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## **Inside this issue**

[Panic Attack Number 5](#)

[Strategy Update](#)

[The Bailout Scorecard](#)

[Millennium Trust Clients News](#)

[Heritage Capital In The Media](#)

[Friends And Family Plan](#)

## **Panic Attack Number 5**

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My original list of topics for this issue has now been put on the backburner by one of the most embarrassing and ridiculous series of events in the history of U.S. government. I guess it's not enough for these elected clowns that the entire global financial system is collapsing around them. How anyone can possibly play politics at this time is beyond me!

It's not even worth choosing sides. Does it really matter? As far as I am concerned, we should wipe the entire slate clean and start over. Leave it to Congress to make a bad situation worse by acting like a bunch of teenagers. Wait. Scratch that. Congress is behaving much worse. And you need only to watch the financial markets' path of destruction when it became apparent that the rescue plan was not going to pass.

Although it looks like the politicians are back to square one with no meetings planned until after the Rosh Hashanah recess, I do expect a rescue bill in some form to be passed before the weekend. They should work on explaining why this is so vitally necessary for Main Street and not just a bailout for high risk taking, fat cat Wall Street executives.

Should something not pass right away, we will certainly begin to hear stories about small business owners not being able to meet payroll and other essential business functions due to the credit markets being totally frozen. Not only will that be awful, but I cannot envision any politician standing for reelection being able to tolerate that.

So where are we stock market-wise?

We are now experiencing the 5th panic attack of 2008. January was the first one as commodities exploded higher, credit seized up and a rogue trader at SocGen was outed. The Bear Stearns collapse in March was number two, followed by IndyMac Bank, Fannie and Freddie in July. Number four was just a few weeks ago with AIG and Lehman. Now, we are dealing with the 5th wave.

Looking back in history, I can only find one valid comparison for such behavior, the 1930s with now equating to 1938ish. It doesn't matter whether that comparison holds or not. The stock market has been assaulted from the land, sea and air by the worst fundamental backdrop in 70 years.

As I mentioned before, this is not a stock market led event. You can argue all you want, but if I told you on January 1st that AIG, WaMu, Wachovia, Fannie, Freddie, Bear Stearns and Lehman would go bust over a 7 month period, almost everyone alive would guess that the major indices would be down at least 50% and maybe 70%.

That's just not the case. Yes, the stock market has been run over by a Mack truck, but it's the credit market that's pushing this along. I had a call today from someone who asked about buying "real high quality bonds". The heck with stocks he said.

I invited him to research how those types of bond funds and ETFs have been faring lately. It's not pretty with some losses more than 20% this month alone! And even the municipal bond market has been attacked. Those of you seeking tax free yields are now finding some of the best opportunities since the 1994 Orange County Crisis!

If you fit in that category, feel free to call or email me directly and let me help you find some good fits for your portfolio.

Let's get back to the stock market. As I discussed above, we are now in the throes of the 5th attack on the markets this year. Interestingly, each has come from a more compressed basis than the previous one, and it's pretty tough to get much closer than just two weeks away from the 4th wave.

Today set all kinds of historic precedents, but so did every other panic this year. What is so unsettling is the one day magnitude. We are all very conditioned to watch the Dow move in relative increments. But when we see an outsized move, that began as 300 points in January, it gets everyone outside of their expectation zone.

Two weeks ago, the 500 point day became expected and now we hit almost 800. The analogy I used all year still holds true today. Roll a snowball down the hill. It reaches its largest size and velocity the second before it hits the bottom. And that's where we are today and have been 5 other times in 2008.

Will stocks bottom on Tuesday? Maybe. But that's not the relevant question. Is the next 15% move up or down? I feel pretty good that it's going to be up in the 4th quarter. To dial it down even more, it looks to me like stocks could see multiple bottoms between now and the 17th of October.

Why October 17 you ask?

First of all, after tomorrow we are rid of the month end and quarter end. And September has traditionally been the worst month of the year for stocks. Second, October has a good record of reversing the trend that dominated September. Third, hedge funds are seeing their highest redemption period ever and that period ends tomorrow. Fourth, mutual funds, whose fiscal year ends in October typically do most of their rebalancing and tax planning at the same time as derivatives expire, which is October 17.

So, along with historical, precedent setting readings currently being generated by almost every decent indicator, stocks have stretched that proverbial rubber band about as far as it has ever been stretched without breaking. And I would fully expect the initial snapback to begin this week, and as soon as tomorrow depending on how the open looks.

Before I forget, I wanted to pass along this excellent piece on SIPC insurance on the various brokerage accounts. Keep in mind that this is typically the minimum on each account, yet many firms, at least for now, contract additional insurance from CAPCO.

### Brokerage Account Protection

As I've said repeatedly all year, I beg you not to be complacent with your money!

## **Strategy Update**

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As most of you know, we run 8 independent investment strategies at Heritage Capital. During tumultuous times, we often seek the cover of money market instruments for protection in most strategies and short sales in the right situation for two strategies, Diversified Growth and Spectrum to a small degree.

Although tomorrow is month and quarter end and statements will be out shortly, I wanted you to know where our portfolios are allocated right now. Our current average allocations are as follows:

Short-Term Gold - 100% money market

High Yield Bond - 100% money market

Spectrum - 88% money market/12% U.S. indices

Global Asset Allocation - 65% money market/35% long-term treasuries

Diversified Growth - 50% money market/50% U.S. indices

Developed Markets - 50% money market/50% International

Relative Strength Sectors - 75% money market/25% U.S. sectors

Emerging Markets - 100% money market

Please remember that we are active investors seeking to take advantage of changing market conditions. As such, our allocations can and will change quickly during highly volatile times. I expect to be very active in the coming days and weeks!

## The Bailout Scorecard

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If you take a giant step back and look at the events of 2008, it's clear that we are living history in the making. They are writing history books as we speak about this global financial crisis. My take is that years from now, they will view the Bear Stearns bailout as a preemptive strike to save JP Morgan, as its been rumored that JPM was Bear's biggest counter party in derivative trades. Right now, it's just conjecture, but it does make sense.

Fannie and Freddie posed an all out systemic risk to the U.S. mortgage market as well as the international holders of their paper. There was no way the government was going to let them fail, at any cost! And I believe there is a decent chance that we will end up being profitable on that transaction. IndyMac Bank was the opposite and allowed to fail.

The AIG loan made sense from both a business and systemic point of view. Once again, I believe when all is said and done, the U.S. taxpayer will be profitable on that transaction. An 11.50% yield and a majority stake in a company with valuable businesses in a liquidity crunch? That represents good risk/reward.

Unfortunately for Lehman, they came too late in the game and did not pose nearly the risk that everyone else did. So the government let the markets punish them for their hubris in not securing a deal faster.

Merrill Lynch saw the writing on the wall from Lehman (of course with the government's "help") and decided it was better to survive with a bank than be cast aside with relentless attacks from the financial markets that caused another "run".

Washington Mutual did fall victim to a classic run on a bank, resulting from the overwhelming load of toxic paper on its books. But with the FDIC not wanting to expend any of its valuable ammunition, an engineered deal with King Jamie and JP Morgan resulted in yet another fire sale buy for the strongest financial institution on earth. People thought I was kidding when I said that Jamie Dimon and JPM were going to rule the world earlier this year.

And I don't think he's done shopping for bargain basement deals!

Finally, this morning, the other "W" on my Hall of Shame list, Wachovia, was essentially declared insolvent in a pre-packaged deal with Citi. Can you imagine the idiocy of buying an institution, Golden West, for some \$40B, at the height of the housing craze and watching the value go straight to zero? ZERO! Two of the worst personality traits, arrogance and ignorance!!

That's some list above! And all in only 7 months!! I thank the person upstairs that Ben Bernanke and Hank Paulson are driving the bus and not Alan Greenspan and Paul O'Neil. It's bad now. I shudder to imagine where we'd be without Hank and Ben.

This article wouldn't be complete without mentioning the only two major independent investment banks left, Goldman Sachs and Morgan Stanley. But wait, they are gone too! Not in the merger or bankrupt sense, thankfully. But in the entrepreneurial, investment bank way.

After watching Bear, Lehman and Merrill go away, they obviously realized that the world had forever changed. The days when investment banks leveraged up their balance sheets in a gunslinger kind of way were over. If they were to survive, they knew they needed to act more like a bank with deposits. And so they did.

We are now left with no major independent investment banks in the U.S. Just a bunch of boutiques. And that's a sad statement for capitalism.

## **Millennium Trust Clients News**

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If you have an account at Millennium Trust, I thought you'd like to know what steps they have taken to add further protection to your account.

### ***Expanded FDIC Client Cash Asset Protection***

We are pleased to let you know that the final phase of our expanded FDIC client cash asset protection program will be completely in place next week. We've spoken about this unique custody feature before, but let me summarize the program for you. Client cash assets at Millennium are typically placed in highly qualified commercial banks in Chicago when clients' assets are "out of the market".

Rather than using a single bank as repository for cash assets, we now use four separate and unaffiliated banks, each bank bringing its full FDIC insurance coverage. In this combined structure, IRA custody accounts are fully protected by the FDIC up to \$1,000,000 per client and non-IRA custody accounts are protected up to \$400,000 per client by the FDIC. When client cash exceeds these amounts the balances are held in the Federated Government Obligations Fund money market fund.

The Wall Street Journal's *Market Watch* section features a description of our new service ([Market Watch article](#)). More detailed information is available at our web site ([Advisor Services](#)).

## **Heritage Capital In The Media**

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[Lights out at Lehman](#)

[Lehman's financial failure to be brutal](#)

## **Friends And Family Plan**

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Finally, as you know, our firm and this newsletter continues to grow mostly from your referrals. If you know anyone who is interested in securing their retirement, planning for it or just plain worried about it, please send them here. As always, thanks for thinking of us with your circle of family and friends.

<http://www.investfortomorrow.com/newsletter.asp>

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Please Note: Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, equal the performance results reflected, or equal any corresponding historical benchmark index. The historical index performance results for all historical benchmark indices do not reflect the deduction of transaction and custodial charges, or the deduction of an investment management fee, the incurrence of which would have the effect of decreasing indicated historical performance results. The historical performance results for all indices are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of a Heritage program meets, or continues to meet, his/her investment objective(s). A corresponding description of each index is available from Heritage upon request. It should not be assumed that Heritage account holdings will correspond directly to any such comparative benchmark index. The Heritage performance results do not reflect the impact of taxes.

For reasons including variances in the investment management fee incurred, market fluctuation, the date on which a client engaged Heritage's investment management services, and any account contributions or withdrawals, the performance of a specific Heritage client's account may have varied substantially from the indicated portfolio performance results.

In the event that there has been a change in a client's investment objectives or financial situation, he/she/it is encouraged to advise Heritage immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investments purchased and/or investment strategies devised or undertaken by Heritage) will be profitable.

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