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Inside this issue

What I Read on my Summer Vacation

Summers Fall

Taper Talk, Token Taper, Taper Tantrum

Major Changes to the Dow Jones Average

Upcoming TV Appearances

Investment Quotes To Live By

Friends And Family Plan

What I Read on my Summer Vacation

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This week is certainly shaping up to be a busy one with the news of Larry Summers withdrawing his name from consideration to succeed Ben Bernanke (applause) and the "all important" two day Fed meeting on Tuesday and Wednesday. I am also going to be on CNBC's Closing Bell on Friday at 4pm. It feels like the markets have been clamoring to get back to business after the Jewish holidays last week and before, Labor Day and the end of summer to close August.

The Schatz family hit New Seabury on Cape Cod this year and it was one of the greatest weeks we have ever had as a family. Interestingly, it was also a week where we had spotty cell service to say the least. We literally had to stand just outside the front door in a 2x2 square or in a corner of our bedroom to receive
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mediocre service. All that changed when we left the property and traveled a few miles, but it was kind of nice not to hear the phone ring or text message buzz. We did have high speed internet access, thankfully, or yours truly would have been fit to be tied and probably went home.

The kids had all these grand plans for our time away, but when we got to the townhouse in this seaside village with little, tiny streets and kids on bikes everywhere, that all changed. The usual chorus of "where are we going for dinner" or "I don't want to eat home on vacation" turned to "we'll grab leftovers" and "I'm not hungry". For my daughter to say no to sushi and going to a restaurant is like me saying no to a day of skiing!

It was so great to see the kids do things that I did as a kid. They rode bikes and met other kids, played two square, four square and some made up six and eight square. They ran around at dusk with flashlights playing cops and robbers. When Teri and I woke up each morning, the kids were already outside playing with their new friends and had to be dragged inside in the darkness to shower. Oh the money they save us!

As longtime readers know, I only read books when I travel for work or on vacation. I can bang out a short book on each flight without much trouble. Last month, I continued my theme of reading every book written about the financial crisis with Michael Lewis' Boomerang, one of his best! It's short, easy to read and will make you shake your head time and time again. This piece focuses on what went on in Iceland, Ireland and Greece.

As I sat outside reading it one morning, my eight year son asked me what the book was about. I thought about that really hard for a few minutes and replied, "well Ry, it's about how all these small countries thought they could spend more money than they had and ever would have without anyone caring or noticing". In true Schatz form, my son said, "Dad, are they stupid? Don't they know you can't spend more money than you have?" I said, "Ry, I am proud of you. That's an excellent analysis." To which he added, "Yeah. I know. If you say no to me, I am sure I can find someone else who will want to give me money."

Don't forget to check our blog for intra-issue updates. Investfortomorrowblog.com. The stock market is entering a period of heightened risk for the next 4-8 weeks.

Summers Fall

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What a pleasant surprise when I walked in the door from my daughter's softball game and saw that Larry Summers had withdrawn his name from consideration to succeed Ben Bernanke. It's not a new topic here nor in my **commentary in the media** that I thought Summers was the wrong person at the wrong time for
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the job. The man doesn't play well in the sandbox with others and stuck his feet in his mouth regarding women when he was president of Harvard.

There is no argument that Larry Summers is brilliant, but there are many brilliant people on earth who should not be running the most powerful central bank on earth. Let's not forget that Summers was a strong proponent of repealing Glass-Steagall, the depression era legislation separating banks and brokerages. That didn't work out so well for Citi, Bank of America, Wachovia, etc. in 2008. And to go a step further when he worked in the Clinton administration, Summers was also one of the architects who allowed those derivatives of mass destruction, credit default swaps, etc. to be created and allowed to exist unregulated. You remember those, right? The alphabet soup of fancy products that no one understood.

Finally, as I have mentioned before, the Fed has an almost $5 trillion balance sheet, something I forecasted years ago and was laughed at. Even if Larry Summers did not have all the baggage he does, it's not the right time for a Fed chair who basically was opposed to Bernanke's quantitative easing (money printing) and would unwind it much quicker than a more dovish person.

Once again, Janet Yellen becomes the front runner and with the bipartisan support already in place, her nomination should sail through. I keep scratching my head why President Obama would push so hard for Summers when congressmen in his own party are so opposed that they felt it necessary to sign a petition supporting Yellen. And that doesn't take into account how fierce republican opposition already was for Summers. To a dummy like me, Summers nomination was DOA...

Taper Talk, Token Taper, Taper Tantrum

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Why does it seem like every single Fed meeting has become "the single most important FOMC meeting ever" in the media? And here we are again. The Fed begins a two day meeting tomorrow and it is widely expected that they will announce the first of many subsequent tapers at either this meeting or the one in November. The only surprise will be if they remove any kind of taper talk from their announcement or commentary. Although I do not agree with tapering here, I think the Fed probably begins with a token taper of $10-$15 billion per month. Whether that's this week or in November is purely a crapshoot in my opinion.

Currently, the Fed is buying $85 billion a month in mortgage back securities and treasury bonds to keep interest rates, specifically mortgage rates, artificially low. That, in turn, helps the housing recovery which is so vitally important to the economy. Equally as important, the printing of $85 billion per month has
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resulted in dramatically higher stock prices because investors have been almost forced into other investments as bond yields plummeted, not to mention the additional torrent of liquidity in the system.

Should the Fed taper? Should they not taper? How much? When?

There is no right or wrong answer. Once the Fed Funds rate dropped to 0%, Bernanke & Company were forced to use other monetary tools. Printing money has similar results as lowering rates, so in this case, interest rates have effectively been below zero for some time. By beginning the process of ending QE, the Fed is returning rates to 0% for an eventual move to 0.50% and above much later this decade.

I completely understand those who believe the Fed's hand is too heavy in the market. Forget about the thumb on the scale; Bernanke has his hand, wrist, elbow and arm on it. By that token, those people would rather let what's left of the free market to rise and fall where it may. No arguments here.

On the other hand, we have an economy that is performing like almost every other post financial crisis period with sub par growth and stubbornly high unemployment. Since our elected clowns in Washington cannot get any fiscal policy passed, the Fed has become the juice of last resort. In effect, the Fed is plugging dykes and adding sandbags until the waters hopefully subside down the road which I continue to believe to be after the next recession.

We cannot have it both ways. I believe that tapering will drain liquidity and adversely impact the markets and economy over the intermediate-term. But long-term, we will be in excellent shape. The quicker we taper, the closer we come to recession and eventually get to the other side. But that comes with pain. Staying the course prolongs the markets' and economy's addiction to the crack of QE but prevents more serious short-term injury in hopes of an eventual fiscal solution from Washington.

Take your pick.

Major Changes to the Dow Jones Average

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Last week, Dow Jones, the keeper of the popular stock market indices Dow Jones Industrials, Transportation and Utilities, announced a major shake up in their most widely watched Industrial Average. Being thrown out are Alcoa, Bank of America and Hewlett Packard. On the other hand, Goldman Sachs, Nike and Visa are coming on board this Friday.

On the surface, this makes all the sense in the world as Alcoa has been a stodgy
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old aluminum company while B of A and Hewlett are kind of boring and old fashioned. Oh yeah, and all three have cheap share prices. Let me repeat that in a different way; all three are lower priced stocks. Unlike almost every other popular stock market index, Dow Jones weights each company based on price. So the more expensive the stock price, the more impact on the index. The three downtrodden now account for roughly 2.5% of the index.

With GS, NKE and V trading around $168, $68 and $190 respectively, the divisor for prices move in the Dow just changed significantly. That means the index should have bigger price moves simply because the components have higher share prices. Think of it this way, is it easier for an $8 stock like Alcoa to move $1 or $190 stock like Visa? Of course, it's Visa by a wide margin.

Now comes the fun part. On the surface, you should conclude that Dow Jones is throwing out AA, BAC and HPQ because they no longer represent our economy as the index intends to and by replacing the with GS, NKE and V, the index is more representative of the economy. I cannot argue with that conclusion.

HOWEVER, I do find it "curious" when Dow Jones reconstitutes the index every few years that we usually see higher priced shares coming in to make it much easier to move the index. Given the Dow's popularity as the bellwether for what stock market is doing, this change adds some strong juice to get the Dow moving. Wouldn't it be amazing if this change helped the Dow exceed 16,000, 17,000, 18,000 and beyond next year?

Upcoming Appearances

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CNBC's Closing Bell - September 20th at 4:00pm

Yahoo Finance Breakout - October 29, 2013

Fox Business' Markets Now - October 29 at 1:00pm

You can view most of the past segments by clicking below.

Media Appearances

(http://www.investfortomorrow.com/InMedia.asp)
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Investment Quotes / Adages To Live By

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"The only easy day was yesterday."

- The U.S. Marines

"When in doubt, get out!"

"If it's obvious, it's obviously wrong."

-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."

-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can stay irrational longer than you can stay solvent."

-John Maynard Keynes

"Government is best which governs least" - Thomas Jefferson

Inflation is the one form of taxation that can be imposed without legislation.

-Milton Friedman

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for,that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it." - Dr. Adrian Rogers,
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1931

"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market."

- Robert Rhea via Tim Woods

"Free enterprise is a rough and competitive game. Nobody too big to fail. Nobody too small to succeed. It is a hell of a lot better than government control." - Ronald Reagan via Dan Kennedy

"A government big enough to give you everything you want is big enough to take everything you have." - Gerald Ford via Dan Kennedy

"The problem with socialism is that, sooner or later, you run out of other people's money." - Margaret Thatcher

"Diversification alone is no longer sufficient to temper risk... You need something more to manage risk well."

- Mohamed El-Erian

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.

Sign Up Here

You can also forward this email to family and friends by hitting the "forward email" hotlink at the bottom of this email.
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