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Are You a Madoff \$50 Billion Victim?

It's been a shocking headline for the past month. Bernard Madoff, former Nasdaq chairman and respected advisor to numerous celebrities and charitable organizations, has been charged with orchestrating a \$50 Billion Ponzi scheme for several decades. Madoff's client list consisted of high-profile so called "sophisticated investors", which were accepted into his fold on a referral invitation only basis. Fortunately we live in rural America far removed from the unscrupulous financiers that stalk Wall Street and the glitz of the big city. Unfortunately, some mutual fund managers fell prey and invested portions of their funds portfolio with Madoff. Hopefully, your fund manager resisted the "Too good to be True" temptation. The pieces of the puzzle are yet unraveling.

An article published on msn.com a week ago addressed the issue "If the rich, famous and sophisticated can get bilked (and the Madoff scandal makes it clear they can), how can you know whom to trust? The article goes on to offer several suggestions to prevent becoming a victim:

1. Background check: The SEC (Securities and Exchange Commission) maintains a public database online where investors can search for information on investment advisors and brokerage firms which list any actions, charges, court filings or arbitration awards. The address is www.sec.gov. To test the site you can find our information listed under our firm name "1st Securities Management, Inc." Virtually anyone can call themselves a financial advisor, investment advisor, or financial planner. You need to know who you're dealing with and the experience and credentials they possess. You need to know where to find your advisor when you have questions and need answers.

2. Understand your Strategy: Many of Madoff's investors ultimately admitted they never understood his investing strategy, but because they were making money many believed Madoff was simply smarter than they were. You may not need to understand all the intricate details or the complex formulas but you absolutely need to understand the underlying concept. This relates

to being able to answer this relatively straight forward question about your investments, "Do you know what you're doing, and why?" If you can't honestly answer "Yes" to this question, you need to question your advisor until you do, or find a new advisor. It's a new twist on an old proverb, "If it seems too good to be true, it probably is."



3. How is your advisor paid: Your advisor should be paid by you not some big brokerage firm. Otherwise, don't expect them to work for you. Advisors who earn commissions for selling certain financial products have a strong incentive to base their advice on what makes them money, not what's best for you. - continued on page 3

The stock market during the past 18 months has been one of the most devastating any of us can recall. Trillions of dollars in investor’s portfolios has vaporized. Millions of Americans at all stages of life have been shocked by the massive losses in their investment accounts. Most investor’s had no idea about to the amount of risk they were taking and the corresponding extent of loss exposure they had. And yet today, when it comes to fixing their investment portfolios, many investors remain in denial about correcting the problem: “I’ll Stop When I Get Even.” An old Chinese proverb once defined “Insanity” as: “Continuing to do the same thing(s)...and expecting different results.”



Most investment advisors today are recommending clients remain disciplined and not sell out at the bottom and lock in permanent losses. I emphatically agree, but, and this is a big but, only if you are properly allocated and diversified to begin with! Some things are NOT coming back...EVER. Look at the Nasdaq, which today is at about 1,600, at its peak in early 2000 it approached 5,500 just before the Tech Bust. How many examples can you recall of once prominent companies, household names, that are now extinct? Names like Enron, WorldCom, Lehmann Brothers, Bear Stearns, and countless others that have been forced into sale or liquidation. The simple fact is any, and I mean any, individual stock or company can go to ZERO.

Allocation and Diversification are the keys to successful investing. Not just among a few stocks or mutual funds. The portfolios we recommend provide exposure to more than 14,000 companies in 39 countries around the world. Certainly some of those now extinct companies I referred to above were contained in our recommended portfolios, but the exposure was minimal as a result of the vast diversification over more than 14,000 companies.

The Point! Is controlling risk important to you? Most investors answer ‘Yes’ to this question, as it should be. But even though most investors know risk is important, few are able to answer my next question. Can you show me an academic number, a study, a statistic that shows the amount of risk and volatility in your portfolio? Most investors don’t even know you can measure volatility. And the next question is, if you can’t actually measure risk in any meaningful way, is there any way you can control it? The resounding answer is – NO!

In most cases investors have never been provided with any meaningful way to compare and contrast the risk inherent in creating and managing differing mixes of assets in their portfolios. It’s no surprise that most investors were blind sided by how much their portfolios dropped in the past several months. They had no idea they could lose that much money because they were never shown or given any statistical tool for understanding it. There is a prudent academically meaningful way to measure volatility, its called standard deviation, and prudent investors need to know what this is.

I have observed investors who have lost large sums of money, but vehemently defend their portfolio decisions and deny that they lost an money at all. Much like the gambler who returns from Vegas and brags about all the money he made, but “forgets” the losing nights. As humans, we tend to selectively remember the wins and intellectually deny the losses and give ourselves more credit than we deserve.

Psychologists call this phenomenon “hindsight bias” and in the field of investing it reigns supreme.

The next question I’ll ask is, “If you took imprudent risk to get where you are today, is this something we need to solve? Is it a problem that needs to be addressed?” And then, the imprudent response, “I want to fix the problem, but I’ll stop when I get even. I had a million dollars, it’s down to \$500,000 (or \$400,000 or \$300,000) and when it gets back up to a million dollars, that’s when I’ll stop.” And you can sense the compulsion and the obsession in their reply. Very much like the gambler who’s down \$10,000 in Vegas, who says he’s going to stop when he gets even.

And then, I like to ask the investor: “When is the Best time to be Prudent?” And the inevitable response is: “It’s always the right time to be prudent.” And that’s exactly right! If imprudent risk-taking and speculation has cost you money, the worst thing that you can do is continue to participate in imprudent, speculative, and such risk-taking activities going into the future. So why do people often insist on continuing their imprudent behavior? Because to admit there’s a better way, they, in effect, have to admit that they were originally wrong. To admit that our own behavior or decisions were ill-founded in the past is threatening to the ego.



“If only it would come back,” many investors subconsciously muse, “Then I could feel vindicated in my actions and solve the problem.” This fantasy that everything will soon come back and everything will be OK is often at the root of the investor’s ... continued

malady. Don’t fall victim to this trap. The opportunity here, to avoid this trap, is to realize that you are not your decisions, and just because you made an improper decision in the past, does not mean that you are less of a person, or less intelligent. As a matter of fact, it’s a sign of intelligence and growth to solve and put an end to a destructive process when you become aware that one exists.

If somebody could really help you pick the best stocks and forecast which way the market was going to go, all you would need to do is look at a commonly available ranking system and see which manager had done it in the past, and give all of your money to them to repeat their performance and you could

do this with very little real thought or self-introspection. If someone could actually do all this stuff, life would get real easy as far as investing is concerned, because you would be making 20%, 30%, 40%, or 50% a year with no risk. And who wouldn’t like that? But it’s kind of like a belief in Santa Claus. It’s just not founded in reality.



Investors are often sucked-in by the illusions, fantasy, and addictions of gambling while they are being led to believe by the brokerage firms that the odds are really in the investors favor.

You can be a successful investor by utilizing the proper academic and statistical tools. Watch for the premiere of our upcoming movie “Navigating the Fog of Investing,” it’s a must see if you’re serious about growing your wealth and achieving true peace of mind about your financial future. If you’d like more information about how markets work and our academic based investment philosophy contact our office. You can’t blindly entrust your financial future to anyone else, it’s up to you!

Are You a \$50 Billion Madoff Victim? (continued from cover)

Conversely, an advisor who is paid a fee, or percentage of profits, has a stronger incentive to generate returns for you.



4. No one else is watching: Madoff was able to avoid detection for a long time because his company handled the cash, invested the cash, cleared the transactions through his own firm, and prepared the investor reports stating the fictitious cash in their accounts. Investors can protect themselves by making sure that their investments are held by a independent custodian, cleared by a outside entity, audited by a reputable firm, and receive investment reports prepared by someone other than their advisor.

5. Your advisor doesn’t invest alongside you: If you advisor believes in his/her strategy, they should be invested in the same manner and methods they recommend to you.

Investors should ask how much of their advisors wealth is invested alongside you. This will tell you if the advisor has his interest aligned with yours.

To properly protect yourself you need to educate yourself about how markets work and adopt an investment philosophy that matches your beliefs. Additionally your advisor should have prepared a risk tolerance assessment so that your emotional tolerance during market downturns is properly aligned with the exposure to risk in your portfolio. This is exceedingly true today given the extensive and extreme down market we’ve been experiencing. How many times have you heard family, friends or loved one’s say, “I didn’t know I could lose that much!” If



you didn’t how much risk was in your portfolio before, chances are, you’ve now found out the hard way. It requires a commitment of your time and effort to understand your investments. You’ll be rewarded with greater peace of mind concerning your investments and you’ll sleep better during the intervening



period.

Watch for the premiere of our upcoming movie “Navigating the Fog of Investing,” it’s a must see if you’re serious about growing your wealth and achieving true peace of mind about your financial future. If you’d like more information about how markets work and our academic based investment philosophy contact our office. You can’t blindly entrust your financial future to anyone else, it’s up to you!



For a brief preview of “Navigating the Fog of Investing” visit our web site at www.1stsm.com

It's tough to tell how much one investor can do alone to preserve their assets in 2009, particularly with unprecedented government intervention in world markets. But there are some general ideas to employ as markets and economies hopefully stabilize in the New Year:

Start with a plan – or review an old one: If you've worked with a good financial planner, you should be able to articulate your long-term investment goals by yourself. If you can't discuss such goals in detail, it might be time to meet with a comprehensive financial advisor who can assist you in assessing your individual risk tolerance, assist you in adopting an appropriate long-term investment philosophy and design an appropriate asset allocation and globally diversified investment portfolio. Additionally an investment advisor should educate you about how markets truly work and provide the life long coaching to enhance attainment of your investment goals. Much of the riskiest investing, overbuying and panic selling during the late 1990s and early 2000s could have been avoided if individual investors sought advice for achieving long-term specific goals such as retirement or a college education.



Check all your assets in banks: As a result of the federal economic bailout legislation, the Federal Deposit Insurance Corporation (FDIC) temporarily raised the per-deposit account, per bank coverage level from \$100,000 to \$250,000 through Dec. 31, 2009. Certain retirement-related accounts carry \$250,000 of FDIC coverage, but again, check in with your bank to make sure you're covered, and if not, get the right advice for moving funds so you don't incur an unexpected tax liability or fees.

Review your risk tolerance: One of the first items an investment advisor

should assess is your tolerance for risk. If you haven't had one done you need a new advisor. Essentially, risk tolerance is an individual's ability to emotionally withstand an investments decline without reacting in panic. Unfortunately, as simple as this sounds, most investors have never truly determined their tolerance for risk and therefore their portfolio level of risk is not properly aligned with their emotional tolerance for risk. Tragically this ultimately results in unnecessary stress, anxiety and, worst of all, panic trading during temporary market declines locking in permanent investment losses.

Prepare to stay invested: Market downturns are often filled with panic selling – and buying. If your investment portfolio has been academically and scientifically asset allocated and globally diversified, you shouldn't be in panic. A properly educated, allocated and diversified investor will be rewarded with long-term success by remaining disciplined.

Check your credit: No one knows how long it might take to unravel the nation's current credit situation. It's definitely a good time to schedule a review of each of your latest credit reports at staggered intervals throughout the next year. Why? Because in tough economies and times of tight credit, identity theft is on the rise, and you'll need to make sure the information on your credit report is accurate.

Pay attention to your cash: You should have an emergency fund of three



to six months' worth of living expenses. Not every investment that's lost value is necessarily a bad investment, and with careful study, you should be able to have cash on reserve so you can capitalize on legitimate opportunities.

Re-budget: It's a good time to make a budget or re-assess the one you have. Though the federal government would love for consumers to start spending again to lift the economy, that doesn't mean you have to jump in with both feet. Keep your spending smart, your debt low so it's easier to meet savings and investment priorities that will do you the most good when the economy and the markets recover.



Check your retirement: How will the activity in the market affect your retirement timetable? You might want to continue working full-time or plan a phased-out approach as you continue to build retirement assets. The greatest single fear concerning retirement is running out of money. Contact our office for a No Charge/No Obligation review of your investment portfolio.

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At www.terrencemcmullen.com, our regularly updated newsletter also provides timely articles to help you achieve your financial goals.