

## Questions and Answers about the Credit Crisis

### 1. What caused the massive declines in the financial markets?

Our economy runs on credit. So when the credit markets froze in mid-September after the government seizure of Fannie Mae and Freddie Mac, and then the failure of Lehman Brothers, it stifled business activity and stoked fears of major failures throughout the global financial system. Businesses couldn't access the short-term capital they'd relied upon for decades to fund normal business operations. Since September the credit markets have been largely dysfunctional and the risks to the broader economy rose throughout October and November. These factors led to a massive selloff in every asset perceived to have any risk.

### 2. Why didn't my diversified portfolio perform better?

There was virtually no place to hide in this selloff. Every investment type, from U.S. stocks, U.S. bonds, International stocks, Emerging Market stocks, Foreign bonds, Municipal bonds, Real Estate Investment Trusts and Commodities all declined severely. The only assets that performed well during this period were U.S. Treasury securities, Japanese Yen and Swiss Francs. In fact, the demand was so great for the safety of some U.S. Treasuries that investors were willing to accept a 0% return. Naturally, it might cause you to wonder whether diversification still works. It does, but diversification is not a short-term strategy for a crisis as it does not protect against systemic risk. It is a time tested, long-term strategy for building and sustaining wealth.

### 3. When will the credit crisis be over?

We don't know when, but it will end. For now, financial institutions, hedge funds and households are reducing debt at the same time. This is forcing sales of investment assets and shrinking the amount of capital available to borrowers. Governments worldwide have taken action to supply capital, but the problems won't be fixed overnight. Further government action should be expected.

### 4. Why shouldn't I just sell everything and sit this out?

You can and some have chosen to do just that. However, before you do, please carefully consider the potential consequences of selling all your investments.

First, you've likely spent years saving and building up your portfolio. Just as you've "dollar cost averaged" into the markets over many years, we recommend that you sell your investments over time, too. This reduces the chance that you sell at the wrong time.

Second, holding a lot of cash – like consuming candy, is not good for your health in the long run. Cash is simply a means of exchange that shouldn't be used to meet longer-term needs. Cash is virtually guaranteed to lose purchasing power even if held for short periods of time. Assets that have a longer-term focus like stocks, bonds, real estate, etc., are like fruit and vegetables. They promote growth and ward off disease (inflation).

Third, the decision to sell is most likely based on short-term emotions brought on by these extraordinary times. Our objective is to lessen the emotions of investing and keep you focused on the bigger picture. We continue to believe that a carefully constructed investment strategy and properly positioned portfolio will serve you well whether you are retired, nearing retirement or still years away. If you exit the markets, you then have to be “right” twice; right about the timing of when to sell and when to get back in. History has repeatedly demonstrated that investors are lousy at determining the “right” time to enter and exit the markets. We recommend that investors follow an investment strategy tailored just for them that does not require anyone to be right about the short-term direction of the markets. When following a plan, often inaction is the best action as it minimizes the chances of getting tripped up along the way.

## **5. When will the markets recover?**

As in past downturns, investor confidence will return and over time the markets will recover. Any time a large number of investors head for the exits at the same time, prices have to go down. Thus, some of the losses are temporary and a recovery will begin as the selling abates. We don’t know when this will occur. Others may make predictions, but they are just best guesses, not fact. The bond markets might begin to recover when banks start lending to other banks, when companies can obtain the financing they need, and as investors emerge from their bunkers and begin looking for opportunities outside of low yielding Treasuries. The equity markets might rise as the outlook for the global economy stabilizes and as investors begin to appreciate the values now available to them.

## **6. Why hasn’t my portfolio performed better versus the market benchmarks?**

A couple of reasons. First, we don’t manage any portfolio to beat any particular benchmark. We manage portfolios to support your financial goals. Whether we outperform or underperform a benchmark is not really relevant to whether you are able to achieve your goals. So far, none of our clients has told us that their goal in life is to beat a benchmark. Certainly, all things equal, a higher return is better but benchmark beating returns are usually not required for you to meet your life’s financial goals. Second, benchmarks do not fully reflect the way we’ve constructed your portfolio. For example, the benchmarks do not reflect all of the various asset types and investments we use in a portfolio. In many cases, it results in a bit of an “apples vs. oranges” comparison. Therefore, we encourage you to look at benchmarks for what they are--useful signposts on a very long journey. Sometimes you’ll be behind schedule and sometimes you’ll be ahead, but you will reach your destination.

## **7. Why should I continue to be excited to work with Madison?**

In working with you we strive to be open and honest, and to communicate proactively. We invest our own money alongside yours using the same strategies and investments. We have a team of professionals with many years of experience that is committed to helping you stay on track to meet your life’s financial goals. Because we are not selling specific products, we don’t have conflicts of interest that hinder our ability to provide unbiased advice to you.

It’s probably safe to say that the investment results you’ve experienced with Madison over the last twelve months are not to your liking. Even if we’ve outperformed a benchmark, no one wants to lose money. You are not alone. Anyone who invests in stocks and bonds has been deeply impacted by this credit crisis. We know our limitations: it’s not within our ability to see this type of crisis coming and completely protect you from it. We don’t control the markets and we cannot predict where they are headed. We can, however, build an adaptable investment plan that provides you with the greatest chance of success over the course of your life. This approach remains our focus.