

## Global Fiscal Policy

The global economy is teetering between growing out of the recession and slipping back into another one. When pundits talked about a double dip recession a year ago it wasn't possible. Today it is possible and I would say it is equal either way. We are kind of in the middle as to whether or not it will happen. It isn't a big deal either way, but the media will go crazy if it happens. Government has been on a spending spree in the past few years to offset the lack of spending in the personal sector. This needed to be done to avoid a fiscal train wreck in 2008. Despite many criticisms, the TARP program actually made the government 25 Billion dollars. That is likely the best money the government has ever spent. Certainly the highest return on investment of any government program I'm aware of. That program is mostly all wrapped up now, with very few small institutions having any outstanding debts.

The last elections sent a clear message that fiscal discipline needs to be the priority. The political class is not handling this responsibility well by digging into camps and acting like infants, but we're dealing with the issues now. In Europe it is impressive how they are working across countries, through independent bodies to find solutions to complex problems across countries that have entered into the Euro currency. The Euro was meant to unify the region. In actuality it enabled weak countries to continue to borrow beyond their means and that is what leads us to where we are today. The forming of the Euro countries lowered borrowing costs for the countries that are on the edge today financially.

The answers to these complex problems will not come easily, but they will come with time and work. The big questions today are how costly will the solutions be, whom will pay, will they take a toll to the financial system in Europe, and if so will that spill over across the globe? The answer is absolutely not, just like our financial system didn't stop in 2008, Europe's will not implode today. This very fear along with our political folly is what has

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## Ideals

I am a real fiscally conservative person but simultaneously a socially very benevolent one. Helping people in need is something we should all do. It is a responsibility we all share. What goes around comes around so help as many people as you can. Someway, someday, somehow it will all come back to you when you or a loved one need it most. In our family we actively help many of those around us both fiscally and with our physical sweat. We reach out to help in many places, whether it is our church, our local soup kitchens, the local schools, sports organizations, etc. It is my hope that we all do this to fullest extent of our god given abilities and talents.

The world has become an incredibly complicated place lately, with deep rooted fear piercing the very heart of almost everyone on the planet. The current budget woes with our government are tough to say the least. We have a political system that is broken. The parties, their values and their rhetoric have become far more important than doing what is right for our great nation. It is my hope that our elected leaders can get beyond their jobs, their backers and their affiliations to address the real issues at hand, the fiscal ones.

Our budget woes are painful and we need to fix them, but they're not yet critical. If we do not find the proper path to fiscal discipline, they will one day become critical in the decades ahead as Europe's are today. None of us want to relive the folly of the budget debate of last month which was an embarrassing joke and a glaring example of our lack of leadership.

Europe is already in the critical phase fiscally as we speak. This summer the rage was Greece and its potential insolvency. Greece is a place where the government has become so big and so hard to work with due to corruption and regulations. The economy simply isn't working. This has led to not enough businesses and capitalists producing to pay all of the government made and mandated bills. Think about how many people come here from Greece and build empires in America? I know dozens of them. They don't leave their homelands because the grass is greener at home, they leave because the opportunities here are greater. Once given the real opportunity America offers, they thrive. Many immigrants from any country are often much hungrier than

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## Fiscal Policy (continued from page 1)

been the root cause of our markets falling precipitously lately. I couldn't see this clearly until very recently. Very similarly to 2008, the short sellers are forcing down prices of European financial stocks, and many other European stocks in general. This has come across the pond and started to happen here as well, with our domestic financials coming under pressure due to the fears of that European situation. This isn't logical on many levels because most of our small financial companies in America have zero exposure to European issues, but it happens anyway due to fear and emotion. For the large financials, there is exposure but many firms have identified such potential exposure and either reserved against such outcomes or hedged to profit from them so the fear and selling based on panic and not on value is what is causing the current drop. I don't know how long this will continue or how bad it will get, but it will create awesome opportunities for us in the near future. This environment isn't logical at all and is hard to predict. It is best for us to sit tight with our cash in hand and in the safety of bonds and let it unfold and strike while the iron is hottest.

Do not get paralyzed by this current frenzy, the current issues will pass and we'll soon be on to a new set of problems to deal with in the world that we cannot fathom today. Once we move beyond these problems, the values of companies will stabilize and begin to rise and we'll have another opportunity to profit handsomely as we did in the past few years. Even today as the European area seems to be falling apart, there are great companies that are getting hammered price wise simply because of their geographic headquarters. Many globally dominant ultra-competitive firms are headquartered in Europe and do not have anything to do with the government budget fiasco's currently unfolding. They are not immune to the current world wide sell off we are experiencing, but the process is simply creating value for us to take advantage of in the future.

In the interim, while the chaos unfolds across the globe we've found some very interesting places to profit today. Some areas of the bond market are quite attractive today and we're moving into them in large quantities. I especially like foreign bonds from governments who are fiscally conservative, mortgage bonds and high quality corporate bonds. The corporations today have rock solid balance sheets and more cash than anyone. Many mortgage bonds today are being purchased from the banks for 50 cents on the dollar and provide a 5-6% coupon to investors. The coupon is just the start of returns; the bonds will ultimately mature to 100% so in some bonds we have an opportunity to earn close to a double digit return. If some of the bonds are refinanced, we earn all of the money up front for a bigger short term return. Volatility creates opportunity. ☺



## The Downgrade

Almost all of the news in the past month has been about the political folly of our budget fiasco and subsequent downgrading of the U.S. debt credit grade to AA status instead of AAA status.

The country has historically enjoyed the AAA status but we have come to a place where there is a new game in town. People, countries and entities continue to buy U.S. Treasury securities every day and the auction right after the downgrade saw strong buying. People today often talk about the fall of America but if this were the case people would stop buying our bonds altogether. Amazingly, more bonds were bought from us in July than in June, despite the political fiasco. The move will impact sentiment, but not security because people across the globe trust us more than anyone else. Where are they going to go as an alternate, Eurobonds? I don't know that currency of the Euro will survive, is it really a reserve currency option? Chinese bonds? People talk about the loss of the dollar as the global reserve currency, but in times of fear like today the globe flocks to us. They're flocking so strongly to us that the yields are actually negative on the 90 day treasury. There are many stable and safe governments to buy bonds from, but none of them are big enough to accept the amount of money in the system that ours does.

Our bond market is the deepest and most liquid in the world, and the credit rating downgrade isn't going to change that. If people were really concerned about our credit worthiness, they'd stop buying our bonds and that is not happening. Buyers of our bonds include central bankers, insurance companies, individuals, mutual funds, hedge funds and institutions the world over. This isn't the same as 2008 and therefore will play out differently. The volatility is the same but the underlying issues are very different. In 2008 companies were in bad shape and the government provided massive stimulus to re-lubricate the system. Today companies are in the best shape ever, but the governments are too fat with debt and bad policies. Prices are cheap today, but the fear is high. We'll use this to our advantage.

The downgrade is more of a political message to the 535 3<sup>rd</sup> graders in Washington D.C. to get their act together and stop the nonsense. This is likely to be a blessing in disguise, as the fiscal discipline issue now needs to be addressed sooner rather than later. Our situation isn't as critical as the Euro's, but it's clearly really important to fix now before things get to a tipping point.

## Noteworthy News!!!

- Congratulations to the Gallagher family on the birth of baby Jalynn Jennifer. Princess # 1 for the family. ☺
- Congratulations to Regina Place on her recent retirement! ☺
- Congratulations to the Tierney family on the birth of grandbaby Lain Marie!
- Congratulations to the Megan Whitney & Ben Rogers on their recent engagement! ☺
- Congratulations to Ross Guastella on his new job at Yale! ☺
- Our condolences to the Doolittle family on the passing of Sharlene, a wonderful woman, mother, grandmother, wife, sister, aunt and friend.
- Our condolences to the Piazzarolla/Zotto/Tedesco families on the passing of Lisandro Roberto Piazzaroli, a wonderful man, father, grandfather, uncle friend and brother.
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## Question & Answer

Ask any financial question you have and we'll address it here.

*Q: Why are the markets going so crazy like in 2008?*

There is no easy answer for this question but it appears that the European debt dilemma is one of the main driving factors. For most of the summer we've known Greece had issues, but they seemed isolated to just Greece. Now it's painfully apparent that the Eurozone has several weak countries that may have to restructure their debts to stay in business. Greece, Italy, Ireland, Spain and Portugal all have issues to deal with. The crazy volatility is coming from the unknowns of government's ability (or inability) to find fiscal discipline, and the markets hate unknowns.

The situation is very different from 2008 in that businesses are fiscally solid, the consumer is in better shape but now the governments are in debt. We'll need structural reforms from the government side to right the ship.

The volatility is for different reasons between 2008 & today, but it is equally volatile of an environment. I am quite surprised at this, I thought with the extreme of 2008, we wouldn't see anything like this again for a generation. The good news is that the volatility creates opportunity and there is a lot of it out there today. I can see great values today if you have an iron stomach and don't mind riding the extreme waves. For most people, we're playing defensively and waiting for the best time to pick up the deals, hopefully at the bottom to avoid any more turbulence.

In 2008 the governments across the world pumped money into the financial system to keep it liquid. Today we have ample liquidity in the system, but fear about government insolvency causing bondholders to take a haircut (this is when you get less than you're owed, they should call it a scalping) is putting pressure on shares today. This is mostly a European issue but the world is so interconnected today it'll impact us all to some degree.

## Ideals

*(Cont'd. from page 1)*

Americans born in America and outwork them to get ahead, way ahead. Many who do not work hard or are on the government take do not have any motivation to work or produce. This part of the country is getting larger and larger, and they all vote for those politicians willing to give them more. That is great for them, but at what ultimate costs to us as a nation?

After many rounds of back and the Greek debt situation seems to be in the process of being handled. The cost for Greece to borrow money (sell bonds) is now beyond what the country can afford so there has been a rescue package where they can sell their bonds at a fixed price to a rescue body. If it were up to the open market, Greece would be out of business. This same thing is now beginning to happen to Italy and appears poised to be spreading to Portugal, Ireland and Spain. It should be no surprise to anyone that this is happening; all of these social programs are absolutely unaffordable. It is quite sad to see our country steering towards this fiscal train wreck despite the clear and compelling evidence of where it leads.

The common ground on all of these countries is their strong social policies where everything is provided for everyone in the country, people don't worry about most things and are not very thrifty because they're spending someone else's money. The other constant is that these countries are taxed very high. It is a great thing to provide for everyone, but on the fiscal side of the balance sheet it simply isn't workable. I'd love a world where the government can take care of everyone, but it kills personal motivation and production. Government takeover of countries absolutely kills capitalism and the work ethics of people. The working people are the ones who pay the taxes to pay all of the bills. If government keeps taking from the working class to give to those not working, a tipping point can be reached where it no longer makes sense for the working class to work. This is a very scary tipping point.

Everyone agrees unemployment is far too high and reducing unemployment is what will take us out of the economic situation we are in. With that universal agreement, if you ask an employer to hire someone, they are either hesitant to do so or cannot afford to do so. The employer has higher costs from insurance (not to mention the new health care law), legal, compliance, regulation, materials, energy, all around the spectrum costs are higher. The way out of this economic bind is to reduce government, the associated red tape, and allow people who want to work to work. Take away incentives not to work and get the population motivated and excited. Now we're fat, dumb and happy assuming someone else will take care of us. The tide has begun to turn. It is too bad it had to get this close to the edge.



## Money Quiz

How many unsold homes are on the market as of July 31<sup>st</sup>? As of July 31<sup>st</sup> 2008 there were 4.58 million of them. We're in much better shape today, but what is the # of homes for sale as of July 31<sup>st</sup>, 2011? Last month's quiz wasn't won, the average American owes 114% of his or her after tax income in debt. The winner will enjoy a meal on us at Ruby Tuesday. © 08/29/11:08

## Inspiration

We all need a little inspiration sometimes and when problems or frustration occur, it's inspiration that solves the problems at hand. Our world has no shortage of obstacles and challenges today, but don't let that make you hide out under the covers. These frustrating times are what motivate people to change the game over time, usually for the better.

We are in a situation where the news media is instant and unfortunately focusses on the bad, but there is a plethora of good happening daily that goes unnoticed and unsaid. Look at all of the good that goes on in your school, town and church virtually every day that you never hear about on national media.

People are frustrated today about all of the issues in our world and they are currently working on solutions. Solutions to the current problems will be forthcoming and life altering. For those who don't curl up under the covers and hide from the world, they're going to choose to work through it. It is what we should all do, but not everyone is geared up to do these things. When man is challenged, the sheer lack of giving up will ultimately lead to a better way of doing whatever it is he or she was trying to do.

History has taught us many times that whenever we're presented with an obstacle, we have two choices. Option one we can turn around and go the other way and simply give up. Alternately, and preferably, we can choose to find a way around said obstacle. If a wall were put up in front of me, I'll do whatever is necessary to get over, around, through or under it. There is always a way as long as you don't have a self-limiting attitude. Attitude is altitude in life. Never let your attitude down. Where there is a will, there is a way. Virtually all great people and great inventions and processes were born of an attempt to solve a problem or find a better, more efficient way of accomplishing an old task. Keep the faith! ☺

## Stagflation

This has been one heck of a popular topic lately. What exactly is stagflation? Before we address it specifically, let's first discuss inflation and deflation. Inflation is where prices are going up on goods and services that we all consume, and deflation the opposite, prices are going down on the same goods and services we use each day. Today we have an environment where prices of food and energy are certainly on the rise, as is government interaction as they fee and tax everything to death on the local levels.

Stagflation is defined as high inflation, rising interest rates and low economic growth, often accompanied by high unemployment. We have some qualities of stagflation today. Many things can cause stagflation, such as rising oil prices in an economy highly dependent on imported oil (us) as well as inappropriate monetary or regulatory policy. It can also be caused by higher taxes or a shortage of natural resources, or war. We certainly have an accommodating monetary policy today but the regulatory environment is certainly a contributor to this situation as well as the energy costs, wars and tax increases on the local and state levels country wide. This situation is likely to worsen as the federal government at some point will come to a balance of spending cuts and tax increase to fix the budget.

So now the question becomes what investments do well in an environment of stagflation. Traditional theory says hard assets such as real estate; commodities and energy do well in such an environment. This is worth considering for further research as these things have done well until now. There has been some hemorrhaging in gold lately and all of these assets are pricey, so the question becomes just how high can they go.

To a value investor like me, it's so hard to think of buying things like these that are expensive today, but that doesn't mean they aren't good investments, and may in fact be the leaders for the near future. I'll do more homework on this to see if it makes sense moving forward to shift allocations towards these areas. Another solution that works well in this type of environment is simple rotation through the big swings. Big market swings of 30% or more are "normal" in this type of environment and buying into assets as they dip down and holding them until they go up, but not forever, has been successful in the stagflation environment. Nobody wants to hear that 30% swings are normal, ever, but be prepared for the possibility.

We're in a new phase of the globalization of the world as the planet is becoming truly globalized. We're all so interdependent upon one another like never before. People still feel we're all on islands as our countries or regions (Eurozone) are separated by borders, but the truth is we're all so economically connected it's beyond belief. What we do impacts Europe, Asia and Africa big time, and to a degree the reverse is also true. We'll find a way to pick our spots and profit.

# Inspirational Quotes

- Always make a total effort, even when the odds are against you, Arnold Palmer
- A part of kindness consists in loving people more than they deserve, Joseph Joubert
- A kind speech and forgiveness is better than alms followed by injury, Proverb
- Kind words conquer, Proverb
- Failure is only the opportunity to begin again, this time more wisely, anonymous
- The willow knows what the storm does not: that the power to endure harm outlives the power to inflict it, anonymous
- Defeat is not defeat unless accepted as a reality in your own mind, Bruce Lee
- Problems are only opportunities in work clothes, Henry Kaiser



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



# School Shopping

Our kids are back to school at the end of the month and summer shopping season is in full swing. We give the kids a limit of how much they can spend and that is it, it's a hard limit. This motivates them to be thrifty and simultaneously drives them away from paying top dollar for their clothes and school supplies. I'm not a big fan of the kids getting sucked into name brands and certain stores until they start earning their own money.

They did a great job this year. I just love it when they find an article of clothing for \$4.00 - \$7.00. That is something to be proud of when many items tweens typically "want" can cost \$50.00 or more per item. That gets a little insane when it comes to spending that much per item; an outfit could cost several hundred dollars. If you've got a lot of disposable income I guess it doesn't matter, but it's so hard for me to justify that type of an expense for something that could be had on the cheap if you're a good shopper.

My experience is that if the children are not given the incentive to be thrifty they'll default to being sucked into overpaying for anything and everything.

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If anyone you love or care about would benefit from receiving our newsletter, tell us who they are and they will be included on our mailing list. They'll certainly appreciate you thinking about them and having their best interests at heart.

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