

For Clients and Friends of Financial Connections

The third quarter of 2007 featured a worldwide credit crunch, housing market decline, and hedge fund debacles—even so, the stock market finished in the black. A closer look at the numbers shows wide variation within the returns. For seven years, value-style investing outperformed growth-style investing. This quarter, value was down while growth was up. Commodities, international stocks, and bonds also had positive performance this quarter.

Economic predictions are not accurate and cannot form a basis for investment decisions. But we like to know what prognosticators are thinking: many of them anticipate an economic slowdown with a possibility of recession. Other relevant points:

- The weaker dollar, while making trips to Europe more expensive, is helping U.S. exports and reducing the trade imbalance
- Corporate earnings will most likely decline from historical highs
- Problems with subprime mortgages and the decline in the housing market are expected to continue

The Credit Crunch

In our first quarter's newsletter, we discussed some issues with subprime mortgages. Since then, hardly a week goes by without discussion of this or a related topic. We will try to convey the high points on a very complex topic.

Various debt instruments such as residential and commercial mortgages, car and bank loans are bundled and sold to investors. The idea is that there is less risk in buying 1,000 loans than in buying just one.

These loans are divided into different groups (called *tranches*). The groups are divided by the likelihood (risk) of default. A rating agency (Moody's, Standard and Poor's, or Fitch) assesses the pool of loans. A good overall rating may hide what really lies within the pool.

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**Quarterly Newsletter,
3rd Quarter 2007,
10/18/2007**

WEB SITE'S NEW LOOK

Financial Connections Group, Inc. has a new Web site. Please log into www.FinancialConnections.com. We welcome your comments.

If you go online to TD Ameritrade, please do so through our Web site. Click on Clients Only in the lower right-hand corner on the home page. It will link you to a page to access TD Ameritrade.

20th ANNIVERSARY OF BLACK MONDAY —STOCK MARKET CRASH

On Monday, October 19, 1987, the Dow Jones Industrial Average fell 22.6% in one day. Many economists predicted dire consequences and cited the 1929 crash that preceded the Great Depression.

Global markets were not immune. By the end of October 1987:

Hong Kong	down 46%
Australia	down 42%
Spain	down 31%
United Kingdom	down 26%
Canada	down 23%

The stock market had been volatile in 1987, as the S&P 500 peaked over 39% and the Dow at almost 44%. Interest rates were rising. The Treasury-Bill yielded 6.3%, up from 5.8% in January 1987.

Potential causes of the abrupt decline were:

- Program trading
- Overvaluation of the stock market
- Illiquidity
- Market psychology
- Recession fears
- Dollar devaluation
- Monetary policy with the G-7 nations

But, by the end of 1987, only the NASDAQ had a loss for the year.

Money Market	6.3%
S&P 500	5.2%
DJIA	5.5%
NASDAQ	(5.3%)

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NEWS AT FINANCIAL CONNECTIONS

Brian was quoted in *Financial Planning Magazine*, October 2007, about service to clients who are not superwealthy.

Jill earned her credential as a Chartered Retirement Planning Counselor, offered through the College of Financial Planning.

Brian and Jill attended the National Association of Personal Financial Advisors (NAPFA) conference in Santa Barbara. The theme of the conference was "Forever Young," Planning for the First Wave of Baby Boomers.

Jill and Bonnie purchased a vacation home in Little River, CA (2 miles south of Mendocino). The house is in a senior residence community called The Woods and it faces Van Damme State Park.

20th ANNIVERSARY OF BLACK MONDAY —STOCK MARKET CRASH (continued)

Can such a crash happen again?
Yes. Those who sold in October incurred a loss. For those who held on, 1987 was a positive year.

The S&P crossed the 300 mark on March 23, 1987. On October 11, 2007, it closed at 1554. If you did not sell and kept a long-term view, you had a nice return for your retirement over those 20 years!

QUARTERLY REPORTS

Enclosed are your reports. Please let us know if anything changed in your situation or if you would like to get together.

Little Known Facts of Interest

100 and older: Since 1950, the number of people 100 and over doubled each decade in more developed countries. Globally, this number is expected to quintuple between 2005 and 2030.

1st Place: U.S. philanthropic giving as a percentage of gross domestic product—twice as much as second-place Britain

83 years: Average age at moving into an assisted living facility

52.5%: Percentage of 60-65 year-olds working in 2006 vs. 45.8% in 1996

Check scams: Go to www.fakechecks.org to learn how to recognize a scam

*For Clients and Friends ...
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The tranches with higher risk are supposed to pay higher interest because of the higher likelihood of defaults. The difference between interest rates with high credit quality and ones with low credit quality is called the spread. Over the past several years the spread between these credit risks has narrowed to unrealistic levels.

Insurance companies, hedge funds, pension funds, etc. purchase these pools of loans. Many believe that one of the reasons for worldwide economic growth is that these pools of debt allow investments in individual loans of low credit quality because they are part a pool that diversifies the risk.

Subprime loans have always existed. Lenders loan only 80% of the value of the house. They confirm your employment, ask for tax returns, and use ratios to determine if your income is enough to make the mortgage payments.

But in 2004, loan practices began to change. Many new loans carried an Adjustable Rate Mortgage (ARM) with low teaser rates, which substantially increased later. The newer mortgage products also included loans called "no-doc" (they did not require any documentation such as tax returns, pay stubs, etc.) and ones with 100% financing. These newer loans accounted for 47% of those issued in 2006.

Once these risky loans were put into the loan pool, loan defaults were higher than anticipated. But—despite the large portion in default—the ratings on the pool did not change! As a result, the value of the investment lessened.

No one is really sure how to price a pool of loans, even with great credit quality, in order to sell them. Companies like Countrywide and others want to sell pools of loans (of potentially very good quality), but investors are scared to buy them because they don't know how to price them.

This problem extended to Europe, Asia, and Australia so that for the first time in history, the U.S. loan problem has a global impact.

More subprime loans with ARMs will be reset over the next 12-18 months. Hence many analysts expect this problem to continue.

One of the best sessions at the NAPFA conference in Santa Barbara was "Plan Your Livelihood, Fulfill Your Life: A Guide to Planning for Life With Meaning and Purpose" taught by Kathryn Garnett of Future in Focus.

We want to share some highlights of this session with you.

Our perception of "old" has changed.



Aunt Bee Taylor was the 65-year-old aunt on the "Andy Griffith Show" in 1960.



Jane Fonda at 69 in 2007

When we retire, we need to explore or adapt activities to sustain us during the decades that lie before us.

- Work Relationships: Much of our socializing involves people we know at work.
- Self-Esteem: Much of our identity is tied to work. One of the first questions people ask when meeting someone new is, "What do you do?"
- 2,500-3,000: The number of hours per year at our disposal after we stop working.
- Rewards: We need to replace the sense of accomplishment, teamwork, and challenges the workplace held.
- Marital Relations: With more time together than evenings and weekends, our relationship needs to change. We can develop joint or complementary projects.

We need to face and discuss some issues that are usually difficult.

- Death and Bereavement: One partner is likely to outlive the other.
- Living Arrangements: Have we looked over the house to figure out what changes need to be made if one of us has a stroke? It's hard to make adjustments after the event.
- Legal Papers: Do we have them? Are they updated? Does our successor trustee know where everything is?

There are all types of tools to help with planning. On the other side of the page we printed one called Fantasy Day that Garnett uses.

Fantasy Day in Retirement

When did you get up?

How's the weather?

Where are you living?

Is it in the country, town or city? What geographic area?

What kind of house?

Is it the house you have now? Is it a condominium? A mobile home? A tent?

If you have kids, how old are they now?

Are they all married? What are they doing? Where are they living?

Are your parents still living? Where? How are they doing?

What about you? Who are you living with?

How have you spent your morning?

What will you have for lunch?

Today, what things will you do for yourself – for your own enjoyment or satisfaction?

What will you do this afternoon?

What will you do this evening?

Do you have enough money to enjoy the things you want to do?

What do you do for others?

Who besides your spouse/partner do you spend time with?

How is your health?

If married, how is your spouse's/partner's health?

In your reflections today, what things in your life did you think about that were of special importance to you?

What are you looking forward to – what goals do you have for the future?