



WEALTH DIMENSIONS

January 18, 2008

Since our October letter, the markets have been on a roller coaster ride with investors seeking to interpret conflicting signals about the housing market, sub-prime credit issues and the overall health of the U.S. and world economy. As the fourth quarter began, fears that pushed markets to lows in August dissipated and many markets reached new highs by mid October, only to fall back on renewed concerns about these same issues by quarter end. With the continuing uncertainty, markets across the world were generally lower in the fourth quarter, with the S&P 500 finishing down 3.32%,¹ while the S&P Midcap 400 finished down 3.04%.¹ International markets experienced similar volatility with the MSCI EAFE (Europe, Asia, and Far East) declining 2.04%² after the early quarter rally. Meanwhile, high quality bonds rallied on the economic concerns with the Lehman Brothers Aggregate Bond Index finishing up 3.00%.³

As we start the new year, the markets have experienced abrupt volatility, weakening further with the news media trumpeting daily that we are either headed for or are already in recession. The Federal Reserve and Congress are actively seeking to mitigate these risks through renewed fiscal and monetary stimulus. On the fiscal front, Congressional leaders have pledged bipartisan cooperation to put an economic stimulus package of tax incentives and rebates on the President's desk within 30 days. Fed Chairman Bernanke has stated that the Fed will do whatever it takes on the monetary front to stimulate the economy in order to stave off a recession.

Will they ever learn?

Those who cannot learn from history are doomed to repeat it.
– George Santanya

We spent a great deal of time scratching our heads in the late nineties at some of the absurdities that we observed as Wall Street cranked out deal after deal, preying on the greed and naivety of investors as they bought into "the new economy" and the resulting internet tech bubble. Fast forward to the present and, unbelievably, we find ourselves in a similar situation; this time looking back on Wall Street's unscrupulous exploitation of the bond and credit markets through the creation, packaging and selling of non-conventional mortgage pools as investments. As Wall Street created securities by pooling these loans to allow banks and mortgage companies to sell them off to investors, the machine went into full production. The enormous profit that was being generated by this business resulted in a disregard for good judgment as many banks and brokers loaned mortgage money to virtually anyone who wanted to purchase property (see our July, 2005 letter) and turned the loans over to Wall Street to package and

sell to investors. Meanwhile, the underlying risk in these securities was cloaked in unwarranted top credit quality ratings for what were, in many cases, junk bonds.

We never cease to be amazed at the collective greed that drives bright, capable people to take profoundly irresponsible and arguably criminal actions. As always, these excesses reach an extreme where they become painfully evident and are shaken from the market. This unwinding generally ends with a lot of pain for those involved and unfortunately, a measure of pain for everyone. As of this week, Citigroup and Merrill Lynch have announced cumulative write-offs in their portfolios totaling almost \$50 billion with potential for even more. For Merrill Lynch, the write-offs have now exceeded over one-third of the book value of the company. The misguided pursuit of profits has caused these companies to risk their very existence, forcing them out of desperation to turn to foreign governments in Asia and the Middle East to raise capital for survival. In total, the financial sector has announced over \$140 billion in write-offs and more is expected. Investors in financial sector stocks have lost over \$600 billion in market value over this period. We have not seen any measure of the losses that investors have incurred in the actual investments that were created out of these sub-prime mortgage pools, but the total amount of the pools is estimated to exceed \$500 billion.

We find it amazing that companies like Merrill Lynch continually run ads portraying themselves as “the right choice” for helping clients plan and invest for their future, while at the same time recklessly manufacturing and selling these products to their clients and ultimately, incurring losses in their own portfolios that have jeopardized their own solvency. According to Allan Sloan of Fortune Magazine, this situation forced Merrill Lynch to sell over \$5.6 billion of their own common stock at \$48 to raise capital in the fourth quarter. Earlier in the year, Merrill paid 75% more - \$84.48 – to purchase those same shares. Its additional sale of \$6.6 billion of convertible preferred stock in January, 2008 to foreign investors fetched an implied price in the low \$50s, well below the \$84.48 purchase price. This certainly does not speak well for the quality and independence of their advice!

As investors, what do we do when situations like these occur? There is no question that volatile markets and a steady drip of negative news can weigh on investors emotionally. When negative market events take place, it is tempting to “abandon ship” by trying to time the markets. Our experience has demonstrated to us that these attempts generally do more harm than good. Many individual investors tend to react based on current circumstances, while the markets, as a whole, generally reflect what is anticipated to happen 6-12 months in the future. The plain and simple fact is that the markets are risk pricing mechanisms and have an amazing ability of working out the excesses that occur from time to time. As we have previously stated, investors tend to underprice risk when times are good and to overprice risk when times are bad. In a nutshell, when driven by emotion, they buy high and sell low. A perfect example of this was 2002, where many investors grew weary of market declines and headed for cash, just as markets were actually bottoming out and starting a rally that ran into 2007.

By positioning portfolios to capture the returns available from compensated risk, utilizing proper diversification to moderate downside risk, and rebalancing asset classes based on relative performance, we take advantage of volatility and the tendency for investors to be overly optimistic in up periods (greed) and overly pessimistic in down periods (panic). Unfortunately, the fact is that risk and reward

are related. Therefore, no strategy can efficiently capture all of the market upside and eliminate all of the downside. We take great care in helping clients choose portfolios that are appropriate for their personal circumstances and risk tolerance. As your partner, we are committed to guiding you through times of market dislocation using our disciplined approach to building wealth for the long term.

In our continued commitment to excellence, we are pleased to announce that Mike McCaw has joined Wealth Dimensions Group, Ltd. as a firm principal. Mike has a BA in Accounting from Ohio State, earned his Juris Doctor from Santa Clara Law School, and is an admitted member of the Ohio Bar Association. He brings a wealth of expertise and business experience to Wealth Dimensions. We will be mailing additional information on Mike's association with the firm as a separate mailing.

As with any successful business, we are always looking to grow our business with new clients that would benefit from our expertise. If you know of a family member, friend or colleague that might benefit from our services, we would certainly appreciate your referral.

We have recently amended our Form ADV Part II that is filed with the Securities and Exchange Commission. If you would like a copy, please feel free to contact us and we will be happy to mail you one.

Thank you for your continued confidence in our services!

Wealth Dimensions Group, Ltd.

¹ www.standardandpoors.com

² www.msccibarra.com

³ www.morningstar.com

Investment indices are represented by the Dow Jones Industrial Average, S&P 500, S&P Midcap 400, Nasdaq, EAFE, and Nareit. Performance of these indices is not indicative of any particular investment. The indices are unmanaged and individuals cannot invest directly in any index. The Lehman Brothers U.S. Aggregate Bond Index is comprised of a variety of taxable bonds, and is used as a measure, or benchmark, of the US bond market. No strategy including diversification can guarantee a profit in a down market. Past performance does not guarantee future results. FSC Securities Corporation does not provide tax or legal advice, nothing contained in this letter should be construed as advice for the purpose of avoiding taxes.