

"HELPING YOU MAKE SMART CHOICES ABOUT YOUR MONEY"

WOULD CHAOS RESULT IF THE U.S. PAID OFF THE NATIONAL DEBT

United States politicians and voters have engaged in heated debate this year over the skyrocketing debt owed by the federal government.

Over the last decade the debt has ballooned to nearly \$15 trillion. Some taxpayers and politicians, angered by the legacy being left to their children, have argued that the U.S. should balance the budget and pay down the debt.

Many may have forgotten that just 11 years ago we were on track to pay off the entire debt by 2012. What we didn't know until now was that the prospect of an end to U.S. debt sent government officials scrambling to put together an emergency plan to deal with the event.

That's because the U.S. debt—in the form of Treasury bills, bonds, and notes—is considered the world's risk-free asset and safe haven, serves as the most important interest rate benchmark, and is used by the Federal Reserve to implement monetary policy.

A potential crisis

In the last year of the Clinton Administration economists at the Treasury worked on a secret report speculating on the effects of the debt pay down and on alternatives that the government and markets could use in place of Treasury securities. That report, titled "Life After Debt," was never publicly issued. It was recently obtained by National Public Radio through a Freedom of Information Act request.

It shows how worried some in the Treasury Department were about the projected debt elimination.

U.S. Treasury securities have become a pervasive holding for large and small investors, foreign countries, and even the Social Security System, and there is no clear idea how disruptive the absence of such debt would be.

For instance, where would the Social Security System stash the billions it collects daily from payroll taxes? It needs



These days the United States is swimming in debt. But 11 years ago government planners worried about the effects of paying off the debt.

to earn interest but it also needs a rock-solid security that will guarantee payout later in this century when the retired population increases.

Fed left high and dry

What would the Federal Reserve use to manage monetary policy? Currently the Fed buys and sells Treasury securities in order to increase or decrease the money supply and interest rates. It needs a large, orderly, and very liquid market to achieve its objectives, and the Treasury security market is made to order.

The report proposed alternatives to using U.S. debt. However, in light of what happened during the financial crisis of 2008, such alternative instruments appear to be a lot riskier today than they did in the year 2000 when the report was written.

(Continued on Page 2)

WHAT'S INSIDE

- ◆ 401(k) Loans Are A Tax Trap That Can Damage Retirement Chances
- ◆ Investors Should Know Their Real Returns
- ◆ Are We Repeating The 1930's? For the Markets That Could be Good
- ◆ Financial Frauds Multiply During Economic Hard Times

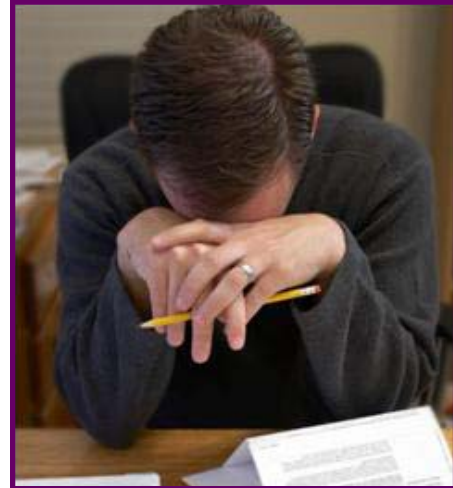
... IF THE U.S. PAID OFF THE NATIONAL DEBT

(Continued from page 1)

The report identified government backed agency securities issued by the giant mortgage companies Fannie Mae and Freddie Mac as alternatives. However, even at that time the market for their securities was not big enough. In retrospect we know that the two agencies went bankrupt in 2008 and limp along today with government aid.

The swaps market, where banks and other institutions swap liabilities, was also identified as an alternative because it was “remarkably liquid” and a “vibrant market.” However that market froze solid in 2008 and has not fully recovered since then.

The report shows that even though our debt may be too big now, there may be virtue in always having some debt outstanding as a backstop for world markets.



401(K) LOANS ARE A TAX TRAP THAT CAN DAMAGE RETIREMENT CHANCES

Almost a quarter of employees who have 401k retirement savings accounts are using them as piggy banks, according to a new study by four finance professors from Stanford, Yale, and Harvard.

Although employees who use such loans apparently see the advantages, the potential retirement and tax booby-traps are not so evident, the study found.

Hidden traps

Borrowers are hit by double taxation of the loan proceeds and they may hurt their overall investment gains. They also can get hit by unexpected taxes and penalties if they lose a job while the loan is outstanding.



Beware: Loans from your retirement plan can backfire and cause unexpected taxation.

The typical borrower is a middle-income employee making between \$40,000 to \$60,000 who has been with the employer between 10 and 20 years.

Borrowers can only take out up to one-half of the value of their accounts, to a maximum of \$50,000. That means only those who have accumulated a sizeable account can borrow a significant amount of money.

The median loan is about \$4,000, and most loans range between \$1,050 and \$26,000, the study found.

Taxes and more

The tax-deferred nature of 401k plans works against borrowers. When money is contributed, the worker escapes income taxes on that amount. The worker pays taxes later, when the money—and its earnings—are withdrawn in retirement.

But someone who borrows from their plan must repay the money in after-tax dollars, says James J. Choi of Yale, one of the study's authors. “Your 401k loan interest payments face double taxation, since they are made with after-tax dollars and then get taxed again when you withdraw them in retirement,” he told the financial news site Marketwatch.

Borrowers are required to pay interest on their loans, usually at the prime rate. But since that rate currently is very low, at 3.25 percent, employees may not get higher market returns on their accounts while repaying.

Finally, if an employee leaves or loses a job while repaying a loan, the loan usually will come due. If the employee can't repay the entire amount, he will owe taxes on the balance, as well as a 10 percent early withdrawal penalty if younger than 59.5.

INVESTORS SHOULD KNOW THEIR REAL RETURNS

Many investors and most savers probably think about their returns only in “nominal” terms. That means they only take note of the yield or return on their investment before accounting for inflation.

In that view a 2 percent bond yields 2 percent. A 6 percent annual gain on a basket of stocks is a 6 percent gain.

However, the proceeds of savings and investments are not spent or exchanged in an unchanging world. Every minute of every day relative prices of goods and services are changing. In aggregate they almost always go up over time. That’s the basis of the concept of inflation.

The silent killer

Inflation is the silent enemy of anyone who is trying to accumulate capital. It continually eats away at the value of one’s savings and investments. It can turn even an investment perceived as “safe” into a wealth destroyer.

Investors these days have been faced with two hurdles: a volatile stock market that has had some sharp drops over the past five years, and a very low interest rate environment that has pushed yields at banks and money market funds close to zero.



Inflation is running at a rate three times higher than average bank interest rates and is steadily eating into the value of your savings.

A slow decline

The market’s roller coaster ride has caused many investors to pull money out of their portfolios and put it into cash holdings, mutual fund industry statistics show. Those who are hunkering down in cash may think they are protecting their nest eggs, but, with consumer inflation running at over 3 percent in the past 12 months, savers have actually been losing money that they thought was safe from the stock market’s volatility.

Dimensional Fund Advisors, a Santa Monica-based investment company, notes that the popular press has reported investors are “shifting their portfolios to money market funds... with the intent to return to stocks and bonds when the economy shows signs of improvement.”

At the same time, however, “investors ultimately may lose wealth even as they try to protect it,” DFA says.

The loss can come from two sources: the effects of inflation on the purchasing power of their cash, and by the loss of opportunity to profit in the stock market when investors delay reinvesting their money, DFA says.

“The problem with this strategy is that no one can consistently time markets, and the signs are never clear,”

ARE WE REPEATING THE 1930’S? FOR THE MARKETS THAT COULD BE GOOD

The deep recession and big declines in the stock market in late 2007 through early 2009, accompanied by a lackluster economic recovery, have some observers comparing the present day situation to the dreary 1930’s Great Depression.

Surprisingly, investors may only hope that this is the case, since a good argument could be made that the markets hit their lows on March 9, 2009 and that the recent downturn is just a blip in a long upturn, writes investment newsletter analyst Mark Hulbert.

“Contrary to the popular imagination... the 1930’s actually contained one of U.S. history’s most powerful bull markets,” Hulbert wrote in September for the financial website Marketwatch.

The U.S. stock market suffered a severe downturn from the October 1929 crash through June 1932, with the Standard & Poor’s Index losing nearly 83 percent. But during the summer of 1932, when things looked blackest and millions remained out of work, the market began a powerful rally that helped it increase in value four-fold over the next four years.

The 386 percent increase in the S&P 500 helped investors recover most of the losses they suffered at the beginning of the decade.

However, as always with the market, the 1932-36 rally did not proceed in a straight line—there were dips along the way, including monthly declines of 18 percent, 11 percent and at least one stretch where the market fell four months in a row (note that American stocks fell in similar fashion from June through September this year).

Analogies are dangerous, Hulbert notes: there is no way of knowing whether his analogy to the 1930’s rally or other analysts’ making comparisons to the worst of the 1930’s are legitimate. But it may be a good sign that many analysts compare today to the 1930’s, because bull markets often climb a wall of worry, he says.

Is the stock market today comparable to the market after the Crash of 1929?

FINANCIAL FRAUDS MULTIPLY DURING ECONOMIC HARD TIMES

Con artists come out of the woodwork during times of economic and market stress, preying on investors looking for better returns or alternatives, says the North American Securities Administrators Association.

State officials who regulate securities have seen a host of new scams aimed at those who are looking for alternatives to low bank interest rates and a volatile stock market, the organization said.

“Con artists follow the news and seek ways to exploit the headlines to their advantage while leaving investors holding an empty bag,” said Association president David Massey.



Financial scam artists ply their trade during times of economic distress.

The current top five financial products designed to trap unwary investors include:

- Distressed real estate schemes that offer investment in foreclosed homes.
- Energy investments like the one that says “wave energy” will eventually power your home.
- Gold and precious metals investments, often linked to promises to mine gold from dormant claims.
- Promissory notes that “guarantee” high interest rates on privately placed loans.
- Securitized life settlement contracts, where an investor “buys” the death benefit on someone’s life insurance policy and the results are “guaranteed” by bonds.

“Unsuspecting investors can be lured into these schemes, especially if they sound familiar,” Massey said. “These offerings require careful research and a strong reminder that if it sounds too good to be true, it probably is not true, nor will it be profitable to anyone but the promoter.”

2012—WHAT WILL THE NEW YEAR BRING?

No matter what side of the aisle you are on, 2012 will certainly bring with it plenty of political fervor, rhetoric, and show-boating. During an election year, we have to wade through all of the debates, political conventions, and political TV ads. Only time will tell who gets elected and down which path we will go. However, the freedoms in this great Country of ours allows us the right and the responsibility to vote for whoever we individually feel can lead our Country, State, and local governments in a manner in which we would like to see them run.

No one can predict with any accuracy exactly how the financial markets will go in 2012. Will we continue to

have the same volatility in the markets in 2012? In the long run it really doesn’t matter much. We will continue to take advantage of fluctuations in the market through rebalancing of your portfolios. Remember that historically the stock market has moved upward the majority of the time. Do not pay attention to all of the media hype. They are trying to get your attention, and they know that negativity gets your attention and sells advertising—so beware. If you have concerns, please contact us.

As we close the year 2011 putting another year in the history books, we will address the New Year—2012 as a new adventure—not knowing what is around the next bend or what the future will hold.

We Wish You a Happy and Prosperous 2012 ~

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors’ returns within their tolerance for risk. Here is what sets us apart:

- ◆ Fee-only investment management
- ◆ A disciplined investment strategy
- ◆ Access to institutional no-load passive asset class funds
- ◆ An academic Nobel Prize-winning investment approach

- ◆ Continued access to academic research
- ◆ A tax-efficient focus with valuable tax- and estate-planning ideas
- ◆ Risk tolerance assessment
- ◆ Periodic portfolio rebalancing
- ◆ Regular communications and state-of-the-art reporting
- ◆ No front-end loads, no back-end loads, no surrender fees, not locked in
- ◆ **MOST IMPORTANT ...**
A TRUSTED ADVISOR RELATIONSHIP

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INTRODUCTIONS—REFERRALS ARE
ALWAYS APPRECIATED.

Investments provided through Wealth Management LLC, a Nebraska LLC, Registered Investment Advisor.