Control What You Can Control (and don't sweat the rest)

These are scary times. The economy is in the worst tail spin we've seen in many decades, the stock market has been like a roller coaster (and that's on its best days!), and there seem to be more questions than answers when we consider where to go from here. If you're like the many people who are losing sleep worrying about the economy and the stock market and what they portend for your job, your retirement, or your kids' education, we've assembled a few things that we hope will help create a sense of context and perhaps the basis for a plan of action.

When considering what you can do, however, it's important to begin with a clear understanding of what you control and what you don't control. None of us has control over what the stock market or economy does, for example. And that lack of control extends to making predictions about what will happen in the financial world. Many will claim otherwise and some will hold up pronouncements from the past as proof of their prescience. By and large, such claims are like the stopped clock that shows the correct time twice a day. At any given point in time, there are hundreds of thousands of pundits and prognosticators making every claim imaginable (including a few that probably violate the laws of physics), and it would be amazing if a few of those claims didn't happen to correspond with unfolding reality. Moreover, the question of how well economists (let alone anyone else) can predict the future has been systematically addressed time and again (mostly by other economists) and the answer is always the same: economists are terrible at predicing almost any economic variable! That's not to say economists aren't pretty useful, however. One thing they do very well is explain why things have happened. This is more valuable than you might think, for understanding why things have happened in the past helps us to formulate long term plans for meeting a range of contingencies in the future.

So, if we can neither control nor predict the economy or the stock market, what can we do? To begin with, we can work to program resilience and survivablity into our financial lives. You'll find some suggestions for getting started in "Recession-Proofing Your Life," in the next section of this guide. We can also try to get some perspective. It's hard to act rationally when the press is telling us every day that the world is coming to an end. For that, we've provided several illustrations of how easily our emotions can send us astray ("Play-by-Play of the Fourth Quarter, Armchair Quarterback"), of how this latest downturn compares to others ("Bear Market Declines: a Graphical History"), and a selection of recent commentaries from the past six months ("Excerpts from Client Mailings"). In this last section, you'll find discussions of where to look for the silver lining, the limitations of economic statistics, tips for avoiding the Bernie Madoff's of the world, and the neuroscience of investing. We hope this material provides a little perspective, a few useful tips, and a ray of hope in these perilous times.

Recession-Proofing Your Life

Written by David Yeske, CFP, Yeske Buie Inc

As you've no doubt heard, we're in a recession and have been for over a year now. How long it will last is unknowable but the best guesses of economists and business analysts all suggest that we have a ways to go before we'll see the proverbial light at the end of the tunnel. In the meanwhile, what can you do to ensure that you not only survive but thrive in these hard times? Adopting these four financial planning policies is a good start.

1.) Create an emergency fund. If you don't already have cash reserves equal to three months worth of living expenses, this is your first priority. Emergency reserves allow you to reduce expenses (see below) and weather a job loss or short-term disability. It puts you in the driver's seat instead of leaving you at the mercy of forces you don't control.

2.) Work down that credit card debt. Interest rates may be down for mortgages and other long-term loans but credit card debt can still cost you 18% a year or more. Many people entered this recession with big balances on their credit cards, having become accustomed to easy borrowing from the home equity line and generous bonuses and raises at work. Now that the bonuses have dried up and the bank froze your equity line, that credit card debt can eat you alive. This is especially true if you pay only the minimum so buckle down and add something extra to every payment. Consider this: adding an extra $50 to your monthly payment will shave an entire year off the time it takes to rid yourself of a $10,000 credit card balance, assuming an 18% interest rate. And even if you have a low promotional rate, read the fine print. In many cases it takes only one late payment to find yourself paying high double-digit rates again.

3.) Consider raising the deductibles on your insurance. Once you've got that emergency fund in place, you have the luxury of higher deductibles, which translate into lower premiums. So, ditch that $50 deductible on your auto policy and opt for $500 or $1,000 instead. Do likewise with your homeowner's or renter's policy. Take that premium savings and use it to pay down credit card debt or add to your 401(k) plan. Speaking of which . . .

4.) Stick with your systematic investing program. For most of us, that means ongoing contributions to our 401(k) plan. If you've stopped, call payroll today and reinstate. The last year wasn't exactly the best advertising for the stock market but it's at exactly these moments that it is most important to stick with the program. No one knows when the turnaround will come but the one thing that we can be sure of is that stocks are "on sale" right now. The global stock market is trading at valuation levels not seen since the 1970s and many analysts believe this to be the buying opportunity of a lifetime. As Baron Rothschild once famously quipped, "buy when the cannons are booming and sell when the violins are playing." Warren Buffet's version was "be greedy when everyone is scared and scared when everyone is greedy."

The economy and the financial markets are a lot like the weather, subject to complex and chaotic patterns that defy prediction. But just as we can stay warm and dry by weather-proofing our homes, recession-proofing our finances is also possible if we just commit ourselves to a few simple financial planning policies.

Play-by-Play of the Fourth Quarter, Armchair Quarterback

Adapted from a piece by Bruce Berno

9/15-9/19 (five business days, gain: 4.51%)

9/22-10/10 (15 business days; loss 27.36%): *What is happening? Should we get out? Will it bounce back tomorrow?*

10/13-10/13 (1 day; gain: 10.28%): *Okay, there is hope after all.*

10/14-10/15 (2 days; loss 10.03%): *Maybe not.*

10/16-10/20 (3 days; 8.77% gain): *Is it okay today?*

10/21-10/27 (5 days; 14.15% loss): *Here we go again. Should we sell?*

10/28-11/4 (6 days; up 18.72%) *Never mind. It will be okay.*

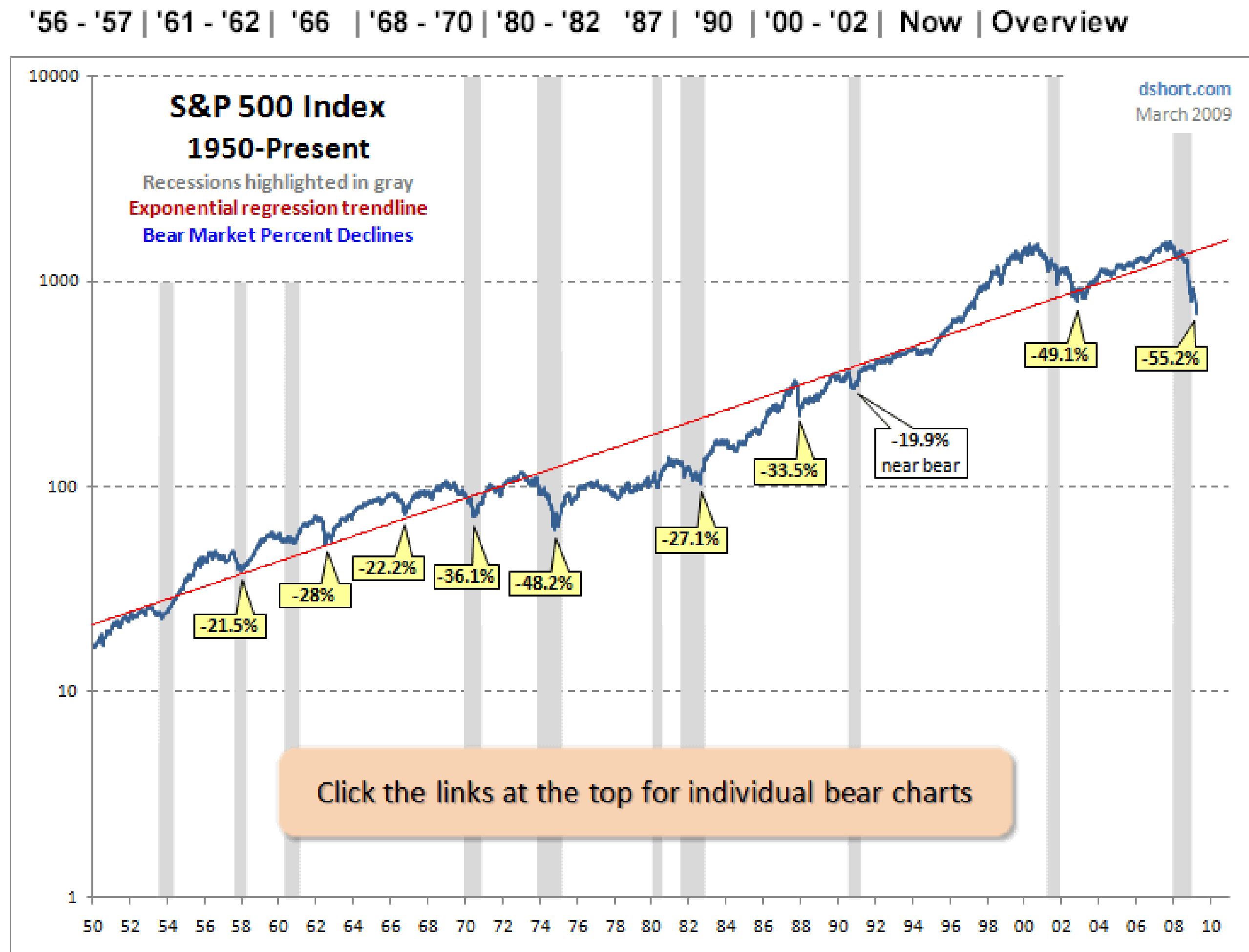
11/5-11/20 (12 days, down 24.50%) *Wait a minute. I can't take this anymore.*

11/21-11/28 (6 business days, up 18.59%): *I'm glad I didn't sell last week.*

12/1 (one day; down 8.74%): *I wish I'd sold yesterday. What will tomorrow bring?*

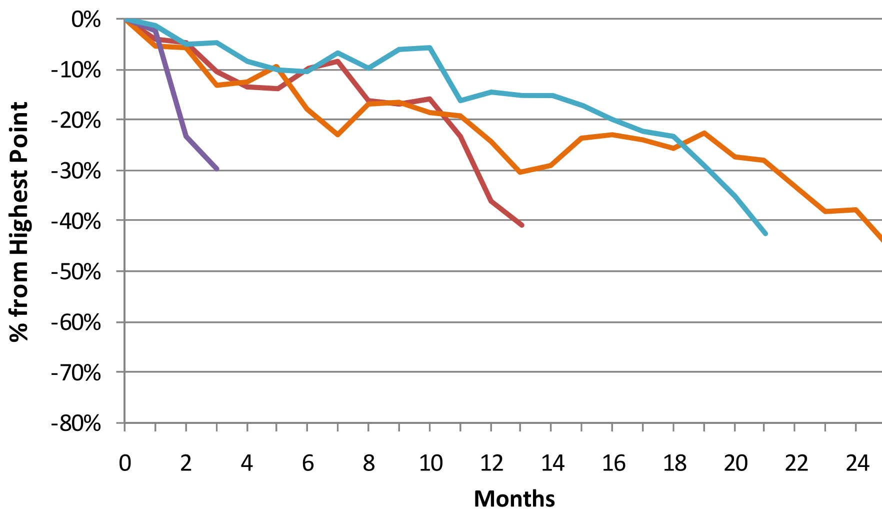
12/2-12/31 (22 business days; up 9.81%): *Looks like we're back on track now. Or are we?*

Bear Market Declines: http://dshort.com/charts/bear-recoveries.html?bears-since-1950



This is a screen shot of an interactive website (http://dshort.com/charts/bear-recoveries.html?bears-since-1950) that shows historical bear markets against a regression trend line. The website is interactive and has tabs for each time period that allow you to see the inner workings of each bear market. Even as a diagram, however, it is fascinating to note how bear markets fit into the big picture.

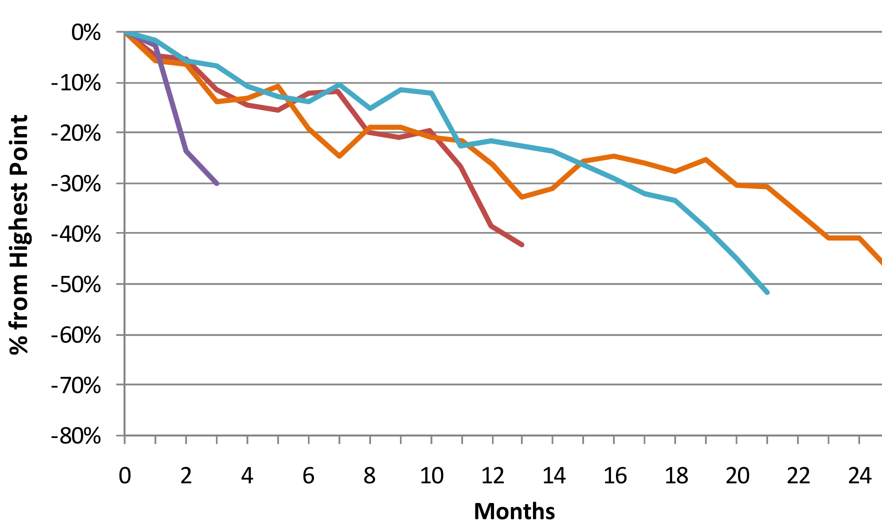
Fall from Highest Point - S&P 500 (US) - Nominal



- Oct 07 to Nov 08 (-41%)
- Aug 00 to Sep 02 (-45%)
- Aug 87 to Nov 87 (-30%)
- Dec 72 to Sep 74 (-43%)

For each index, the graph starts with the highest value before the crash began and follows the decline to the lowest point using monthly data. All graphs start at 0% and each point is the percentage decline from the highest value. The graphs are of different length because the crashes took different periods of time from top to bottom.

Fall from Highest Point - S&P 500 (US) - Real



- Oct 07 to Nov 08 (-42%)
- Aug 00 to Sep 02 (-47%)
- Aug 87 to Nov 87 (-30%)
- Dec 72 to Sep 74 (-52%)

For each index, the graph starts with the highest value before the crash began and follows the decline to the lowest point using monthly data. All graphs start at 0% and each point is the percentage decline from the highest value. The graphs are of different length because the crashes took different periods of time from top to bottom.

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Excerpts from Client Mailings

Yeske Buie regularly sends out emails to our clients, not predicting the markets, but explaining what is happening and why our methodology remains sound. Often the information in these emails is comforting. We hope you find them so for you.

17 February 2009: "Storm Clouds and Silver Linings"

So, here's the weather report: dark and stormy and likely to stay that way for some time. The financial sector remains weak with continuing fears of more write-downs in bank assets. The energy sector too is down, as a consequence of plummeting industrial production around the world. Unemployment rises with each new report and retail demand is weak as consumers focus on paying down debt and building reserves. All signs point to this recession being longer than usual, possibly persisting through the end of this year. And while Congress just passed the largest stimulus package in history, it's far too early to know if it will have the desired effect. As a consequence of all this, stocks have retreated to near their bear market lows of last November.

Those storm clouds have a silver lining, however. And it's a big one.

First, based on every credible valuation technique, stocks are priced for extremely high returns. They are priced for those high returns for the very reason that things are really ugly in the world economy. It's true that stocks got priced for high returns by having their valuations hammered in a really dramatic and scary fashion. But for better or worse, that's old news, there's nothing we can do to change it. What we CAN do is acknowledge the very real silver lining that leaves us with. Yes, things are ugly out there in the world economy. Yes, that's taken us on a scary stock market ride over the past year. But in planning our actions, we have to focus on where we are now, not where we wish we were, or on what we wish we might have done had we possessed perfect foresight. Right now, the most powerful thing we can do is hold tight to portfolios that are like coiled springs. It's impossible to say when we'll realize these high returns currently embedded in our portfolios, but see them we will if we stick to the plan.

9 January 2009: "May You Live In Interesting Times"

"May you live in interesting times."
Traditional Chinese curse

It's certainly hard to deny that we've been living in interesting times of late. From the collapse in real estate prices to the ensuing credit crunch and onward to a near record fall in stock prices, the times are interesting indeed. And as we look forward

to 2009, we can find yet more cause for gloom on the horizon. Mortgage delinquencies, foreclosures, bankruptcies, and unemployment are all projected to rise in the coming year as the current recession continues to play itself out.

Fortunately, we can also find a few bright spots. First, most of those dire economic statistics tell us more about where we've been than where we're going. Measures like the unemployment rate, for example, tend to lag the general direction of the economy, rising only after the economy has been shrinking for some time and not falling until long after renewed growth has taken hold. Just as starlight reaches us only after a long delay -- so that the twinkling star you observe may well have burned out centuries ago -- so most economic statistics, arriving as they do with a great sense of freshness, of nowness, on the front page of your newspaper, are really telling a story about where we were many months ago. The bottom line is this: things will be getting better long before government statisticians will have anything to say about it.

19 December 2008: "Safe and Sane in a Crazy World"

In the most recent bad news from Wall Street, Bernard Madoff, former NASDAQ Stock Market chairman and founder of Bernard L. Madoff Investment Securities LLC, was arrested and charged with securities fraud.

What did he do? He allegedly collected money to invest from clients, made up false statements to show that they were doing well, and used new clients' money to pay interest and withdrawals to existing clients. This is known as a Ponzi scheme and is estimated to involve more than a $50 billion loss for his investors.

His clients didn't see this coming. Could they have? Let's look at three key safety tips that would have prevented this from happening.

Know what you own. Stick to stocks, bonds, ETFs, and mutual funds that are publicly traded and listed on major exchanges like the New York Stock Exchange. They are valued independently at least daily, if not minute-by-minute, while the exchange is open. You can check their reported returns against your own portfolio. If you can't look up the prices and performance in the newspaper or on the Internet - that's a red flag - ask a lot more questions.

Use an independent custodian. Madoff held his client assets, managed them, and priced them, too. See the conflicts of interest? Investment performance can look better if the prices reported to clients are manipulated, which is allegedly how Madoff showed winning year after winning year despite market turmoil.

At Yeske Buie, our clients have an independent third party, Schwab Institutional, pricing each investment they own. We have no input on investment pricing, and that separation is a very good thing. We also stick to the publicly traded securities mentioned above and avoid the kind of private funds that Madoff ran.

Check on insurance. Our clients benefit from fraud insurance. The first part is Securities Investor Protection Corporation (SIPC) coverage for $500,000 per

account. Then, at Schwab Institutional, there is an additional $149.5 million per account from London insurers.
Fraud insurance does not protect against market declines; but it does protect against theft of securities and/or related fraudulent transactions.

When Madoff's clients go to find their assets, which have allegedly been fraudulently paid out over the years, will there be insurance in place? No insurance protects 100%, but at $150 million in total coverage, our clients have one of the largest and best plans available.

One final thought - if an investment sounds too good to be true, it probably is. Reportedly Madoff claimed consistent annual returns of 10-12% with little volatility and no annual losses. Can you name any legitimate investor who can make that claim in recent years?

16 October 2008: "The Credit Crunch Chronicles"

As you may or may not have noticed, this week opened with a record rise in the stock market, followed on Wednesday by a record fall (at least in point if not percentage terms), and as I write this the market has just closed with a 400 point gain after having been down by almost that much earlier in the day.

Is this starting to feel "normal?" The one thing we can be sure of in a world where the dollar fluctuates by five cents and oil by $10 on any given day is that anyone who thinks they can make short term forecasts on the economy or the stock market is fooling themselves.

However, while I'm probably not entirely free of self-delusion, I do believe that a general sense of optimism is not misplaced. That theme led my friend Mark to give me a set of poms poms on Monday to better equip me for my role as cheerleader (I'm still going to give you a show Mark, as soon as I can figure out which words precede "what's that spell?"). However, I think it's important to emphasize that the advisory team here at Yeske Buie is not unmindful of the magnitude of the current crisis. We know that the near-term negatives are real, and include, among other things:

- The housing crisis
- Falling consumer confidence
- A credit crunch that has reduced access to capital for companies and consumers
- A recession both here and abroad

These are all real problems and they have been reflected in falling stock prices. The situation is complex, however, and includes many positive factors as well. Among those can be found:

- Significant, coordinated intervention by central banks around the world to contain the crisis and provide liquidity to the system.

- The banning of short-selling of financial stocks to reduce the more extreme forms of speculation
- Dropping oil prices (now less than half their recent highs) which reduces concerns about inflation, giving central banks more latitude to keep interest rates low or reduce them further.
- Stock valuations that by many traditional measures have reached bargain levels.

Of course, at all times and in all places, one can find causes for both optimism and concern.

If we had made our list of positives and negatives 10 years ago, in the Fall of 1998, we would have included threats from what was then called the "Asian contagion," which involved the collapse of currencies in Asia and the Russian ruble and the implosion of Long Term Capital, a massive hedge fund that blew up and nearly brought the world financial system down with it.

Had we carried out this exercise at the end of 1990, when the market was also down sharply, we would have listed recessions in the US, Canada, the UK, and Australia; the S&L lending crisis (the last time the government had to intervene); and the broad slump in residential and commercial real estate. Not to mention the huge uncertainty about how to respond to the invasion of Kuwait by Iraq.

In December 1990, the Knight Ridder newspaper chain ran an article with the headline "Bank crisis risks turning recession into depression." The causes for concern in this gloomy article look pretty familiar:

- Banks going under at a level not seen since the 1930s
- A resulting credit crunch and pullback in lending
- Plunging consumer confidence
- A 50% decline in the stocks of leading banks

Psychologists tell us that the human brain is unable to recall pain accurately. As a result, we overestimate the level of pain we're feeling today compared with the past. Whenever we enter these kinds of market conditions, it always feels like it's much worse than it's ever been before.

The tech bubble in 2000 was rationalized by investors who said, "it's different this time." Today, we're hearing people using the same words, saying today's downturn can't be compared to those of the past.

The aftermath of the tech crash reminded us why the words, "it's different this time," can be so costly for investors. It wasn't different in 2000, and a strong case can be made that it's not fundamentally different today. And, in fact, that when it comes to market cycles, it's never really different.

I'd like to end with a quote from the Oracle of Omaha, Warren Buffett, speaking last Friday on CNBC:

"I have no idea what the stock market will do next month or six months from now. I do know that, over a period of time, the American economy will do very well, and investors who own a piece of it will do well."

9 October 2009: "Lions and Tigers and Bears"

I found a great article by Jason Zweig, staff writer for Money Magazine and author of "Your Money and Your Brain: How the New Science of Neuroeconomics Can Help Make You Rich," that I wanted to share with you (http://money.cnn.com/2002/09/16/pf/investing/agenda_brain2/index.htm).

In this article, he discusses the fact that financial gains and losses are felt most keenly in a portion of our brain called the amygdala, which is in charge of "fight or flight" responses. As Zweig puts it, "neuroscientists have found that financial gains have a fairly strong effect on the amygdala -- and losses make it flare up like a hot coal." This is the part of your brain that evolved to deal with the saber toothed tiger lurking around the next bend in the trail, but as one of my colleagues recently put it, "it saves you from the lion but it kills you in the market."

Thinking about this bear market has also made me think about the advice David Borgenicht, author of "The Worst-Case Scenario Survival Handbook," gives for surviving a real bear attack: "the best thing to do is to play dead and NOT to run." Of course, this advice is completely at odds with what our amygdala tells us to do. In the same way, the most successful response to the bear market is also completely at odds with what our amygdala is telling us and this is why so many investors are finally throwing in the towel.