



## Weathering the Storm

By Michael Hershkowitz

It seems that you can't turn on a TV these without someone telling you how much trouble the economy is in, or worse, how the money you already have might start disappearing before your very eyes. Apparently, when the S&M Economic Newsletter goes on vacation, the global economy crumbles.

Granted, the past few weeks have been the most financially eventful since the Great Depression, but we here at S&M feel that the amount of financial fear mongering in the media is a little overblown. Inducing fear of terrorism to illicit votes is one thing, but promoting panic in financial markets has the potential to cause some serious damage in a very short amount of time.

We'll get into some details later in this newsletter. As usual, our goals here are to enable our readers to understand the financial and economic world enough to generate your own opinions and control your own financial fate. Instead of telling you your money is safest in a pillowcase under your mattress, we throw out some ideas for things that might profit. Instead of telling you to pay rent for a year or two until the market settles, we talk about what kinds of real estate will kill your wealth, and what kinds will make you rich.

So hang in there, don't panic, and let the S&M Team help you weather the storm.



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## The Financial Meltdown of 2008

By Michael Hershkowitz

Though reporting simple news events is not what really we do here, I feel compelled to discuss the magnitude of the events of the past few weeks. At the time of this writing, Lehman Brothers, a 120 year old investment bank that survived financial crisis after financial crisis for, well, 120 years, has filed for bankruptcy. Merrill Lynch is now owned by Bank of America. Goldman Sachs and Morgan Stanley, known for their clever investments and stellar profits, will now act as traditional bank holding companies, with lower risk and lower returns. Fannie Mae and Freddie Mac have been semi-nationalized by the federal government. AIG, which insures everything from homes to lives to oil rigs, narrowly avoided bankruptcy by getting a "bridge loan" from the Fed (basically allowing the

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company to sell off its assets instead of going bankrupt – either way, it’s just a matter of time). As a stipulation of the AIG deal, the Fed now owns 80% of AIG, making the United States Federal Government essentially the largest hedge fund, investment bank, and insurance company on Earth.

Any of these events would have been labeled as one of the biggest happenings in the financial world since the Great Depression, (or at least the Savings and Loan Scandal of the 80’s), as was the Bear Stearns meltdown back in March. The fact that they all occurred back to back over a few weeks, some even in the same day, conveys the sheer magnitude of our current situation.



So that begs the question – How did this happen? WTF?

In the interest of time and space (spacetime, for all you physicists out there) I’ll try to make this brief. A few years ago, you didn’t need to show a bank how much money you made to get a loan, you just needed to tell them. They were called no-doc loans, or Liar’s Loans, depending on who you ask. All you had to do was tell the lender how much you earned in a year, and they would believe you, without any effort to verify it, and the loan was yours. Seriously, I’m not joking. And nobody with enough power or huevos to do anything about it thought this was a dangerous idea.

In addition, the people who brokered these loans, mortgage brokers, made a living on the commissions. So it was in their best interest to have borrowers take out lots of really big loans. When the common sense of many of these borrowers kicked in, and they questioned the affordability of the monthly payments for this ridiculous loan they knew they couldn’t afford, they were reassured by lenders that they would be able to make it affordable. In an “Adjustable Rate Mortgage,” your interest rate (and therefore your monthly payment) started off relatively low, and increased over time. Borrowers were assured

(by their mortgage broker or lender, of course) that they would get raises in the future, wouldn’t lose their job, wouldn’t suffer any health problems, or my personal favorite, that they could always refinance their loan when the rates go up, because the house will have appreciated. After all, *houses always appreciate, right?*

Anyway, you see where this is going. An eleven year old could see where this is going. But it gets better. The banks who owned these loans made money off of the interest, so they were viewed as assets. (They were really liabilities, as we now know). As assets, they could be sold. And once they’re sold (for a profit, of course) the banks freed up space on their balance sheet to make more loans, and that process was repeated over and over again.

But since it was assumed that some of these loans would go into default, the banks had to be creative in order to sell them. They combined a lot of these loans into one investment “package,” and sold them to other investment banks and entities with a few billion on their hands, looking to make a profit. The sales pitch was that “if X% of these loans go into default, you’ll still make a Y% return on your investment.” “X” was generally accepted as a conservative estimate, so these loans were packaged and repackaged, sold and resold to investment firms as a conservative investment.

As it turns out, X was not a conservative estimate, the percent of loans that defaulted was actually much greater, but it didn’t stop the lenders from making the loans. After all, the people making the loans and the people suffering from the defaults were many links on the chain apart, so to speak. Banks would make the loans, sell them off, rinse, and repeat. Eventually, the foreclosure rate got up so high that no one would buy these investment packages, and their value went down the toilet. Some companies, like Bear Stearns and Lehman Brothers, were stuck holding the hot potato at the worst time, and suffered the consequences.

Which brings us to today, where the Federal government is working on a mysterious \$700 billion plan to purchase these “bad” investments from whoever happens to own them, in the interest of preventing any more major casualties of this mess. Our tax money is about to be used to bail out investment banks (even foreign investment banks) because they made really bad investments, like a parent paying off a teenager’s credit card debt and saying “I hope you learned your lesson,” when the lesson the teen probably learned wasn’t one of responsibility, but of the knowledge that if she gets into trouble, her parents will bail her out.

# Creative Flux

## *Creative Solutions to Common Problems*

### Q & A

Q. What does it mean to short sell a stock?

A. Most people are familiar with the common way of trading a stock – first buy (preferably low), then sell (preferably high). But what if you think the stock is going down? Well, in a short sale, you can sell high, then buy low. Basically, you borrow shares from someone who owns them, with the promise to return them at a later date. You can sell those shares, and if the stock decreases in price, buy them back, return them to the person who loaned them to you, and keep the difference. With the invention of online brokerages, there's no borrowing necessary. You just open a short sale position by selling some shares, and close the position by buying the shares back at a lower price. You still make a profit by buying low and selling high, but with a short sale, the selling comes first.



### Tip of the Month

A turkey was chatting with a bull. "I would love to be able to get to the top of that tree," sighed the turkey, "but I haven't got the energy."

"Well, why don't you nibble on some of my droppings?" replied the bull. "They're packed with nutrients."

The turkey pecked at a lump of dung, and found it actually gave him enough strength to reach the lowest branch of the tree. The next day, after eating some more dung, he reached the second branch. Finally, after a fourth night, the turkey was proudly perched at the top of the tree. He was promptly spotted by a farmer, who shot him out of the tree.

Moral of the story:

Bullsh\*t might get you to the top, but it won't keep you there.

In the interest of fairness, there are reasonable macroeconomic arguments for this decision. In taking on all these assets and investments for pennies on the dollar, it is possible we could actually make money off of these bold transactions. Most importantly, however, the desire to avoid a major stock market crash is a big priority of anyone who has the power to prevent one. Last week, for the first time in 75 years, this became a legitimate threat as global markets plunged. The stock market was already down 20% this year, costing many of our parents tens of thousands in retirement funds, and probably a few of their golden years, as they will have to work longer to make it back. Between 9/15/08 and 9/17/08, two days, the market dropped over 7%, and there was no sign of recovery as bad news kept mounting.

In stepped the Fed, with its Big Bailout of everyone else (sorry Bear and Lehman, guess you missed the boat) and the SEC, with a big market saving move of its own. Christopher Cox, chairman of the SEC, temporarily banned the short-selling of 799 financial stocks. (For more on short-selling stocks, see this issue's Q&A section). In London, they banned short-selling altogether, and that idea is still being tossed around here in the States. The result? The stock market closed the week with a massive surge of epic proportions, closing right about where it opened on Monday.

So where does that leave us now? Only time will tell if these ideas will actually work. There's been minor outrage from all sectors of the public, from Republicans who thought they elected a small-government president, to Democrats who are upset that their tax dollars are being used to bail out billion dollar investment banks. Surely both presidential candidates will say whatever the polls tell them to, so we really won't be able to see into the future until after we know who the next president is and how he really feels.

In the meantime, America, please don't panic. The economy might not go back to the gluttonous wealth we thought we had for the past decade, but that doesn't mean we're going to be sleeping in the streets by Halloween either. Don't sell all your stocks, hedge your investments by buying gold (which always seems to do well when the market falls) or buying some put options. And most of all, remember the words of the last great leader who pulled us out of a financial crisis, President Franklin D. Roosevelt: The only thing we have to fear is fear itself.

# Fast Facts For Fall

By Sarah Tingen

The “Housing and Economic Recovery Act of 2008” was signed into effect by the President on July 30<sup>th</sup> 2008. There have been a few changes which highly benefit the first time home buyer.

**First Time Home Buyer Tax Credit** – Here ye, Here ye, if you are first time home buyer looking to purchase a home for your primary residence before July 1<sup>st</sup> 2009 you could get a \$7,500 interest free 15 year loan from the government. **You do have to pay this back.** With either option, we’re assuming you pay back the \$500/year (w/ the full credit), from another source of funds and don’t deplete your equity or touch this investment.

## What can I do with this money?

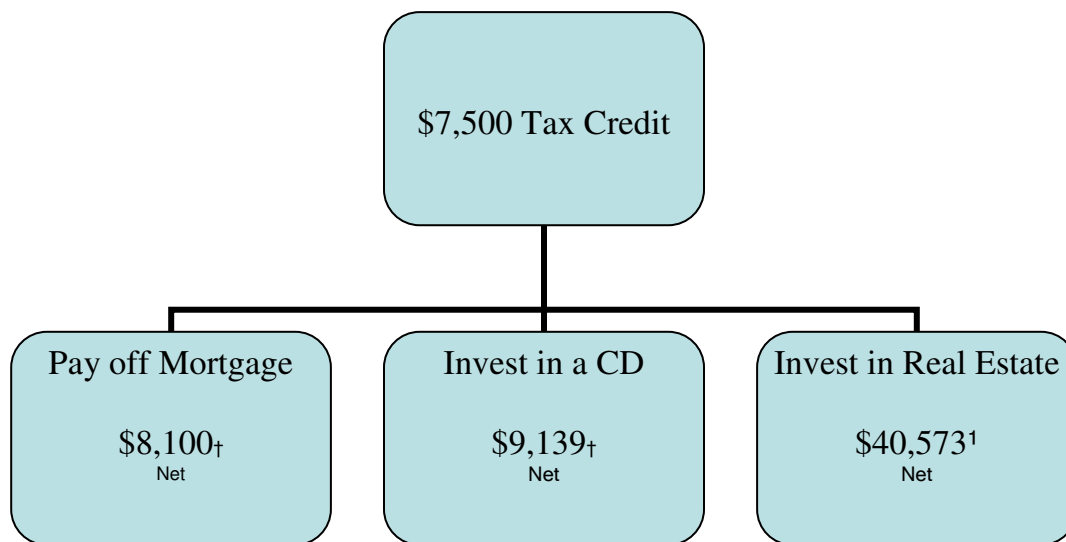
There are a few options here.

- #1 Pay off your 30/year fixed rate mortgage of 7% by \$7,500, saving \$8,100 in interest payments.

- #2 Invest in a certificate of deposit (CD) earning 4.26%\* interest compounded daily and leave in the account for 15 years.

This gives a final value of \$14,209 and a net profit of \$6,709<sup>^</sup>. You can see this amount saved is less than the \$8,100 saved from interest over the life of your loan. **BUT**, factoring in the tax break you’d get from deducting the \$8,100 in interest you would have paid off of your taxes at a 30% tax bracket (a savings of \$2,430), you’d actually end up making an extra \$1,039 if you invested the money in CDs.

**NOTE:** Earning 4.26% interest is a very conservative investment. Real-estate cash-flow investments can exceed 20% returns a year and smart stock traders can make over 10% a year easily. Either choice, you still may come out on the positive side investing the money instead of locking it into the bricks and mortar of your home’s equity.



\*GMAC Bank courtesy Bankrate.com ^ MoneyChimp.Com Compound Interest Calculator † Actual Values May Vary

¹ Assuming \$200 cash flow a month for 15 years and 1% appreciation on a \$75,000 house with a \$7,500 down payment (highly feasible)

# Getting Connected

By Sarah Tingen

Networking is a crucial part of any successful business. If you want to work smarter rather than harder it helps to have a steady stream of referrals from a well connected sphere of influence.

Some tips on making a powerful connection:

- Focus on the person you are trying to connect with, listen to their words and try to find out what their greatest business needs are for the upcoming year.
- Help them if you can! Providing something of value makes for a memorable connection.
- Leverage the power of multiple connections. Join a community group or organization.

How connected are you? Take the test below to find out.

## The Little Black Book Connection Self Test (Gitomer, 2006)

Circle the number that represents your present achievement level.

1 = Poor 2 = Average 3 = Good 4 = Very Good  
5 = The GREATEST

1. People like me.  
1 2 3 4 5
2. I am constantly meeting new people.  
1 2 3 4 5
3. When I meet new people, I engage them right away.  
1 2 3 4 5
4. I have a GREAT personal commercial to introduce myself.  
1 2 3 4 5
5. I help other people regularly.  
1 2 3 4 5
6. I look to make connections for others.  
1 2 3 4 5
7. I network at least ten hours a week.  
1 2 3 4 5

# Reader Response Contest

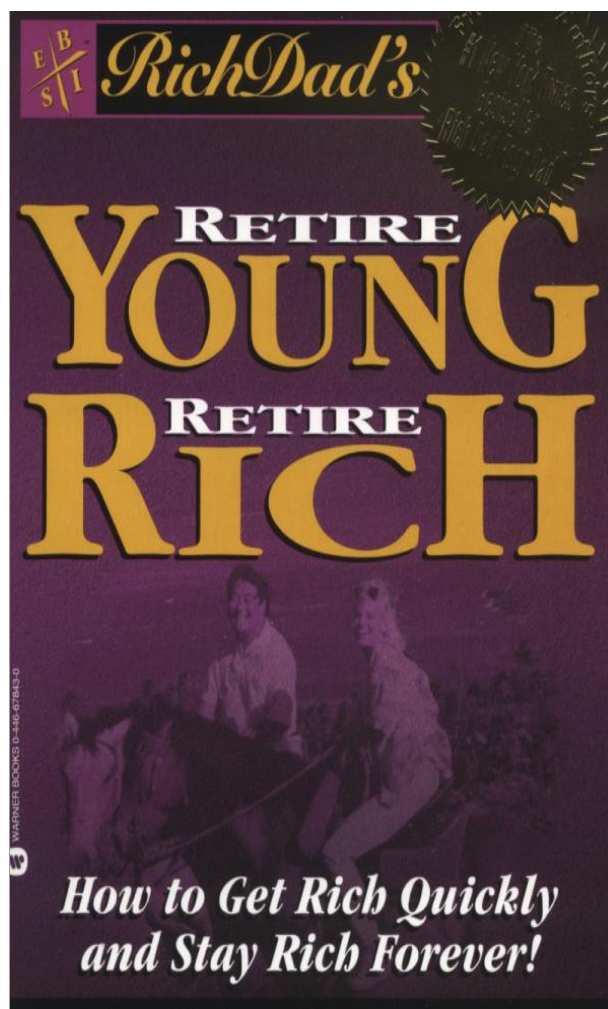
In response to the controversial bailout planned by the government and in preparation for the next edition of the S&M economic Newsletter, we want to know what our readers think. S&M columnist Chris Grubbs asks the readers to consider the following topic.

## Government Intervention vs. Free Market

“Should the government bail out the economy or should it allow free markets to work?”

Please send your answers to  
SnMChem@gmail.com.

We'll send a free copy of Robert Kiyosaki's “Retire Young Retire Rich” to the author of the most convincing response.



8. I have my own Web site and publish useful information there.  
1 2 3 4 5
9. I have my own E-zine that goes out to all of my connections.  
1 2 3 4 5
10. I am published someplace on a regular basis.  
1 2 3 4 5
11. I give speeches at industry events.  
1 2 3 4 5
12. I know the most powerful people in my community.  
1 2 3 4 5
13. The most powerful people in my community know me.  
1 2 3 4 5
14. I know the most powerful people in my industry.  
1 2 3 4 5
15. The most powerful people in my industry know me.  
1 2 3 4 5
16. People call me to help them make a connection.  
1 2 3 4 5

### Score the Test

**80** = Perfect score! You're fully connected.

**70-79** = Great score! An indication that you're on the move – UP!

**60-69** = You're in the BIG CLUB of people who think they're "pretty good," but in reality are just getting there. Make a game plan to intensify your efforts.

**50-59** = You don't know the right people in the right places.

**40-49** = You're being passed over by people better connected than you.

**30-39** = You need Altoids and a makeover.



# Sudoku

	1		5					
9	3					4		6
		2		7				8
7		1		2	9			
	5						6	
			1	4		2		7
5				9		7		
1		6					8	9
					7		2	

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