



# Quarterly Memo

April 2009

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## Being Positive in Negative Times



The recession drags on, now in its sixteenth month, and soon will be the longest postwar economic contraction. Not only in the US, economies across

the globe are contracting or at least seeing growth rates slashed. World economic growth is expected to contract this year for the first time since WWII, according to the World Bank.

Unemployment is rising with rates in double digits in many locations, including North Carolina at 10.8%. Worries about the Federal government's stimulus, TARP, debt levels, P-PIP, etc. cloud our thinking and burden

our minds. Daily, it seems some financial writer dreams of a new scenario that will prove to be the end of civilization as we know it. Add to that the obvious and substantial losses in investment portfolios. For the newly retired, the combination is especially unnerving. Dreams, even a basic lifestyle, now seem threatened. Is it anything remarkable that people

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## How Your Brain Thinks About Money

Your brain is the most remarkable part of the created universe. An exquisitely complex three pound electrochemical computer, it makes the world's most powerful supercomputers look crude by comparison. In its 100 billion neurons lie our thoughts, emotions, dreams, and self-awareness. It is an essential part of our humanity.

This great gift allows us to perceive, know, judge, decide, and live in the physical world. Through

it, our cave dwelling ancestors overcame the daily dangers facing them. Yet in the modern world, our brains can lead us in counterproductive ways in making investment decisions. The new science of neuroeconomics studies how our thought processes and brain functions lead us correctly or astray. Among the books on this subject, Jason Zweig's *Your Money and Your Brain* is very readable and enlightening. During this period when many people

are struggling with making stressful financial and investment decisions, a review of recent research findings might help you understand why you are thinking and feeling the way you are right now.

Chapters in the book focus on each emotion

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## Being Positive in Negative Times (continued from page 1)

find it difficult to not be worried or even depressed in times like these?

First, it is important to recognize what is going on in your brain when you are feeling fearful or panicked (see accompanying article). Secondly, you can decide whether to give in to your feelings or at least make an attempt to do something about them.

Here are our recommendations for keeping a positive attitude in the midst of negativity:

**1. Get your focus off yourself.** Many clients are involved in activities giving of their time and talents to some very worthy causes: medical missions in India and Africa, serving in area Hospice organizations, working with the homeless, working with youth, church leadership, blood donors, etc. In a future newsletter, we intend to highlight some of

the great things our clients are doing to serve others. All of them would say that one of the rewards is a perspective that your needs are usually inconsequential compared with those of others. Many of us are busy with work and family matters, but somewhere out there is a noble cause with your name on it. Find it and get involved.

**2. Accept the losses happened. OK, now what?** Some people are fixated upon a very meaningless number – the value of their portfolio at the stock market peak in November 2007. Focusing on that number does not help plan for your future. Your portfolio doesn't care about that number, the markets don't care about that number, and to be honest, we don't care about it either – it's in the past and there's nothing we can do to change it. As we have said a lot lately, "it is what it is." The cost basis of an investment is useful for tax planning –

and nothing else. It is time to move on mentally. Where your portfolio goes from here is of great importance. How it got here is immaterial. People waste precious mental and emotional energy regretting what was or what might have been.

The fact is that if you felt positive about future investment returns two years ago, you should be absolutely giddy right now. An extended period of poor investment returns (like the last ten years) has always been followed by a period of above average returns.

**3. Consider how far you've come.** Your net worth may be down from two years ago, but likely up from ten years ago and almost certainly more than 20 or 30 years ago. You may have your favorite story that begins "We were so poor that..." Mine is: in 1979, we were so  
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***"People waste precious mental and emotional energy focusing on what was or what might have been."***



## Janice McGunnigle Awarded CFP® Designation

The CFP Board of Standards recently announced that Janice McGunnigle has been awarded the Certified Financial Planner™ designation. Janice has been a key member of the financial planning team at Matrix since 2008. The CFP® designation adds to

the Certified Trust and Financial Advisor (CTFA) she previously attained.

Matrix commends Janice on her achievement. The CFP® is the most recognized professional designation for a financial advisor. It requires broad knowledge, significant

study, and commitment to fiduciary standards.

Janice serves on the firm's Financial Planning and Trust Committees. She was recently selected to serve on a Trust Representative Office Committee with National Advisors Trust Company.

## Tax Changes You Might Have Missed

The American Recovery and Reinvestment Act has expanded the first-time homebuyer credit created in 2008, and extends it to homes purchased by qualified first-time homebuyers through November 30, 2009. The credit is 10% of the purchase price of a qualified home, but the dollar limit has increased from \$7,500 to \$8,000 for married couples. The credit is phased out based on modified adjusted gross income of \$150,000 to \$170,000 for a married couple filing a joint return. While few clients will be first time homebuyers, this could apply to adult

children or grandchildren. The Act expands the definition of qualified higher education expenses for 529 qualified tuition programs. 529 plan funds can now be used for computers, printers, software, and internet access used while enrolled at an eligible educational institution through 2010.

The alternative minimum tax received another "fix" in terms of an additional \$1,000 exemption amount, which is now \$70,950 for married taxpayers.

Moderate income (<\$250,000 if married)

taxpayers can now deduct sales taxes on the first \$49,500 purchase price of a new automobile, light truck, motor home, or motorcycle through 2009.

While realized capital losses will lower tax burdens for many in the next few years, the expected increase in tax rates in 2011 and beyond mandates more attention to tax planning. It is always difficult to pay a tax now even if a higher tax is expected in the future. However, we may have the lowest tax rates now that we will see for decades.

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***"529 plan funds can now be used for computers..."***

## Surviving Financial Meltdown

Are you worried about your financial future? What should you be doing in light of the turmoil in the economy and investment markets? We hope our clients feel that these issues are properly addressed through the financial planning process. What about others? What advice makes sense now?

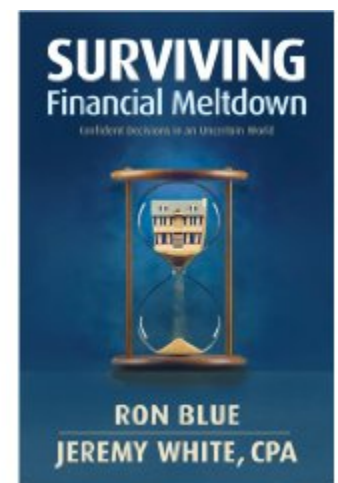
Fortunately, a common sense guide has been written to help the layperson deal with the current issues of job insecurity, fear and uncertainty, goal resetting, budgeting, liquidity, debt management, and portfolio losses. Written

from a Biblical perspective, authors Ron Blue and Jeremy White have packed a small volume with enough wise advice that, if followed, would eliminate 98% of the financial problems people face.

### **SPECIAL BOOK OFFER FOR MATRIX CLIENTS**

While many of our clients are already practicing the principles in this book, you may know others who could benefit from it. For that reason, we are offering a copy of this book to our clients upon request. Contact Donna Barrow to obtain a copy.

If you need more than a book, check out the **Surviving Financial Meltdown Symposium** on May 8-9 at Carmel Presbyterian Church, located at 2048 Carmel Road in Charlotte. Giles Almond will be speaking on the topic "Honey, I Shrank the Portfolio!" You can register online at [www.carmelpresbyterian.org](http://www.carmelpresbyterian.org) or by phone 704-366-5114. The symposium runs Friday from 6:00-8:30 PM with dinner included and Saturday from 8:00 AM to 2:30 PM with lunch included. The cost is \$35 or \$65 for a couple. Space is limited.



## Being Positive in Negative Times (continued from page 2)

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***“Focus on what you can do over the course of each 24 hours, and you’ll be the only expert on the future you’ll ever need.”***

***Dan Sullivan***



poor I had to read the electric meter every day so we wouldn't exceed the budget for the electric bill. One particularly cold day, I arrived home, looked at the meter, and was aghast that we had used 30 kwh instead of the budgeted 20 kwh. Going inside to find out what happened, my wife blurted out before I could speak "Yes, I turned up the heat. I was freezing in here!" A portfolio was not a consideration back then – we were just trying to make ends meet. Rather than bemoaning my reduced portfolio, I should be thankful I need not daily read the meter now.

### **4. Relationships are what make you rich.**

How easily we take for granted our family and friends. None of us would exchange those relationships for any amount of portfolio gain.

One of the best things I do to keep life in focus is go to prison – as a volunteer, that is. Through the Jail & Prison Ministry of Central Church of God, I have the privilege of assisting with evangelistic services at a medium security prison several times per year. No, I don't preach but I can shake hands and just encourage the inmates. "Well, they deserve to be there!" some might say. True enough, but seeing a picture of a toddler taped to the back of a prison ID card is a powerful

reminder that these men, too, are fellow flawed human beings that, unlike me, can't go home to a family every evening. How much is that "worth"?

### **5. Today matters more than the future.**

That may sound strange coming from a firm that focuses on planning for the future. The reality is that the past is gone and the future can only be affected by what we do in the present. The financial future we create is determined by decisions we make today about saving, investing, giving, and our lifestyle. The future is not affected one bit by how much we worry or obsess about it. As Dan Sullivan has said "Focus on what you can do over the course of each 24 hours, and you'll be the only expert on the future you'll ever need."

### **6. Your self-worth is not your net worth.**

Some people equate their personal well being with the size of their portfolio. With a smaller portfolio, they feel less significant and experience all kinds of negative emotions: guilt, regret, irresponsibility: "How could I have been so stupid? How could I have not seen this coming?" The truth is that you are in pretty good company. Lots of people with PhD and other initials behind their names who study the economy and investment

markets full-time are right there with you. No one should feel guilty or stupid for failing to predict a "black swan" event. The only predictable thing about the investment markets is that they defy predictability.

### **7. Complaining will get you something.**

Maybe an ulcer or at least a persistent negative attitude. Every morning when we wake up, we can make a fundamental decision that will change the course of our day. We can decide before our feet hit the floor whether we will complain about our supposed misfortunes or foster gratitude for our blessings. The attitude we cultivate has the best chance of dominating our thinking for that day. Scripture says it best: "...whatever is true, whatever is noble, whatever is right, whatever is pure, whatever is lovely, whatever is admirable—if anything is excellent or praiseworthy—think about such things." (Philippians 4:8)

None of us has any control over the economy. We do have complete control over our reaction and response to these events. This is an opportunity for your best thinking and actions to be exhibited in the face of the negativity of others. To that end, you can make a difference!

## How Your Brain Thinks About Money (continued from page 1)

that enters into the investment decision making process and the current research on the brain's role in creating and processing it.

The brain's functional architecture can be divided into the reflexive brain and the reflective brain. The reflexive part of the brain runs rapidly, automatically, and sub-consciously. It focuses on change – picking up a stimulus that could mean danger or opportunity. The reflective brain calculates and seeks patterns to evaluate, even when they don't exist. The key for successful investors is to balance the useful intuition of the reflexive brain and the thinking skills of the reflective.

Greed works well for animals – the greedier you are, the better you eat. Scientists have discovered that the nucleus accumbens area of the brain is where anticipation of gain or reward takes place. They also know now that the anticipation of a gain is more powerfully felt than the realization of the gain. Put another way, more money can never create the good feeling that thinking about having more money does.

Prediction was an essential ability for our farmer and hunter ancestors. Humans have always tried to predict. A Babylonian relic in the British Museum is a clay model of a sheep liver

with cuneiform instructions for the priest to interpret the future using 63 areas on the liver. Your brain will try to predict based on any pattern or repetition it perceives – it's unconscious, automatic, and you can't turn it off. When a prediction comes true better than expected, dopamine is released in the brain, a powerful reward of good feeling. Is it any wonder investors kept piling into internet stocks in the late 90's? The dopamine rush was too much to resist.

Most people rate themselves as an above average driver, even though most people can't be above average. Overconfidence is not all bad. Entrepreneurs start businesses believing the chance of success is high, while reality is 50% of new businesses fail. Familiarity resides in the hippocampus and increases our confidence level. Hence many 401(k) plan participants tend to put too much into their employer's stock. Some amount of confidence is good, or else we would never take a risk of any kind.

Risk tolerance has been found to be extremely mood dependent – anxiety makes us risk averse. Being more concerned about losses than gains served our ancestors well. Better to avoid the big risk of being eaten by a lion than finding some extra food. "Framing" plays a big part in our perception

of risk – the emotional words used to describe a situation matter.

Surprise kicks our brain into neuron overdrive. That's good if your survival depends upon quick reaction to some threat. It can be a bad thing if it causes investors to panic sell a stock that missed its earnings prediction by a penny.

The anterior cingulate cortex seems to be the brain's "oops!" center. We feel regret in its orbitofrontal cortex region, where we evaluate what we expected to happen with reality. As in many cases, we can learn how parts of our brain work by studying patients with brain injuries. People with injured orbitofrontal cortex regions may know the bad consequences of their decisions but proceed anyway, since they are incapable of feeling any regret about them. To the extent it helps us make better choices the next time, regret can be a good thing.

### **SPECIAL BOOK OFFER FOR MATRIX CLIENTS**

We believe understanding yourself is a powerful investment tool in times like these. If you would like to learn more about your own brain and how it thinks, feels, and makes decisions, we have a limited number of copies of ***Your Money and Your Brain***. You can obtain a free copy by contacting Donna Barrow.

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***"...more money can never create the good feeling that thinking about having more money does."***



Babylonian sheep liver model – amazingly, it works just as well now as it did in 1900 BC!

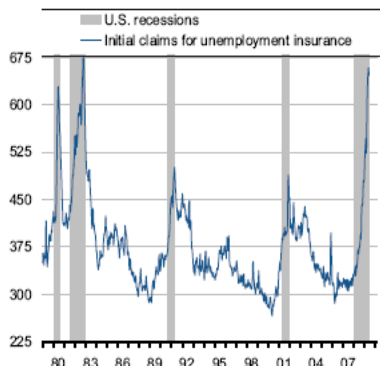
## Looking for the “Green Shoots”

The President is now talking up the economy, saying recently there are “glimmers of hope across the economy” and “we’re starting to see progress.” Is this just political pep-talking or could there be genuine signs that the recession may be bottoming out?

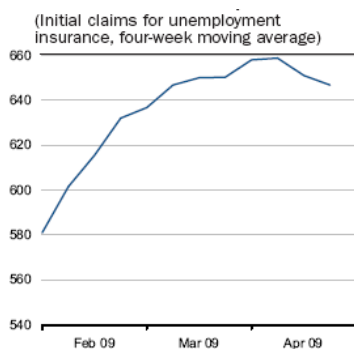
which surged from 26.9 in March to 39.2 in April. The University of Michigan’s sentiment indicator stood at 61.9, up from its November low of 55.3. What’s not to like? These are still very low, pessimistic readings – just less so. However, it could signal a bottom.

Auto sales for April are expected to reach an annualized rate of 10 million. Believe it or not, this slightly tops March sales levels and will be 10% higher than February, albeit still down 31% from a year ago. Used car prices were up and dealers report more showroom visits. With the number of autos scrapped in the US estimated at 13 million per year, even if people hold on to their clunkers a while longer, eventually more cars will need to be bought just to replace those wearing out.

**“...eventually more cars will need to be bought just to replace those wearing out.”**



Sources: Department of Labor; Haver Analytics  
Data through April 17, 2009



Sources: Department of Labor; Haver Analytics  
Data through April 17, 2009

One of the most obvious improvements has been the 27% rally since March 9 in the S&P 500 index – the best two months since 1938. Optimists further point to a number of economic statistics that are improving, stabilizing, or at least getting worse more slowly.

Unemployment falls into the latter category. While new jobless claims are still high, the latest data indicate they may have peaked. This means the unemployment rate may still rise for some time, but at a slower rate. The initial claims number has peaked towards the end of prior recessions, so if the peak has occurred, a recovery may be around the corner. (See charts.)

Similarly, durable goods orders were down .8% in March, an improvement over the 2.1% decline in February and a better number than expected. This is another case where less bad can be considered good.

Another less bad number is consumer sentiment,

Housing statistics show 356,000 new homes were sold in March, just slightly down from February’s 358,000. At this rate, the inventory of new homes amounts to 10.7 months of sales, down from the peak of 12.5 months’ supply. Existing home inventory stood at 9.8 months of supply, down from a peak of 11 months of inventory. The median existing home price rose in March by 4.2%, perhaps a sign that the bottom is near. The new homebuyer tax credit appears to be working, as larger than average proportion of homebuyers are purchasing their first home.

Inflation is dead – for now. We saw the first year-over-year decline in consumer prices in 55 years. Gas, groceries, and housing are all more affordable. This has helped real hourly earnings improve. So long as consumers do not perceive deflation to be a long term problem, it is probably helping consumer confidence and spending.

Is there the possibility of reasonable equity returns from this point forward? Or was the recent rebound a meaningless bear market rally or the proverbial “dead cat bounce”? The one thing you can say with confidence is that no one knows. Positive signs include the largest amount of liquidity “on the sidelines” in decades, with around 47% of the market capitalization in cash. One can also look at the history of market returns for a decade following a decade of poor performance – returns have uniformly been excellent. While the price to earnings ratio is currently wildly distorted due to financial company write-off’s, alternative measures (prior peak earnings, ten year averaging, etc.) indicate valuations are good.

## Is This the Dark Before Dawn or Just Midnight?

While people search for reasons to be optimistic, are they just whistling in the dark? There are plenty of reasons why many are concerned about the future.

Corporate earnings are expected to fall 37% in the first quarter, the seventh straight quarterly drop, and the longest since the 1930's. AIG recorded the largest loss in US corporate history (\$61.7B), causing the entire S&P 500 index to report negative overall earnings. This has pushed the price/earnings (P/E) ratio to levels never before seen, even in 2000.

Industrial production in Canada, France, Germany, Italy, Japan, the UK, and the US fell at an annualized rate of -28.5% according to the latest numbers available for the six months ending in February. The US manufacturing capacity utilization rate hit a new low at 66% in March, as compared to the post-war average of 81%. The ISM Purchasing Managers index for March was at 36.3, up from its lows but still indicating a very weak economy (a reading below 50 indicates contraction.)

The Baltic Dry Index of freight rates measures the demand for seaborne transportation and is said to be a bellwether for the world economy. It stands at 1,790, down from its peak of 11,793 last May.

Corporate junk bond defaults are accelerating, having reached 7% this month and expected to peak at 14.6% globally later this year.

While existing home sales rose last month, about half were foreclosures and "short sales". Another round of mortgage rate resets is on the horizon for next year, causing speculation that the foreclosure wave is not half completed.

Commercial real estate problems may get worse. Corporate bankruptcies have left many building owners with empty, unleased space. Commercial real estate loans have dried up, leaving building owners with balloon mortgages with few choices.

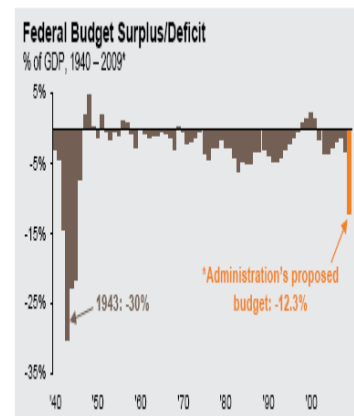
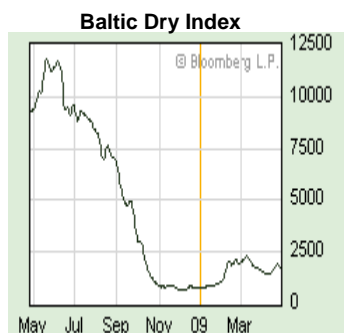
Huge government deficits could potentially crowd out private borrowing and add to obligations owed to foreign powers. Unlike WWII, where deficits quickly ended after the war years, the President's proposed budgets project huge deficits for the next ten years: 12.3% of GDP in 2009 to 5.7% of GDP in 2019. The interest on government debt will rise from 1.7% of GDP to 3.8% of GDP by 2019. With 61% of Treasuries owned by foreigners, the drain of capital to other countries will be significant. Clearly, we are being set up for significantly increased taxes and painful cutbacks

in budget and entitlement expenditures down the road. At the same time, the economy must grow as it did after WWII to reduce the massive debt we are creating as a percentage of GDP. The other way to reduce the debt is to massively inflate the economy, a possibility that seems remote now but could be a serious issue in a few years.

We have yet to determine the long-term effects of effective government ownership of automakers and financial companies. Who could envision the day that the President of the United States would fire the president of General Motors? Can anyone have faith in the markets when political decision makers are now determining the success or failure of firms?

It is conceivable that the Great Recession could prove to be an L or W shaped rather than a U or V shaped event. The problems we face are serious and alarming, but not unsolvable. Many times in the past, The End of the Economy was predicted due to inflation, debt, or high interest rates. Our parents and grandparents lived through the Great Depression and rose to the challenge of a world war. If we are to succeed, our generation must exhibit the same tenacity, character, faith, and wisdom as they did.

***"...we are being set up for significantly increased taxes and painful cutbacks in budget and entitlement expenditures down the road."***



## President Barack Obama – Market Guru?

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In response to a previous newsletter article that associated President Obama with the 20% market decline following his inauguration, a client wondered if we would give the President credit if the market went back up. Of course - what's fair is fair. The President has now presided over both a bull and bear market in his first 100 days – quite a feat. The S&P 500 index (at 844) has risen 5% since January 20.

After “talking down” the economy after taking office, the President suggested on March 3 (with the S&P 500 at 696) that stocks might be a good deal. A few days

before (February 26), Bill Gross (arguably the world's largest money manager) was quoted that there was no point investing in stocks given the lack of foreseeable economic growth and the risk of corporate bankruptcies.

Since March 3, the S&P 500 has risen by 147 points. If you listened to the President, you would have gained 21%. If you had invested in Bill Gross' PIMCO Total Return Fund, you would have made 2%. So what should we conclude?

The recent rise in equities is welcome, but may not signal a sustained rise. It

might prove to be the quintessential “bear market rally”. Time will tell.

Bill Gross is a bond manager (one of the best). Few bond managers ever have nice things to say about their main competition, i.e. equities.

One correct market call does not make you a prophet. However, if your audience is large enough (e.g., the civilized world), your prediction may be self-fulfilling! We can't promise any particular action if the President makes another market call, but rest assured we will be paying attention!

### About Matrix Wealth Advisors, Inc.

Planning is the process of allocating limited resources among unlimited alternatives according to a system of values to achieve life goals.

Founded in 1990, Matrix uses a very personalized, principle-centered process to offer comprehensive financial planning and investment management services that help clients

close the gap between where they are now and where they want to be. Matrix is a fee-only, fiduciary firm and is compensated solely by our clients.



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