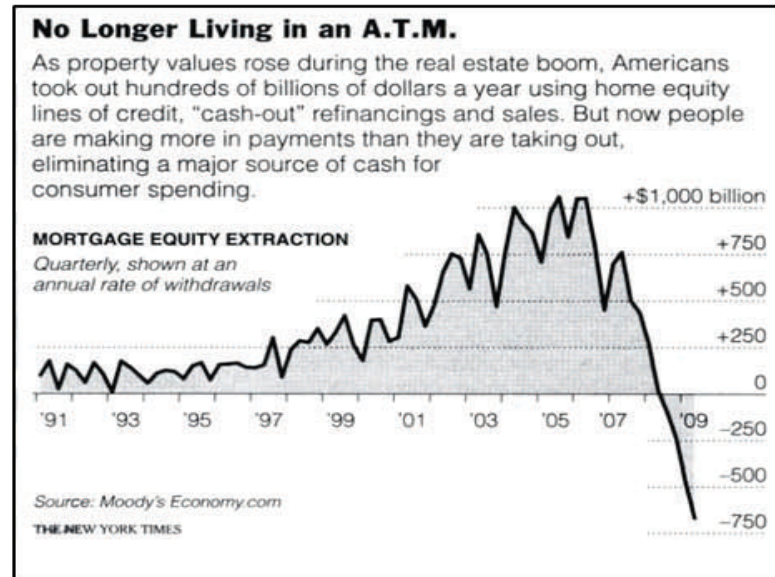


Here is an amazing graph from The New York Times edition from Saturday, August 29, 2009. It illustrates better than anything I've seen where we are and a major problem we face. Keep in mind, that for many years the savings rate in the US was essentially zero. We spent everything we earned. Even so, we kept buying cars, homes, HDTVs, etc. We took nice vacations, remodeled our homes, and pretty much lived for the day. But we did so based on the over-inflated values of our homes. We took out low interest "home equity" loans to pay for a great deal more than things like real home improvements. We refinanced at low rates that were destined to go up in a few years, at the same time pulling extra money out to spend. But as you can see,

the party ended well over a year ago. The change from early 2007 to the most recently reported quarter is a reduction of over \$1.6 trillion.

Compounding this problem is the drop in housing values for those who are current with their mortgages. Tens of millions of homes now have negative or little equity. Banks are requiring a minimum of 20% equity cushion, so most people can't take out a home equity loan, even for emergencies. Credit card companies have cancelled millions of cards and have reduced the credit availability of others.



FINANCIAL CATALYST GROUP

4030 Moorpark Avenue, Suite 105
San Jose, California 95117
Phone: 408-261-7600
Fax: 408-273-6399

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Unless otherwise noted, market statistics and data used in this newsletter were obtained from finance.google.com, and labor and employment statistics were derived from www.bls.gov.

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Wealth Architecture™ Digest

Often people do not plan because they see only what is, and they do not have a vision of what can be. Something is always possible. We believe that, with vision, the possibilities are almost unlimited.

Unhappy Anniversary

For many people the past year has been one of the most stressful in living memory. At the end of August last year we were focused on the acceptance speech in Denver by then Senator Barack Obama. Most Americans had never heard of Governor Sarah Palin. While the S&P 500 index was down about 15% from the previous August, and unemployment had been dropping slowly to its July, 2008 level of 5.8%, there was real pain caused by the price of gasoline that had gone well over \$4 per gallon just a month earlier.

Despite some of the signals of real distress, in mid-July former Senator Phil Gramm had said we were "a nation of whiners" and just in a "mental recession." There were some who felt that the stock market downturn, that started in October, 2007 was just about over. There was concern about the subprime market, but the depth of what was to come was not foreseen by most. The one person who was dead on was NYU economics professor, Nouriel Roubini – known by many as "Dr. Doom."

Just over a year ago, on August 15th, STEPHEN MIHM wrote this in The New York Times:

"On Sept. 7, 2006, Nouriel Roubini, an economics professor at New York University, stood before an audience of economists at the International Monetary Fund and announced that a crisis was brewing. In the coming months and years, he warned, the United States was likely to face a once-in-a-lifetime housing bust, an

oil shock, sharply declining consumer confidence and, ultimately, a deep recession. He laid out a bleak sequence of events: homeowners defaulting on mortgages, trillions of dollars of mortgage-backed securities unraveling worldwide and the global financial system shuddering to a halt. These developments, he went on, could cripple or destroy hedge funds, investment banks and other major financial institutions like Fannie Mae and Freddie Mac."

Although many laughed at the time in 2006 when real estate and the markets were still booming (the S&P500 was up almost 20% over the next 10 months in October, 2007), Roubini was right on almost every prediction he made. The problem was, and remains, that there are often major differences of opinion, and no one economist, analyst, or forecaster is always right as to the time or intensity of economic change, stock market returns, etc.

When Roubini spoke the unemployment rate for August, 2006 of 4.9% had just been released. Two years later – and just one year ago – the rate had risen to the 5.8% mentioned above, with 8.9 million unemployed. Now, one year later, 14.4 million people are unemployed **and** another 8.8 million want full-time work but have only been able to find part time work. In the one year since some said "the fundamentals of the economy are strong," over 4.9 million jobs were lost.

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Although we now know the recession officially began in December, 2007 it was the convulsion that began last September that really turned the world upside down. Lehman Brothers, one of the oldest investment banks on Wall Street filed for Chapter 11 protection on September 15, 2008. In late January Fitch Ratings had given Lehman a AAA-rating, which was still a healthy A-Rating on September 10th (source: fitchratings.com), just five days before the end. The collapse of Lehman, followed by \$180 billion bailout-rescue of AIG the same week, left the global credit markets in a state of shock.

By September 16th the chaos began. The Reserve Primary Fund, the nation's oldest money market fund had hundreds of millions of dollars in Lehman Holdings' commercial paper which had just become worthless. When the funds net asset value (NAV) dropped by 3 cents, it became only the second money market fund in history to lose value, and the run was on. Reserve froze redemptions and people started pulling money from all kinds of money market funds until, within a couple of days, the federal government set up a \$50 billion program to guarantee investor balances in non-bank money market funds. To stem panic, the FDIC insurance was increased from \$100,000 to \$250,000.

Credit dried up everywhere. Banks would not lend to one another, as no one knew who would survive and who wouldn't. The only "safe" investment was short-term US treasuries. The three month T Bill which yielded 1.7% at auction on September 8, 2008, was at 0.04% by December 15, 2008 (source: treasurydirect.gov). A week early it had been just .005% -- a \$1 million investment would have paid \$100 over three months, but at least it was "safe." With credit markets frozen and the consumer scared out of

her wits, business dropped off a cliff and businesses laid off people in droves. In the October-December quarter over 1.6 million people lost their jobs, a 16% increase in unemployment. The auto companies were failing and being bailed out. The major banks were in the midst



of a crisis of confidence unlike anything since the Great Depression, with many commentators calling them "zombie banks" that should be closed. On October 26, 2008 The New York Times ran this photo as a part of an article on the state of the economy. With images like this, who could be thinking positive thoughts.

By the time Barack Obama entered the Oval Office the stocks of major international banks had lost 60-80% of their September 12, 2008 values. Three months later, the number of unemployed had increased by 2.1 million. In February alone the Bureau of Labor Statistics reported that an alarming 851,000 people were added to the roles of the unemployed. There was plenty of room for concern, and politicians on both sides of the aisle fanned the flames of fear and blame.

On March 7, 2009 The New York Times published an article entitled "Even for Market Veterans, It's Uncharted Territory." The author, Jeff Sommer, had interviewed several market luminaries, including former Fidelity Magellan Fund manager Peter Lynch and economist Dr. Henry Kaufman. What was their advice published on the day before the market bottom?

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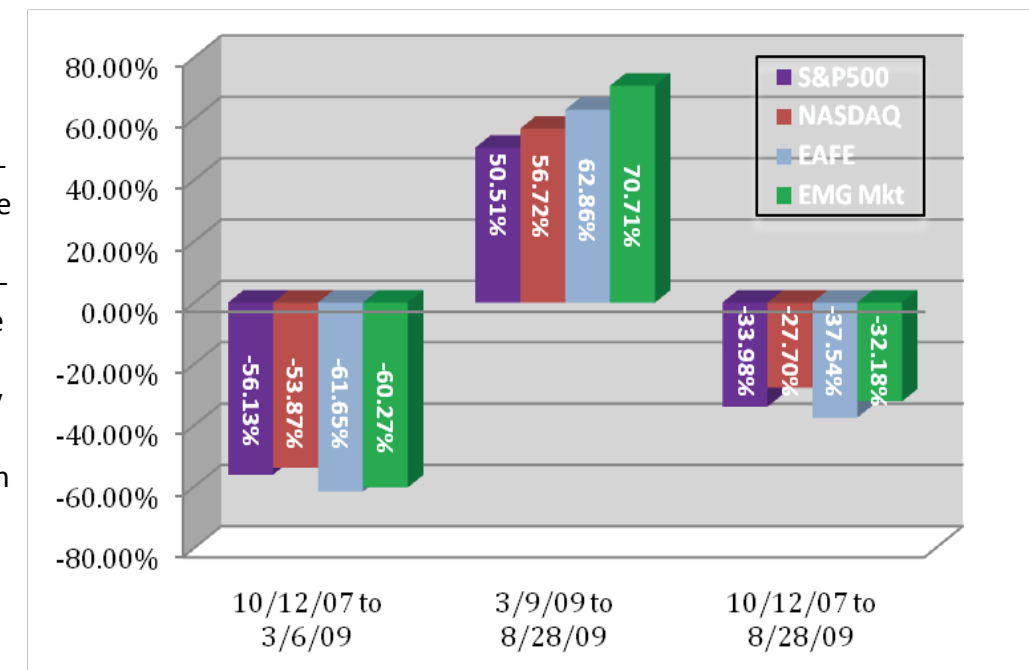
"What should investors do under these circumstances? Buy high-quality corporate bonds, which fell sharply over the last year or so, and which are likely to rise in a market recovery. That makes sense to Dr. Kaufman, as well as Messrs. Wien, Biggs and Lynch. Bonds have the merit of providing steady income, at rates that are now very high..."

Four learned men, not knowing what would happen, and not knowing the circumstances of those reading their opinions, made a prediction that was a little too "one size fits all." Since that very day, the S&P 500 was up 51% through August 28th, while the aggregate bond index is up 3%. While bonds made all the sense in the world from a standpoint of lower volatility that move may not have been suitable for many investors. The media were building fear through articles and broadcast that were often not even well researched.

March 9th was the bottom of the market so far this year. It was less than one month after President Obama signed the stimulus bill into law, and before any of the \$787 billion was dispersed. While the economy is appearing to improve, un-

employment – the lagging indicator is still getting worse, though much more slowly. From April through July unemployment went up only 738,000 less than the month of January alone.

Over the past nearly two years we saw the chaos that started a year ago as mentioned above, followed by the global stock rallies of the past six months. Using data from finance.google.com this is what the results have been to the end of August, 2009:



As has been seen in the past few months there appears to be a leveling off of home prices, an increase in home sales (at very low prices), and a small increase in manufacturing both here and abroad. That being said, there continues to be more people facing unemployment, which in turn is likely to lead to more credit card problems, more home foreclosures, and less ability for consumers to spend – a necessary part of real recovery.