

ADOPTING A "PAY-GO" PLAN WILL KEEP YOU AHEAD OF THE CURVE

Distinguished retail analyst Joseph Ellis - who was ranked by Institutional Investor as #1 on Wall Street for 18 *consecutive* years - describes the stock market as a "sensitive predictive mechanism reflecting corporate profits." Largely due to the credit crunch, the third quarter predictive message was one of substantial *uncertainty*.

Dramatic stock market volatility sent a number of warnings. For one, it signaled the reduced availability of credit - which exacerbated the housing market collapse. Secondly, it exposed ongoing fallout from poor trading decisions by some hedge fund managers, who certainly should have known better.

A financial newspaper indicated that one particular hedge fund leveraged \$35.00 dollars for every \$1.00 of capital retained in their fund. John Mauldin's research* showed that another - the High-Grade Structured Credit Strategies Enhanced Leverage Fund - was found to be leveraged 80:1 before falling from glory. This is reminiscent of the internet start-up companies who - less than a decade ago - continued to sell their company stock while posting substantial negative capital balances. Their 'fall,' when it came, was steep and for many, deadly.

The third quarter correction in financial markets led to a decrease in available capital - or, made it more expensive. Borrowing became less desirable, and may spontaneously reduce the debt risk investors are willing to accept. Homeowners' exuberance for tapping into their home's equity - as though it were an ATM machine - is largely at an end.

We appear to be heading into a 'murky' economic climate. Will consumer spending - the primary driver of growth - channel us back into clear waters? Or, will we see spending continue to diminish as more consumers personally adopt the "pay-go" rule? Congress coined "pay-go" in the early 1990's. The phrase has become Washington shorthand for "pay as you go" and requires that new expenses be offset by an equivalent budget cut**.

While we wait and see, investors may still have reasons to take heart. Goldman Sachs research indicates that the four largest *emerging market* economies – Brazil, Russia, India and China – are responsible for growth in global demand, which remains strong. The global economy is less dependent on the United States than it used to be. Weakness in our dollar – assuming it doesn't go too far – actually helps our exports, for they become less expensive on foreign shores.

In late September, the Federal Reserve stepped in to lower short-term interest rates. This made more capital available at a lower cost. Subsequent action on their part may stabilize market volatility, but will inevitably be evaluated against the likelihood of spurring inflation.

If we ran our household economies like 'traders' – focusing on the hope of stellar short-term performance founded on debt - the virtual risks of losing control of our home economics would be extreme. Fortunately, we can avoid tactics based on speed and 'over-confidence.' Instead, adopting a family "pay-go" spending plan - coupled with patient, long-term portfolio strategies - may help position our families *ahead* of the national economic curve.

**Thoughts From the Frontline Weekly E-Letter, 8/11/2007, John Mauldin.*

***Please note that "pay-go" has not been fashionable in Washington budget policy during recent years.*

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