

## ***For Clients and Friends of Financial Connections***

At the time of this writing, the government is shut down and the debt ceiling crisis could occur shortly. The impact to the economy depends on the duration of the shutdown but in some ways, more importantly, it is the uncertainty raised in the mind of the consumer. If people become afraid to spend, the economy may pull back instead of grow. As Dr. David Kelly, chief strategist for JP Morgan Chase said, " 'Wait and see' are the three most toxic words for the economy."

While the first half of the year favored the U.S. stock market, the third quarter generated good returns internationally. The laggards continue to be bonds, REITs and commodities.

### The Federal Deficit

As a result of sequestration and the payroll tax expiring, debt as a percentage of Gross Domestic Product (GDP) is down to 3.9% -- almost 3% better than 2012.

### Outside the U.S.

According to JP Morgan Asset Management, Europe has turned the corner. Except for Greece, the Eurozone countries are beginning to grow. China's economy is increasing. This has had a favorable influence over Australia and other commodity - driven exporters.

The United States government shutdown and/or potential Treasury default withstanding, the economies of the world are on the upswing.

### The Fed

The Fed did not reduce their bond buybacks (Quantitative Easing) as had been forecasted. Some people feel it is a mistake but the Fed has made clear the danger to the economy of a prolonged government shutdown and not raising the debt ceiling. They will probably delay the decision until their next meeting.

### Stock Market Valuations

Depending upon the metrics used, many find the market overpriced, others say it's fairly valued and some say it's slightly undervalued. No one is saying the market is cheap. In the meantime, bond yields continue to be low and a risk for when interest rates rise (when interest rates rise, bond prices decline).

### Reports

Included in this package are the reports through September 30<sup>th</sup>. As always, please let us know if you would like to discuss your investments, update or create a financial plan.

### **Quarterly Newsletter, 3rd Quarter 2013 10/15/2013**

Social Security no longer mails out your statement. However, it is a good idea to download it annually. If you go to [www.SocialSecurity.gov](http://www.SocialSecurity.gov) you can create a login with security questions and download it.



## PRESENTING THE STAR OF THE FUTURE – THE UNITED STATES

We can all find things to complain about. The dysfunctional government, our education system, stalled wages, etc. HOWEVER, compared to the rest of the world, we are in great shape for the future. Below are some of the reasons why.

**Demographics:** Despite the debate about immigration, the U.S. still has one of the most open immigration policies in the world. Only Canada and Australia are as open as the U.S. (Japan for instance, has no immigration which causes economic problems). Immigrants tend to be younger and of birthing age. This keeps the fertility rate in America close to 2.1 births per child-bearing woman. By comparison, Japan is 1.4, UK is 1.9 and Germany 1.4. Aging populations need young people in the work force to pay taxes and produce. Immigrants are fulfilling this role.

**Entrepreneurial Spirit:** Our country's culture encourages challenging the status quo, questioning, and the ability to fail and try again. This is unique to the U.S. Other countries discourage individuality. The Chinese have an expression, "The nail that sticks up must be hammered down." Not so here.

**Labor Flexibility:** We may not want to but we can work part-time, take less for wages, or retrain for other jobs. This isn't done overseas. Lifetime employment is the rule in many countries.

**Strong Dollar:** It is still the world's primary trading currency. While we might complain about economic, political and financial strength, compared to the rest of the world, we are the most stable.

**Foreign Dependence:** The need for foreign financing is declining. The deficit is decreasing; energy independence is increasing; and robotics and capital intensive manufacturing are increasing. The U.S. will become the world's largest energy producer in 2013. This changes the political and economic dynamic of energy-rich nations as our independence increases.

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## THE AFFORDABLE CARE ACT UPDATE

California's program is called Covered California (<https://www.CoveredCA.com/>). Enrollment began October 1 with health insurance being bought to begin January 1, 2014. For this year only, there is a 90-day grace period for enrollment. The last day to purchase insurance is March 31, 2014. Otherwise, there is a penalty.

The chart below applies to a single person.

PLAN LEVEL	% of BENEFITS PROVIDED UNDER THE PLAN	CO-PAY	PREMIUM
Bronze	60%	40% up to \$6,350	Lowest
Silver	70%	30% up to \$6,350	
Gold	80%	20% up to \$6,350	
Platinum	90%	10% up to \$6,350	Highest

While there are several plans available under each level, the network of doctors, hospitals, deductibles for prescriptions (including generic vs. brand names) may differ. Various medications may be covered differently.

Subsidies to pay for the premiums are offered up to many. For instance, a family of four making \$94,000 has a credit on the premium. Now, you cannot be turned down for pre-existing conditions.

Helpers called "navigators" are being trained to help you compare plans. Insurance agents are being certified to help you through the program. This is the biggest medical insurance legislation since Medicare was created. People need to be patient as the kinks are worked out of the new system.

We suggest anyone who has an individual policy review what is available on the Exchange. If you have an employer group plan, it should be as good as or better than the Exchange plans. A good article for more detail was written by Tara Siegel Bernard, "A Guide to the New Exchanges for Health Insurance," *New York Times*, September 27, 2013.

If you are a client of Financial Connections and would like to review your options, please give us a call. We can put you in touch with some people certified in the program.

**Life insurance:** Jill received a call from her agent reminding her to update her beneficiary designation. A good reminder for all of us. If there has been a change in your circumstances (married, RDPs, divorced, etc.), call your agent and update the documents.

## 5-YEARS AFTER LEHMAN BROTHERS COLLAPSED

Numerous articles have been written about what has changed since the time Lehman Brothers collapsed until now. The tone of most headlines is pessimistic. A couple of examples: "How Financial Reform Became a Fiasco" (*Research Magazine, August 2013*) and "Five Years Later, The Plumbing is Still Broken" (*New York Times, Gretchen Morgenson, September 15, 2013*). Below we will take a brief look at the major issues that led to the collapse of Lehman and subsequently the financial system.

- ◆ **Leverage:** In 2008, one of the biggest problems was the depth of bank borrowing. In 2008, it was up to 50 times what they were worth in net capital. While net capital has increased, there is still no restriction on leverage.
- ◆ **The Volker Rule:** The rule limited bank activities to earning money by making loans and taking companies public. It was removed from Dodd-Frank. Investment banks can use our money in the stock market, derivatives, etc. The JP Morgan Chase Trader - "London's Whale" is the most recent example of the lack of risk management. He lost \$7 billion of the shareholders and company's capital.
- ◆ **Complex Derivatives:** This is the activity that guaranteed payment if derivatives defaulted (think AIG). There is some progress on this front. Interest-rate-swaps must now go through a central clearing house which tracks who owes what to whom. The Wall Street Lobby carved out significant loopholes. Banks and hedge funds continue to actively trade in derivatives without oversight and are unregulated.
- ◆ **Rating Agencies:** They gave AAA ratings to the toxic mortgages. The companies issuing the products paid the rating agencies (conflict of interest). No change.
- ◆ **Wall Street Incentive System:** The toxic products were sold by brokers, traders, etc. and the compensation was based on the sale. The more you sold, the higher the bonus. When these products fell apart, there was no penalty. The money was kept. Nothing has changed.
- ◆ **Too big to fail:** Nothing has changed. Risky bets can be made with the expectation the government will bail them out again.

Intense lobbying by Wall Street has succeeded in blocking most of the changes to the financial system. This does not mean the financial crisis is going to occur again, but it isn't very encouraging that Congress is bullied by the lobbyists into inaction.



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