

Accepting Responsibility and Looking Ahead

October 2008 was one of the worst months in our stock market's history. But it wasn't only U.S. stocks that bore the brunt of investor selling. Foreign and emerging markets, foreign currencies, commodities, corporate and municipal bonds all made their way into the history books for their negative results.

As to what caused this crisis, there's plenty of blame to go around. Unfortunately, few seem willing to acknowledge their role in creating today's problems and are instead engaged in a lot of finger pointing. At this time, we would like to separate ourselves from this "not me" attitude and accept our fair share of blame for the mess we find ourselves in. That's right, we at Madison and other independent advisors like us, helped set in motion the drivers responsible for the current financial crisis. But before you fire us or drag us up to Capitol Hill to testify, please allow us to explain.

First, some history. Traditionally, the big Wall Street brokerage firms made a lot of money by charging big commissions on stock trades, large spreads on bond trades and sold proprietary products with large fees. According to Bob Clark, industry watcher and former editor of *Investment Advisor*, "Well-allocated portfolios sounded the death knell for selling advice about stocks and bonds," and "the real stake to the heart is the threat of independent advice."

The Wall Street firms were forced to find other ways to justify their existence. In the early part of this decade the traditional mortgage business evolved into a securities business, with the Wall Street firms reselling loans as fast as they could buy them. They became "investment banks" and created and sold various complex packaged products like mortgage-backed securities. Clark wonders, "How could they be dumb enough to get caught holding their own over-hyped investments? There's only one plausible explanation: They had no other choice." In an effort to protect their franchises they overreached.

The current crisis isn't so much a mortgage problem as it is a Wall Street crisis. With mortgage default rates at 6% and foreclosures less than that, we are a long way from the magnitude of the Great Depression. Clark suggests, "While a good number of bad loans were written, the problem isn't bad enough to shake the whole financial system to its foundations."

But today, there are no more large Wall Street brokerage firms or investment banks. They are either bankrupt, have been absorbed by regulated commercial banks, or have become commercial banks themselves. Bear Stearns was pushed into the arms of JP Morgan. Lehman Brothers disappeared, with UK based Barclays Bank picking up some of the pieces. Merrill Lynch sold itself to Bank of America. Morgan Stanley and Goldman Sachs changed their stripes and became regulated banks. The landscape on Wall Street changed suddenly and completely.

So, you see, independent advice-driven firms like ours helped create this entire mess. The rise of discount brokerage firms like Charles Schwab and TD Ameritrade enabled firms like ours to cost effectively offer objective advice free from the conflicts of interest inherent in Wall Street firms. This new business model posed a big threat to the entrenched Wall Street firms, forcing them to take risks they shouldn't have and later paying the ultimate price for their mistakes. For this, we accept our fair share of responsibility.

"Change, change, all this talk about change. Aren't things quite bad enough already?"

Lord Palmerston, Prime Minister of England (1859-1865)

Looking Ahead

The first decade of this century has thus far produced negative return for U.S. stocks. However, we do not believe that the next ten years are predestined to be as bleak. And while the market's decline has been second only to the Great Depression's it doesn't have to result in another one. Certainly the government's response has been imperfect, but at least we have not raised marginal income tax rates to 63%, charged an excise tax on every check you write (which in the 1930s created a run on banks when there was no FDIC deposit insurance and many lost their savings), or massively increased tariffs on foreign trade. All these were errors made in the 1930s that exacerbated the real problems of that period. Of course, there is still time for us to make mistakes of a similar magnitude.

While it's unclear if the last throws of this financial crisis have been played out, let's attempt to take a look ahead.

As advisors endeavoring to help our clients manage their wealth to achieve their financial goals, we are always looking ahead. Doing so does not mean that we want or need to predict what's coming around the corner. There is too much uncertainty in this world to consistently predict anything. The good news is that the successful achievement of one's financial goals does *not* require anyone to make accurate predictions. It is possible to live comfortably in an uncertain world.

With this said, it is important to look ahead. In so doing, there are certain things that we know are going to occur even though we can't accurately predict them:

1. We have a finite time on this planet. We don't know when we will leave.
2. At some point most of us will stop earning an income from employment and instead rely on our portfolios to support us.
3. Inflation will erode the purchasing power of our money over time. We must take steps to protect our purchasing power because in the future our money will not buy what it does today.
4. The political seasons will change. We have to adapt to the changes.
5. The financial markets will be volatile. We have to make the most of these fluctuations.
6. Income and capital gains tax rates will change. We have to be flexible.
7. Over the course of our lives, we will likely experience other crises. Whether it's a job loss, a personal medical issue or a financial setback, these crises force us to adapt and change.



Initially some might comfort in blaming others for their misfortune. But ultimately, acceptance and personal responsibility are required in order to take the necessary steps to ensure the future we desire.

Madison is here to help you focus on your long-term financial goals. We build financial plans that take into account the market's volatility, without predicting or knowing when it will occur. Because the seven items above occur (sometimes simultaneously), changes to your financial plan and supporting portfolio are often required. We offer our best judgment and provide unbiased advice to help you live comfortably in an uncertain world.