FINANCIAL CONNECTIONS
GROUP INCORPORATED

For Clients and Friends of Financial Connections

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WAY TO GO, BRIAN!

Brian was awarded the 2012 Outstanding Adjunct Faculty for the Financial Planning Program at Golden Gate University. He was selected for this honor by the entire faculty of the Ageno School of Business.

Whereas 2012 had its share of drama in the political and economic arena in the United States and Europe, stocks shrugged off the worries for an investment return in the double digits. The riskiest assets fared the best. Europe and the Emerging Markets outpaced U.S. stocks.

Much was written about slow growth. But as Joseph Tanlous of JP Morgan Asset Management noted in *Investment News* (11/12/12), "There is a very big difference between a weak economy that's beginning to deteriorate and a weak economy that's improving."

<u>Corporations</u>

They showed great adaptability in an uncertain macroeconomic and political environment (think fiscal cliff). Return on equity averaged double digits.

Corporations continue to hold large sums of cash and have been cautious about spending on capital investments and hiring. Yet it is possible that 2013 will see some of that cash put to work, which in turn will help the economy grow.

<u>Europe</u>

While difficulties continue, the MSCI Europe Index returned 19%. A good portion of its corporate revenue occurs outside of Europe. With the substantial rise in 2012, the "low hanging fruit" may already be picked and a repeat in 2013 will be harder to get.

Globally, political and financial issues remain. We might see volatility when the media publishes negative headlines.

<u>Emerging Markets</u>

There seem to be two schools of thought on investing in this arena. Some believe that significant investment returns have already occurred while others believe the rising middle class in Latin America, Asia, and Africa still lags behind.

Emerging markets contribute 40% to the *global* gross domestic product and owe only 10% of the global debt!

Continued inside...

<u>U.S. Manufacturing</u>

Clients of Financial Connections

(Continued from front page)

There is a revival of manufacturing in the U.S. Many people are subscribing to "Buy American." We have an abundance of inexpensive natural gas that is attractive to foreign companies. Foreign companies opening manufacturing plants in the U.S. include

Rolls-Royce	Bayer	Novartis	Samsung	Siemens

Auto and Housing

The recovery started without meaningful participation of the auto and housing industry. Pent-up demand and demographic trends are anticipated to build momentum in these two industries. The age of cars on the roads is at an all-time highs, and more and more adult children are moving out from their parents' houses to their own places. Many analysts believe these two factors will drive significant growth in 2013.

Inflation

As we've mentioned previously, most sources anticipate an increase in inflation but no one agrees when it will occur. We've written in previous articles that some of the criteria needed for inflation include rapid wage increases, full or nearly full manufacturing capacity, and a rapid turnover of money (its velocity). None of these criteria are in play.

Portfolios

Enclosed are your year-end reports. Included is a Realized Gains/Losses report (if applicable). TD Ameritrade will be sending Form 1099s in February. The two documents should be given to your tax professional.

If you would like to review your portfolio(s), ask questions about strategy, update and/or create a financial plan, please get in touch with us.

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A LESSON FROM HURRICANE SANDY

One of the unpleasant surprises in the devastation of Hurricane Sandy was the role of homeowner's insurance.

Do you have enough?

Your home is one of your largest assets. Does it have enough coverage? Don't be underinsured. Remember we're not talking about the fair market value of your home, but the cost to rebuild it. Construction costs routinely change. Periodically review your policy to see if the coverage reflects today's rebuilding costs.

Coverage in natural disasters

It is important to find out what your policy covers—and just as important, what it does not. For example, standard homeowner policies rarely cover earthquake, flood or mold damage. If you live in a low-lying area and take out flood insurance, note that it usually covers $250,000 including boilers, washers, dryers, and other utilities but no other contents of your house or garage: for those you will need to look into different coverage. Frequently, damage caused by wind is a separate deductible charged as a percentage of the house's value. It can be as much as 10%!

Reputation and financial strength of your insurance company

Cheap isn't always the best. Look for a company with a good rating for financial strength (A.M. Best and Fitch rates them). What is its reputation for claims? Will the insurance company argue over every dollar you claim?

<u>Example</u>

Jill annually grumbles about the high premiums for her homeowner's insurance—but not anymore.

Jill and Bonnie had no idea that their dishwasher was leaking, causing water and soap to go through the kitchen floor to the basement. While ripping out the floor, the contractor found asbestos. The entire flooring for 4 rooms had to be replaced. Not surprisingly, it was a nightmare to live with no kitchen, furniture compressed to a few rooms plus the garage, everything boxed, cabinets ripped out, etc. for more than 2 months.

However, the insurance company paid without any arguments not only to the companies involved in the repairs, but for our out-of-pocket expenses. AND, surprisingly it didn't increase our premiums.

While Jill doesn't wish this experience on anyone, the insurance company became a partner, not an adversary.

Keeping your documents

Whether it is auto insurance or homeowner's, you need your policy available in case of a disaster. If the disaster involves your house or the car in the garage, access to a copy is critical. Clients of Financial Connections could upload a copy to their Client Web Portal (see related article).

PREDICTING THE FUTURE—WHY BOTHER?

People frequently ask what we think the market will do over a given year. As we've always said, our crystal ball is no better than anyone else's.

Here's a look at predictions for 2012 made by various institutions with large quantities of information and the staff to analyze them. With hindsight, we see their errors.

- Morgan Stanley—predicted S&P 500 would fall 7.2%. It was up 13%.
- Goldman Sachs—predicted S&P 500 would drop 25% and the Euro would collapse: it strengthened 9.4% from a July low.
- Credit Suisse, Wells Fargo, and Merrill Lynch—predicted flat returns for U.S. equities. The Wilshire 5000 (measures small, medium and large companies) was up 16%.
- Citigroup— forecasted February 2012 a 50% chance of Greece's leaving the Eurozone in 18 months; in May the forecast increased to a 75% chance and the prediction went up to 90% in July that Greece would be out of the Eurozone by January 1, 2013.

CXO Advisory Group tracks more than 60 "market gurus" and calculates that an accurate forecast occurs 48% of the time over the long term. This is less accurate than a coin flip (correct 50% of the time).

We strive to maintain an even keel between positive and negative expectations when designing portfolios.

ACCESSING INFORMATION QUICKLY AND SECURELY—CLIENT WEB PORTAL

A means to secure documents for easy access is becoming more important in this technological age. Our Client Web Portal is such a vehicle.

Clients are using the portal as an electronic safety deposit box for such items as

- Estate documents
- Tax documents and returns
- Birth and marriage certificates
- Copy of passports

Financial Connections uses the Portal to communicate to clients, with

- Quarterly reports
- Newsletter
- TD Ameritrade forms
- Tax information

The Client Web Portal also allows clients to view their account information in a user-friendly format.

As more and more financial advisors use Web portals, the SEC is requiring their clients sign a letter acknowledging the service. We will be forwarding a letter for your signature with a return envelope in the near future.

For clients not yet taking advantage of this service, we will also send the letter and sign-up information so you can join the network. If you have documents you would like to keep on the portal but don't have a scanner or can't generate a PDF file, let us know. We can help.

If you have any questions, please contact our Operations Manager, Kim Wohler.

THOUGHTS ON CUTTING SPENDING AND RAISING REVENUE

The ongoing debate about putting the U.S. fiscal house in order entails some misperceptions.

<u>Budgets</u>

Robert Shiller, an economist and Yale professor doesn't like the metaphor comparing the nation's budget to an average household's.

In a family budget, we cut back our spending to align with our income. Otherwise, we go into debt. But spending less doesn't affect our income level.

The federal budget's income and spending is interconnected. If everyone stops spending, less revenue is collected through taxes, and that has an impact on the nation's income.

<u>Entitlement Reform</u>

Robert Reich, former U.S. secretary of labor and a professor of public policy at UC Berkeley wrote an opinion in the *San Francisco Chronicle,* January 13, 2013. He made some interesting points we don't usually see in the press.

According to Reich, the law requires money spent on Social Security to come only from the Social Security trust fund. The fund had a surplus for years but the federal government borrowed from it, issuing IOUs. Cutting Social Security doesn't pay back the IOUs, and money from the General Fund can't be used to pay for Social Security.

Reich argues that for most recipients, Social Security makes up nearly 70% of their income and does not keep up with inflation. He suggests the only fair alternatives are to raise the ceiling on income subject to Social Security tax and add means-testing so wealthy retirees receive lower benefits.

His take on Medicare/Medicaid is that the problem is soaring costs of care. His recommendation isn't to reduce benefits but to get more "bang" for the health care dollar. Eighteen percent of our economy is spent on health care compared to 9.6% in other "rich" countries.

Even with this higher spending, we have a shorter life span and a higher infant mortality rate than other developed countries. We were surprised at some of these numbers.

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