwisdom.com](mailto:betsy@fiscalwisdom.com)

**New York Directory (315) 682.0348**

Mark [mark@fiscalwisdom.com](mailto:mark@fiscalwisdom.com)  
 Larry [larry@fiscalwisdom.com](mailto:larry@fiscalwisdom.com)  
 Josh [josh@fiscalwisdom.com](mailto:josh@fiscalwisdom.com)  
 Jackie [jackie@fiscalwisdom.com](mailto:jackie@fiscalwisdom.com)  
 Tom [tom@fiscalwisdom.com](mailto:tom@fiscalwisdom.com)

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Connecticut Offices (860) 673-1942  
CT Toll Free (800) 843-4513  
New York Office (315) 682-0348  
NY Toll Free (888) 693-8390



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15 New Britain Avenue. Unionville, CT 06085  
860.673.1942  
Torrington, CT . Manlius, NY

## Chadwick Financial Advisors Place Financial Advisors

