

THE AMERICAN INVESTOR

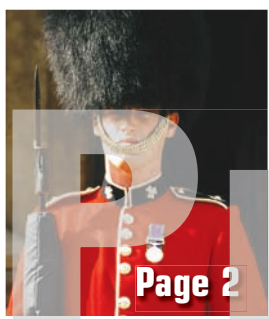
A SOPHISTICATED APPROACH TO BUILDING WEALTH

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MARKET VIEWS



Page 2

What You Can Learn from LIBOR

About half of all U.S. adjustable-rate mortgages are tied to LIBOR (London Interbank Offered Rate).

Source: *London Review of Books*, September 2008

Other Things Matter



Only **13%** of Americans said it was “very important” for them to be wealthy; **67%** said having enough free time was very important to them.

Source: Pew Research Center, 2008

Bad Guess

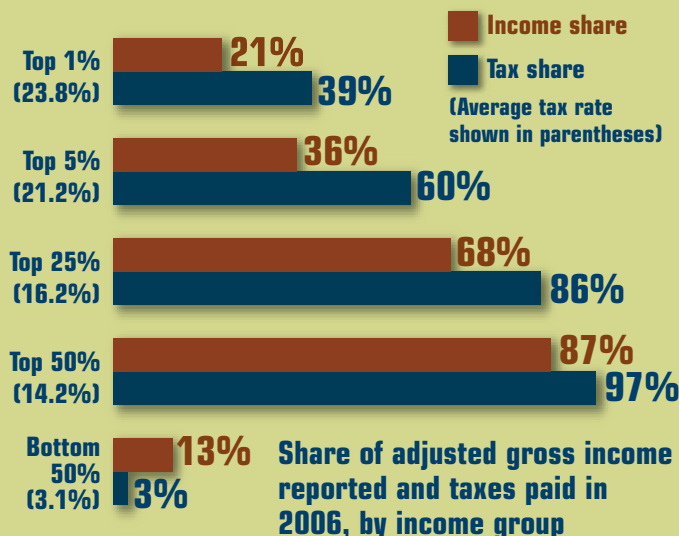
Less than half of American workers have tried to determine how much money they need to save before they retire. Of those who have tried, **43%** guessed how much they would need.

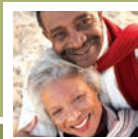
Source:
The Wall Street Journal, June 14, 2008

Who Pays What

The top 1% of taxpayers (who have an average 23.8% tax rate) earned **21%** of all reported gross income and paid **39%** of all income taxes collected.

Source: Internal Revenue Service, 2008





MARKET VIEWS

What You Can Learn from LIBOR

Obscure Benchmark Can Hold Wealth of Clues; What the Neighbors Think

If you've ever owned an adjustable-rate mortgage, you might be familiar with LIBOR, the London Interbank Offered Rate. But have you noticed the extra attention this interest rate is attracting? To investors around the world, LIBOR is more than a mere benchmark for short-term interest rates. It's a proxy for how global markets view the outlook for the U.S. economy.

Over There

About half of all U.S. adjustable-rate mortgages (ARMs) are tied to LIBOR levels.¹ The behavior of this interest-rate index determines whether ARM payments will rise, fall, or remain level each time the loans reset. Worldwide, some \$300 trillion worth of loan contracts are tied to LIBOR. That comes to \$45,000 for every man, woman, and child on earth.²

The British Bankers' Association (BBA) actually publishes 150 LIBORs, covering 10 different currencies and 15 loan maturities ranging from overnight to one year.³ But the most closely watched is the overnight dollar LIBOR, which tracks the interest rates at which the most creditworthy London banks are willing to loan marketable sums of American dollars to each other overnight. Banks don't like to leave money idle, even if only for several hours, so they tend to loan whatever surplus they have available to other banks that need to raise funds.

Once every banking day, traders at the leading banks report to the BBA the interest rate at which they *could* borrow money (they do not report the cost of actual transactions, only what rates are being "offered," as the name indicates). To prevent any

manipulation of the calculation, the association throws out the highest 25% and the lowest 25% of the quotes before averaging the rest to arrive at the benchmark rate.⁴

Money Hub and Hubbub

The overnight dollar LIBOR is important to U.S. investors because the rate is influenced by how London banks view the risk of lending American dollars. The rate generally goes up when the banks believe the likelihood of repayment is low.

In other words, LIBOR is an indication of the level of trust in U.S. finances. Because the U.S. financial markets have relied heavily on foreign capital, global opinions are important. It would be unlikely for stocks to sustain a prolonged rally when LIBOR is outside the world's comfort level.

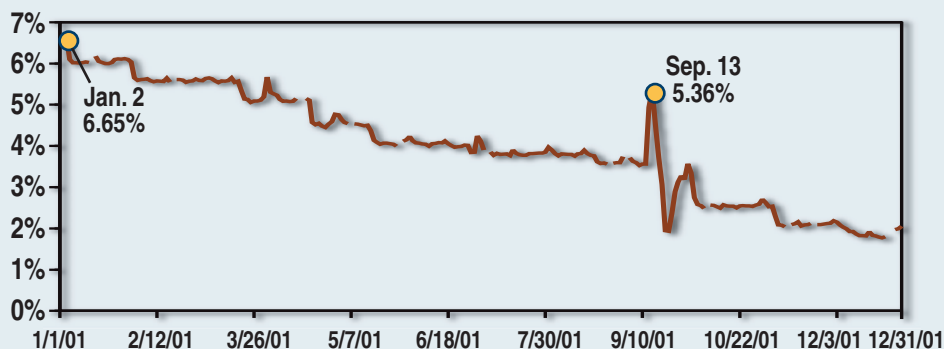
Why do London banks hold so much sway in money markets? London banks began to lend and borrow U.S. dollars (dubbed *eurodollars* when they trade abroad) after the pound failed to return to international currency status following World War II. This helped create a chain of events that eventually led London to achieve prominence in international money markets. Today more than 20% of international bank lending and 30% of foreign exchange transactions take place through offices of London banks.⁵

LIBOR is becoming an important indicator of investor sentiment. Keeping an eye on this benchmark can provide a good source of clues about the future.

1-3) *London Review of Books*, September 25, 2008
4-5) British Bankers' Association, 2008

LIBOR in Action

LIBOR's behavior in 2001 is a good example of how U.S. events can influence international interest rates. The rate was fairly high in January, possibly because of the uncertainty associated with the 2000 presidential election, but eventually fell as concerns about a peaceful transfer of power were allayed. The events of September 11 also caused the rate to spike briefly. Gaps in the line represent banking holidays.



Source: Haver Analytics, 2008, showing U.S. dollar LIBOR for the period 1/2/2001 to 12/31/2001. The performance of an unmanaged index is not indicative of the performance of any particular investment. Individuals cannot invest directly in an index. Past performance is no guarantee of future results.

Meet the Regulators

Securities Regulatory Agencies Have Origins in Volatile Times

American investors have long had a pendular attitude toward securities regulation. When times are high-flying and investors hold a sky-is-the-limit outlook, the public appetite for securities regulation tends to be rather lean. But when things get rough and volatility reigns, the public tends to be rather outspoken in demanding that their elected leaders do something to restore confidence.

For example, when the credit crisis threatened to paralyze the economy in September 2008, most Americans wanted Congress to intervene legislatively.¹ A majority believed that Congress's failure to act would cause a severe recession or worse.²

So it probably comes as no surprise that the main regulatory agencies charged with protecting investors typically had their origins during tough times. It's a good idea for investors to know and understand these key players in securities regulation.

The **Securities and Exchange Commission** was created by the Securities Exchange Act of 1934. Congress passed this act and its older brother, the Securities Act of 1933, at the height of the Great Depression in response to public outcry over the market crash of 1929. During the 1920s, Americans were enthralled with the get-rich promises of stock market investing. But the lack of regulation allowed companies to make the kinds of promissory, misleading, or blatantly false statements about their securities that are specifically prohibited today. The SEC is charged with enforcing these and other laws that require public companies and investment professionals to be truthful in their communications and dealings with the public, and to put investors' interests first.

The **Financial Industry Regulatory Authority** is one of several private-sector, self-regulatory organizations allowed under an amendment to the 1934 act. Congress believed that industry self-regulation would be more effective than expanding the SEC's authority. Although this might sound like the fox guarding the hen house, the securities industry has a strong interest in preventing unscrupulous operators from sullyng its reputation, which would weaken public trust and harm its members. FINRA was formed in 2007 after the National Association of Securities Dealers (formed in 1939) merged with the regulatory arm of the New York Stock Exchange.



The Big Ones

Securities Act of 1933: The first major federal securities law. Requires companies that wish to issue securities to register with the SEC and publish all relevant financial information to help investors understand what they are buying. Prohibits misrepresentation and fraud in the securities markets.

Securities Exchange Act of 1934: Governs trading of securities after they have been issued. Regulates stock exchanges and broker-dealers. Requires corporations to register with the SEC once their total assets and number of shareholders reach certain minimum levels. Requires publicly traded organizations, securities exchanges, broker-dealers, and registered representatives to file periodic reports.

Investment Company Act of 1940: Governs investment companies, including open-end, closed-end, and exchange-traded funds. Sets limits for fees and charges, defines fiduciary duties, and requires disclosure of all relevant financial information.

Investment Advisors Act of 1940: Creates federal authority over investment advisors, who must register with the SEC once their assets under management reach certain minimum levels.

The **Securities Investor Protection Corporation** was formed by Congress in 1970 to protect cash and securities that brokerages hold on behalf of their customers. If a brokerage fails and fully paid securities are found to be missing, it is the SIPC's job to help the clients recover their property.

Securities regulation is necessary for the smooth operation of free markets. The U.S. agencies that protect your interests as an investor are among the toughest in the world.

1-2) Gallup, 2008

Will You Be Ready When It's Time to Go?

The Risk of Planning to Work Forever

Small-business owners are a fairly happy lot. Nine out of 10 say they are satisfied owning a business, and 83% say that if they had to do it over again, they would still become small-business owners.¹ But then you probably already knew this.

So it's understandable that only 11% of surveyed business owners say they plan to stop working in their businesses and retire someday.² They may dream of relaxing on long vacations and taking it easy, but 40% plan to work as long as their health allows, and another 47% expect to cut back someday yet remain involved in their companies.³

This seems like a rosy picture, but planning to work until you drop creates risks that need to be considered.

What If?

If you are planning to work past the traditional retirement age because it will make you happy, that's great. But did you know that only 10% of

workers remain in the workforce past age 65?⁴ Or that more than half of people who retired in 2008 stopped working earlier than they planned?⁵

Eighty-six percent of today's retirees left work at 65 or younger, and 49% were out of the workforce before 62.⁶ Some common reasons were health problems or disability (54%), the need to care for a spouse or family member (25%), and outdated skills (14%).⁷

When people believe they will always work and always have an income, they can be lulled into believing that the need to prepare for retirement is no longer urgent. But even the most successful business people are vulnerable to health issues, market forces, eminent domain, and other events over which they have no control.

A wise approach might be to prepare for the possibility that you may be forced into retirement up to five years *before* your ideal retirement

Life After Owner

Most business owners expect their companies will keep going after they stop working.



Source: Gallup, 2008

age. Using this assumption could help you avoid saving too little or suffering a retirement shortfall if you can't work as long as you had planned.

1-3) Gallup, 2008

4-7) Employee Benefit Research Institute, 2008

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If it's been a while since you reviewed the progress of your investments, please call us. We're here to help you stay on track to pursue your long-term financial goals.

Mark Reynolds