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for all**

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KATRINA

Friday, August 9. The Westin Hotel, Chicago. Working, most of the time, on this newsletter and other business documents, alone, not knowing that an emotional evening was minutes away.

Tired from work, I channel-hopped until I caught Jennifer Lopez in the role that made her famous: "Selena." Selena was a young and profoundly successful musician singing "Tejano" music. She was the first in her category to have a gold recording. At the time of her death, she was producing a "crossover" album, designed to appeal to both traditional North American tastes and to the Latin culture south of the border. Having seen the movie before, and anticipating its conclusion, I shed tears long before the end when thousands of fans held a candlelight vigil in her honor. Had she lived beyond those short 24 years, she would have been as popular as Jimmy Buffett and others who have talent, apparent humanity, enthusiasm, and good business judgment. I rank her murder with that of John Lennon: monumental stupidity, incomprehensible.

Following "Selena," HBO presented a special about the history of the attacks on the World Trade Center. It presented videos from amateurs and professionals, dozens of different angles, and scores of interviews with both leaders and

residents of America's most important city. Again, I shed tears for a half hour, maybe an hour, before switching channels seeking something a little more light-hearted. Instead, I found the magnificent telethon, a national concert, on behalf of the evacuees from our beautiful and productive southern coast. Viewers were asked to contribute either to the American Red Cross or to the Salvation Army.

The first profound event of my life was the assassination of President John F. Kennedy. The second was the landing on the moon. Third was the Challenger space shuttle accident that took the life of a grade school teacher. The fourth remains strongest in my mental imagery: 9-11. Katrina was different. It did not consume me at a single point in time.

Being a sailor, I followed Katrina from its unusual formation near the Bahamas, to its relatively mild trip across Florida, and on north, while the national hurricane center, from the start, predicted that this storm would become very powerful from the warm-water fuel in the Gulf of Mexico. Satellite imagery proved this. Rotating clouds seemed to consume the entire Gulf.

The physics of wind power is not linear. A 20-knot wind is more than twice as potent as a 10-knot wind. A 150-knot wind, striking a surface such a wall or sail, is many times more powerful than 15 times a 10-knot wind. This geometric expansion of power is well known to

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sailors, who can show full sails at 10 knots with little forward motion. At 15 knots, at the ideal point of sail, the boat might reach maximum hull speed. At 25 knots, sails should be reduced by a third. By 30 knots, the big sails should be hauled in and well secured. At 35 or more, the prudent sailor shows only 5 or 10 percent of available canvas. So, sailors had no trouble accepting the dire prediction of the National Hurricane Center or of the mayor of New Orleans. Most roofs, and people, have no chance against 150 knots.

My real life has been more profound than my business life. The great market events of 1974 and 1987 are vague memories compared to the emotional effects of human crises. The stock market seems like background music in the mosaic of life. It is there every day, up and down, generally enhancing the net worths of conservative participants. Unlike natural disasters, the risks of the stock market may be assumed or avoided at whim. The magnitude of stock market risk is manageable. Investors can, if they want, use margin to increase risk or to buy young companies without track records. On the other hand, investors can prudently select among tried and

true blue chips, the companies providing the necessities of modern life. My personal hope is that investors will realize growth in their liquid portfolios, bringing their net worths to a point of personal comfort and security, a level sufficient to fund most personal objectives, to handle unforeseen personal crises, and to make significant charitable contributions whenever our fellow travelers on earth experience insurmountable obstacles.

Do As I Say, Not As I Do

Mark Twain admonished us to avoid speculation during two periods. The first period is October. The second is every other month. He also said something like this: "Put all your eggs in one basket, and watch that basket."

Toward the end of his life, Mr. Clemens invested all his money in a printing and publishing venture. He watched it carefully. He observed that he was losing everything. He became almost destitute.

The National Debt

In 1962, interest on the national debt was slightly less than 7 percent of all federal outlays. In 2004, the figure was slightly more than 14 percent. The Congressional Budget Office forecasts a decline in this percentage through 2015, a positive outlook unlikely to be realized if spending and revenue trends continue.

I was a junior in college in 1962 when Senator Barry Goldwater and others were decrying deficit spending. Today, no public figure presents a moral or economic case against deficit spending, the rising debt, and rising relative interest payments. A reason may be that neither party wants to saddle itself with a budgetary philosophy that restricts its future flexibility to fund national needs.

Shooting the Messenger

Offering direct financial planning advice is like driving down a road with chuck holes. Hit one hole the wrong way, a tire blows or an axle breaks, and the passenger wants a new driver.

Individuals know intuitively when their financial condition is deteriorating. One reaction is anxiety. Another is tension with spouses and companions. Seeking relief, affected individuals begin conversing with various financial advisors, commonly presenting a simple question, such as "Will my stocks go up (to cover an income deficit and debt)" or, "What is the probability of a margin call" or, "Will you call my loans?" After hearing a series of responses, all off the mark because the questions are off the mark, anxiety rises until the individual seeks an impartial opinion from someone he did not know before. This last advisor in a string of advisors is the first to receive the important questions: What is wrong; what can I do about it? Hopefully, the new person is a professional advisor who asks for all information about the distressed person's personal situation, and he or she both sees the problem and expresses the solution. An example of solutions is: "Sell securities to cover your debt and cut personal expenditures," both draconian for a person accustomed to living well.

Professional advisors know that financial planning engagements with extremely distressed clients can be short. Although the client both accepts a proposed strategy and implements portions of it, he later experiences remorse and abandons further conversations with the person who formally reported the bad news. He shoots the messenger. The planner is left wondering whether the client

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Prediction?

Two trends of concern are the increasing deficit of the United States government and unusual appreciation in home prices. In both cases, retiring Federal Reserve Chairman Alan Greenspan has made important comments, couched in mild language that is carefully crafted so that his words, by themselves, neither affect trends nor cause an economic crisis. Too bad that he cannot use straight language. Here is what he said in August (the powerful phrase is highlighted):

The lowered risk premiums—the apparent consequence of a long period of economic stability—coupled with greater productivity growth have propelled asset prices higher. The rising prices of stocks, bonds and, more recently, of homes, have engendered a large increase in the market value of claims which, when converted to cash, are a source of purchasing power. Financial intermediaries, of course, routinely convert capital gains in stocks, bonds, and homes into cash for businesses and households to facilitate purchase transactions. The conversions have been markedly facilitated by the financial innovation that has greatly reduced the cost of such transactions.

Thus, this vast increase in the market value of asset claims is in part the indirect result of *investors accepting lower compensation for risk*. Such an increase in market value is too often viewed by market participants as structural and permanent. To some extent, those higher values may be reflecting the increased flexibility and resilience of our economy. But what they perceive as newly abundant liquidity can readily disappear. Any onset of increased investor caution elevates risk premiums and, as a consequence, lowers asset values and promotes the liquidation of the debt that supported higher asset prices. This is the reason that history has not dealt kindly with the aftermath of protracted periods of low-risk premiums.

Among our limited population of friends, clients and acquaintances, we have noticed a rising interest in real estate speculation. Several persons without real estate experience have attended seminars on how to acquire government-owned homes and to convert them to profitable transactions. Expanded interest in an economic sector by persons having no experience is commonly associated with the top of market bubbles. We also have noticed that since 1960 the interest cost of the national debt has risen. This interest now is the second-largest federal government expenditure behind defense. Earlier in August, Mr. Greenspan noted that rising levels of government debt give our nation “less flexibility,” another of his powerful phrases which understate his meaning. Our observations are that the federal government cannot sustain rising interest costs as a percentage of total outlays and that the only practical way to stop rising debt is for Americans to pay more in taxes.

We do not accept any pessimistic scenario for the United States. Instead, we caution investors. First, prior to making major commitments, such as for distressed real estate, investors must be aware of the risks and of their personal capacity to absorb losses. We feel the same about the stock market, in which diversification of securities is the way to reduce personal pain during times of major economic adjustment. A recent advertising phrase for an insurance company tells it all: “We cannot predict. We can prepare.”

Price, the Predictor—but of What?

Oil prices, as well as gas and gasoline prices, rose sharply in the weeks prior to Hurricane Katrina. No one knew why.

One week after the hurricane struck, with oil wells out of commission, refining capacity severely limited and transportation systems inoperative, these energy prices began to decline, despite aggressive and highly visible predictions—by experts—that prices would rise further.

An old rule of investing is that prices rise, or fall, in anticipation of events. When the event, usually unknown in advance, finally occurs, price trends reverse. Did the market know about Katrina in advance? Does the market “know” anything? These questions we leave to students of the stars. To investors, we say:

If you are investing based on potential effects of a known event, you are 10 yards behind the line of scrimmage.

A Request to Readers

To help us develop a speech and a professional article, please e-mail an answer to this question:

“In the ideal, what is the maximum percentage of a liquid investment portfolio that should be allocated to a single security, such as a single stock or a single bond?”

Please e-mail your answer to thotfull@skynet.net, the personal e-mail address of John Guy, publisher of this newsletter. We will publish results in a later issue. We will not retain your e-mail address for any marketing purpose.

A Loss for Us; A Lesson for All

Starting in early August, our partners did not receive e-mails directed through our web site, www.wpam.com. As complaints mounted, we investigated and learned that our web site provider did not answer phone calls, did not return e-mail messages, and did not honor its support option of a 24-hour per day “live chat” on the Internet. A phone number provided by the corporations division of the Florida Secretary of State was answered by the receptionist at a “virtual” office. She said that she gives messages to the personnel of the company and that they stop by once in a while to pick up their mail. The address of this virtual office, which appears to be an elegant, serious address, is the listed address of the provider. On calling the owner of the company, we learned that his telephone had been temporarily disconnected. On calling the Better Business Bureau,

we found that the company’s status is “unsatisfactory due to unresolved complaints.” Meanwhile, our e-mail forwarding continued to fail, and we could not contact the site to check the forwarding file or to make other routine modifications.

WP&M started with this provider in 1997. It appeared to be a substantial business. Its web site was very serious and attractive, offering multiple services at good prices. Our professional Internet manager, who also edits this newsletter, told us that many businesses exaggerate their substance by using sophisticated answering services and attractive graphics. Formal courses and text books teach budding business people how to enhance their appearance. Creating a solid image, of course, is a tool of any reputable business. Unfortunately, it also is a tool for the

unsavory. The lesson is best expressed in the old cliché: you cannot tell a book by its cover.

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went on to implement all elements of the proposed solution.

Financial anxiety relentlessly arises when personal expenditures exceed personal income. Persons having substantial net worth can afford to continue deficit spending by periodically selling assets. Older persons can afford to liquidate retirement plans over their life expectancies. However, for young persons with limited net worths, deficit spending can lead to destitution. For them, eliminating deficits is vital.

Good night, Dorothy. You done good.

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