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CENTER FOR FINANCIAL GERONTOLOGY

Money Monitor

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JIM'S JOURNAL

Look Back – 2008

To say that last year was a disaster for many investors and the US economy is probably an understatement. All you had to do was look at your year end statement for 2008 to realize that there was something terribly wrong. There was almost no place to hide from the crash of 2008 as markets around the globe suffered historic losses and segments of the bond market stopped functioning.

The venerable DOW Jones Industrial Average was down -33.8% for 2008, its worst year since 1931 (Which was down -52.7% for that year). The broad based Standard & Poor's 500 Index preformed even worse, down 38.5% for 2008 sporting its worse year since 1937. Not to be outdone, the NASDAQ Composite Index fell -40.5%. This plunge was the worst percentage decline in its 38 year history even topping the tech-stock bubble burst of 2000 which saw a low of -39.3%.

It should come as no surprise; almost all mutual funds suffered a similar fate. The average US stock fund was down -38.7%. From a universe that included more than 1,700 funds at least three years old and with more than 50 million dollars under management, only one fund produced a positive return. That return was a meager +0.4%. Old favorites such as Growth Fund of America (-39.07%), Davis New York Venture (-40.03%) and Templeton Growth (-43.47%) were not saved from the carnage. The ever reliable Washington Mutual Fund (-33.10%) was also significantly down for the year. Even Morningstar's Domestic Manager of the Year for 2008, Charlie Dreifus of Royce Special Equity (RYSEX), was off -19.5%. Thus, I am very pleased and thankful that the Haas Financial Money Management Program was up for the year.

Around the globe, world stock funds preformed even worse than their US counterparts. The Europe, Asia, Far East Index (EAFE) was down over 45% in 2008 and Latin American Funds lost an average of -57.3%. The best performing sector was utilities at -13.5%. Even bond funds proved to be no automatic safe haven as the average taxable bond fund was down -9.7% in

2008.

After the Stock Market's third worst year in more than a century, many investors are angry and confused. Over the past ten years, most stock categories are down and their performance trails that of almost every other asset class, including government bonds, gold and real estate (Morningstar Data). So where do we go from here?

Let's review some of the current problems: Economic reports remain dismal and at this time it is hard to see any light at the end of the tunnel. The housing industry remains in deep trouble with sales declining, prices falling, foreclosures rising and mortgages still difficult to obtain. The US auto-industry is facing the prospect of bankruptcy for GM and Chrysler. Sales of new cars and trucks continue to plunge every month. Retailers are seeing less store traffic, sales are disappointing and national outlets are going out of business. Consumer confidence is at a low not seen in decades. Unemployment is rising and there are no jobs to be had. The financial system was only saved by massive government intervention. Credit card defaults are rising with government debt and budget deficits burgeoning. How can we see hope in the midst of all these difficult and deteriorating conditions?

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I think there is! Despite the ever present political bickering, the government response has been massive. Trillions in takeovers, bailout grants, guarantees, loan provisions and flooding the financial system with extra liquidity from the Fed are part of the stimulus package. Financial firms are gradually improving their balance sheets. Odds are good that the auto companies can restructure enough to obtain another bailout loan. A trillion dollar stimulus package for infrastructure repair and replacement is in the works. The number of new homes on the market is beginning to decline. Mortgage rates are falling. And much to our delight, oil and gasoline prices are down. The recession will likely be a long one but a thousand mile journey begins with the first step. We have made the first step.

On a final note. The Money Management Program will have a negative return in January (It had a negative return last January before ending the year up). The strategy that I used much of last year has not worked well to start 2009. Knowing that no investing solution works all the time, I have been spending research hours to refine my current strategies. My approach is not static but eclectic so I attempt to find a solution that works for the current market conditions. I look forward to implementing some new ideas as we move into February and beyond.

The Stock Market Panic of 1873

By Greg Adamczyk and Mark Davis

It was 140 years ago that the US economy started one of its worst depressions. After the civil war the US began a race of expansion in which railroad companies covered the country in tracks, financed by easy credit from the banks. The first major shock of this economic cycle was the **Black Friday Panic of 1869**. Two speculators, Fish and Gould, tried to corner the gold market with the help of President Ulysses S Grant's brother-in-law, Abel Corbin. Grant's reaction and the uncovering of the scandal caused a sell off in the financial markets.

Does any of this sound familiar? Not Yet? Let's fast forward to 1893. By this time runaway railroad expansion continued to stress the banks. In 1893 Philadelphia & Reading railroad collapsed. People started a run on the banks and many more railroads collapsed. Ultimately, this led to the demise of the railroad industry. Unemployment reached nearly 20%.

It wasn't until 1909 that the U.S. economy started to rebound. The prevailing political environment was known as the Progressive Era, a grass roots movement that started at the state level and eventually moved to the national level. The progressives initiated reforms that emphasized control at the local level. On the economic front, companies merged, becoming larger and larger, but were kept in check by stronger local and state governments.

Teddy Roosevelt continued the progressive era policies and was known as the "trust buster" for his regulatory measures which mandated fair and reasonable business practices in the corporate community (you may want to look up the Hepburn act of 1906).

Taft continued the progressive movement in much the same manner as Roosevelt, mandating further corporate reform and also transferring responsibility for oversight to the federal level. He continued to restrain corporate excesses. Prosperity returned with a market expansion that lasted until 1929.

Wilson continued a trend of government regulation of the banks and large corporations with the creation of the Federal Reserve in 1913. Wilson also reformed corporate labor laws eliminating child labor, created the eight hour work day, and he promoted labor unions.

This combination of fair business practices, fair labor laws, industrialization and the assembly line created unprecedented wealth and prosperity. The middle class in the U.S. exploded.

With unchecked prosperity, the US Market went wild. Anyone, anywhere seemed able to make huge profits at any venture. Money became increasingly loose. Regulation was almost non-existent. Stocks, thousands of which were

The Market Panic of 1873, cont.

fraudulent, appeared on the NY Exchanges and politicians started to veer away from Progressive Policies. For instance, Coolidge raised corporate income taxes, added hopeless complexity to the tax code and created costly government farm subsidies.

These factors combined to create an unsupportable bubble and inevitable crash of 1929. **Black Thursday, Black Monday, and Black Tuesday** were days occurring the 24th, 28th and 29th of October 1929 in which the US saw blood in the Street. Exports declined nearly 75%, industrial production was cut in half, prices decreased nearly 60%, new home construction was almost non-existent and nearly half of the banks failed, (without FDIC insurance to back them). Unemployment reached a record, that stands today, of 25%. Adding to the bursting bubble was the great Dust Bowl of the 1930s. The US experienced the worst drought in its history.

FDR attempted to bring the country out of the depression by creating new government programs, injecting the economy with massive amounts of government spending and regulation over every major industry. Government spending was now 10.2% of the GDP and the national debt doubled by the end of 1932. Despite all of the government intervention, unemployment was still high and there was very little wealth creation. Throughout the 1930s many new taxes, like the payroll tax, were created making it even harder for people to support their family.

It wasn't until World War II that the U.S. economy returned to prosperity. The massive mobilization of World War II lifted the US out of the depression. Highly productive and motivated servicemen and servicewomen returned and used their wages to buy homes, cars and to spend on their new baby-boom families. The new economy saw the US dominating world industry and agriculture until 1968.

In the early 1960s Kennedy loosened monetary policy in an attempt to keep interest rates low and encourage further growth in the economy. The fiscal policy had also changed as Kennedy increased government spending which led to the first non-war, non-recession budget deficit. Loose credit and larger government spending would again prove to be a catalyst for economic turmoil as another contraction period was on the horizon.

LBJ continued Kennedy's track record of deficit spending and increased income taxes. Under Nixon government spending continued to increase and government programs became much larger. Most of this increase in spending was on Social Security and Medicare. Interest rates and inflation began to spiral upward. The Oil Embargo of 1973 proved to be the final shock that sent the markets into free-fall, causing the stock market crash of 1973-1974 where the DJIA experienced a drop of 45%.

By the late 70s poorly implemented labor policies made the US the butt of jokes around the world. The Japanese auto industry accused the US of having the most unproductive work-force in the world. The low productivity, loose monetary policy, heavy taxation (the highest marginal income tax rate in 1979 was 90%) and global oil shock kept the US in its contraction cycle until 1982.

Reagan and Clinton both instituted tax reform, drastically reducing income tax. Both drastically reduced trade tariffs and restrictions. At the same time computer processing and robotics changed the face of the workforce. Productivity soared for almost two decades. Through 1999 the US experienced a prosperity unlike any previous boom.

Speculative investment chased the hottest stocks with easy money. Once again, monetary policy was too easy, cash too plentiful and reasoned investing too scarce. Amateurs and professionals alike traded in the market without regard to fundamentals. Each profitable trade created an inevitable tax liability. In April 2000, sell orders flooded the market precisely before taxes were due. This proved the final shock to cause the "tech bubble" to burst. The 9/11/2001 terrorist attack was a catastrophe that touched the entire globe. 2002 was the final year of a three year recession that proved worse than any in 30 years.

The US experienced a few years of prosperity that ended with the bursting of yet another bubble. This time it was an over-blown residential real estate bubble, fueled by unchecked speculation from too easy, poorly regulated money.

The Market Panic of 1873, cont.

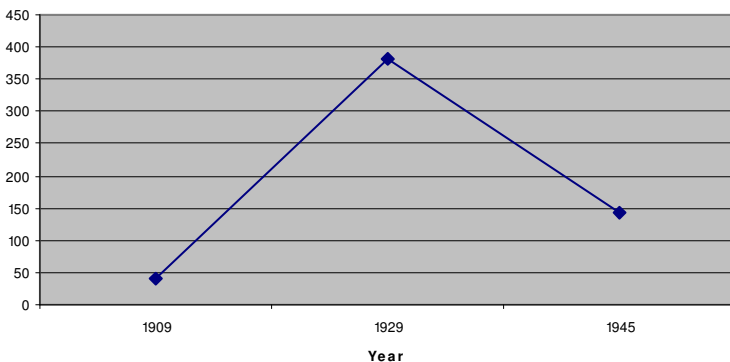
There are common threads in the economic cycles. Each cycle had a long-term contraction period, followed by an expansion period of similar duration. Each contraction was preceded by a period of irrational exuberance, unchecked and unregulated lending which fueled speculative buying. Each boom culminated in a bubble market which in turn burst.

Each expansion cycle returned slowly and stealthily. Productivity gains, invention and innovation provided the fuel for the return to prosperity. Each time the US government responded to the apparent causes of the bubble market with new regulation and oversight to prevent the same excesses in future markets.

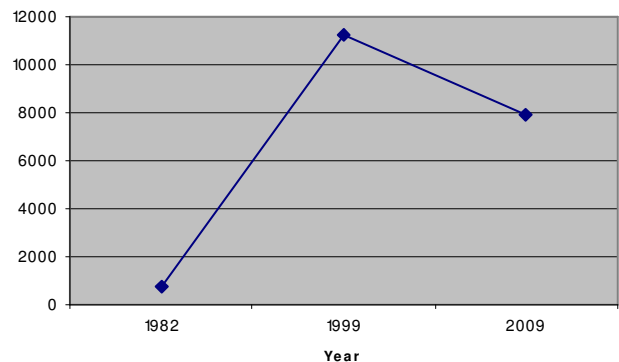
It is now 2009. Unemployment is high, home values are still low, new home construction is still down, interest rates are still low. The US is arguably in the middle of another long-term contraction cycle and US Residents are tightening their belts. In previous contractions (the Depression at the turn of the last century and The Great Depression), US Residents went hungry. Now we are less able to buy toys or even choose to sell the ones we own. In each successive cycle during the last 140 years, each contraction has been less disastrous, each expansion more prosperous.

It is our best guess that the US and the world is about half way into the latest contraction cycle. That means another eight or more years of this contraction. I agree with Harry Dent and Donald Haas, in principal, that difficult times are ahead. BUT, another expansion will come. Even in bad times, there are assets that are profitable. Now it is more important than ever to take conservation measures and actively manage your portfolio. We will get through this contraction cycle with hard work and discipline. We will prosper.

Dow Jones Industrial Average



Dow Jones Industrial Average



Here is a snapshot of two different expansion and contraction cycles. Where do you think we are headed next?

**SECURITIES OFFERED THROUGH HAAS
FINANCIAL PRODUCTS INCORPORATED**

29600 NORTHWESTERN HWY SUITE 114

SOUTHFIELD, MI 48034

[HTTP://WWW.HAASFSI.COM](http://www.haasfsi.com)

PH 248-213-0101

Fax 248-213-4502

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