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WE MEAN BUSINESS

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DARE TO BE DULL

Nightmare on Wall Street — lessons learned

So far this year, household names like Lehman Brothers, Merrill Lynch, AIG, Bear Stearns, Washington Mutual, Fannie Mae and Freddie Mac have needed bailouts by either us, the taxpayer, or larger institutions.

And as of this writing, the U.S. stock market is down 18 percent this year. How did it happen and what does this mean for us? Forget all the psychobabble you hear on TV — here it is, plain and simple.

Greed

When my son was in second grade, I explained the concept of lending to him and he quickly grasped the idea of not lending money to someone who wouldn't pay it back. Wall Street apparently didn't learn that lesson or, if it did, clearly didn't understand.

They enabled hundreds of billions of dollars worth of loans to people who didn't have a prayer of ever paying them back.

I believe that deep down inside they knew this was a very bad idea, but shoved that doubt to the back of their minds in favor of "what the heck," they could make a fortune in the short-run.

Fed failure

Advertisements for mortgages with rates like 3.158 percent annually once appeared in nearly every newspaper.

Naturally, these were tricks to lure millions of Americans into believing they could afford these mortgages. I twice contacted the Federal Reserve Bank to ask why they allowed such advertisements, and got a response that in essence said "not our problem."

Well, it's everybody's problem now.

By my estimates, we are up to a cool trillion dollars now. That translates to about \$3,000 for every person in the country.

Personally, I'm sending the then-chairman Alan Greenspan an invoice to reimburse my family, though I won't be holding my breath.

Kool-Aid

The large financial institutions actually believed what they were saying. Stuff like this was hard for us to resist:

We believe that our clients — whether institutions, individuals or families — require more than the right advice, investments and services. Our clients also require a profound and fundamental commitment to their long-term success.

This earnest, yet sexy, statement, with its reference to "long-term success," came from the Lehman Brothers Web site on the day it filed for Chapter 11 bankruptcy.

It appears these institutions drank their own Kool-Aid and were intoxicated with the belief that they were smarter than the market. In the cold morning light, however, we're all stuck with the Kool-Aid hangover.

Lessons learned

Don't get seduced by Wall Street: The Street's core competency is greed, which



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transfers your wealth to them. There will be another bubble coming down the pike that sounds too sexy to resist. Don't fall for it.

Risk — get in touch with your feelings: Our tolerance for risk is not stable. We tend to believe we are risk takers in up markets and very risk averse in down markets.

Write down how you feel about investing in the stock market today and put it away. The next time you feel like putting more in the stock market (and you will), pull out this document and take a look.

It's far more important to be consistent in your allocation than to get it right in the first place.

Doom and gloom is good for investors: During 1979, Business Week magazine ran a cover story article entitled "The Death of Equities," which gave some compelling reasons why stocks were no longer the place to be.

Of course that expert advice was just in time for the market to deliver an annual 18 percent return during the next 20 years.

Dare to be dull: Sure, long-term index investing is about as exciting as watching paint dry. In up markets, people brag on how much money they made by buying Countrywide and Merrill Lynch.

In markets like this, however, the strategy is very daring because it requires us to stay the course and even to rebalance by buying more stock index funds today. This simple strategy isn't easy.

My advice

I wish I knew what the short-run future holds for the stock market, but I don't. I'm willing to admit that I know I don't know.

What I do know is that capitalism works in the long-run. I also know that speculators are leaving the market in droves and that this is good for long-term investors.


It's OK to feel the pain. At the moment I'm not only feeling your pain, I'm feeling my own. But (and this is a biggie) how we react to it is more likely to determine our financial future than any short-term market movements.

It turns out that sticking to an appropriate asset allocation can be even more important than picking the correct one in the first place. When the market rebounds, don't think of yourself as this incredible risk tolerant person

who can put most of your assets in the stock market. Conversely, don't panic today and get out of the market.

Keep the faith.

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