

INSIDE THIS ISSUE:

Market Overview	1, 5
Real Talk	2, 3
HNW Insights	4

SAFE & SECURE

It is rare that a week doesn't go by without the media reporting another Ponzi scheme, insider-trading scandal, or fund blow-up.

Recently, FBI agents raided three large hedge-funds in Connecticut, searching for evidence of paid tip-offs from corporate insiders. Needless to say, these private funds are in the midst of closing down, and their investors are scrambling.

At MMM, we setup client accounts at a 3rd party custodian to safeguard assets. We also have a controlled investment process with a fact-based approach that utilizes 100% public information. Finally, we apply a robust risk-management process to avoid blow-ups. The result is peace of mind for current and prospective clients.

Raphael A. Martorello
415-793-8014
info@mmmwealth.com
www.MMMWealth.com

Market Factors Point to Further Volatility**Market Overview & Commentary**

After a choppy summer, positive developments emerged to lift equity markets during early Q4/10. This improvement validated our previously expressed view of no double-dip recession, but rather a continuing digestive process from 2009's large gains. Most notably in the US, GDP growth resumed, manufacturing improved, the service sector strengthened, and exports increased. Additionally, the Federal Reserve announced the launch of a new easing program, which temporarily rallied the markets due to its stimulative effects. Overseas, global growth continued to strengthen, especially in emerging markets.

Despite the positives, markets remain highly volatile, with major trends continuing to reverse over short time periods. For example, the US dollar rose steadily in Q2, declined rapidly in Q3, and began rising again in Q4. This constant trend change created significant volatility in commodities, currencies, foreign equities, and fixed income funds, regardless of the fundamental values. Another set of trend reversals occurred when fears of credit default in Greece emerged in Q2, followed by a settling period after the EU bailout of Q3, only to be reignited by a crisis and bailout in Ireland during Q4. This trend change drove volatility in many assets as well, despite little changes in core valuations.

Volatility is also being stimulated by the composition change of market participants. While conviction-less institutional high-frequency day trading has been significantly on the rise, we have yet to see the return of the buy-and-hold retail investor after their mass exodus during the 2007-2009 bear market.

For the most part, the retail investor bought heavily at the peak of 2007, and sold into the depths of the bear market through early 2009, missing out on the massive rebound in late 2009. As was the case during the Great Depression, it is possible that a large number of these investors have been affected for the long term, and may not return to the markets for a while, if ever. As measured in fund flows, retail investor participation in the equity market is incredibly low relative to historical averages. This combination of reduced long-term buy-and-hold retail investing and increased institutional day trading, has contributed to the current market volatility that lacks direction.

As a side note, the majority of fund flows by retail investors have been into...

...continued on page 5

The Groupon Binky Effect

“Hey, did you get that Groupon email for today? \$25 for \$50 worth at Nordstrom Rack!”

“No way! I’ll check it out when I get home after work.”

“You better check it out now because if they sell out, you can’t get the deal.”

“Shoot, you’re right. Let me call you back. I have an app for that.”

Every day, millions of people across 88 U.S. cities and 22 countries make impulse buying decisions based on the fear of losing their binky. As an example, if you’ve ever bought something from Groupon (an online group discount buying service), you did so because it was a great deal (regardless if you needed it or not) AND because you had to decide immediately or else the deal would be gone forever - and no one likes to lose their binky.

In our research, we seek to understand the *typical* or *average* person’s pattern of thought and behavior. By setting a baseline, we understand what mistakes most people are prone to making, and we can help prevent them from doing so. Buying a Groupon deal isn’t necessarily a mistake, but it’s the pattern of thinking that can cause people to get less out of their financial choices than they should.

Looking back at the Groupon example, we see that there are two options being presented: a) save \$25 and lose the deal or b) get the deal and spend \$25.

So what’s happening here?

Loss Aversion

Rather than saving \$25 and locking in the gain, people are willing to spend \$25 to avoid the perceived loss. This phenomenon is known as *loss aversion*.

Thomas Gilovich describes this as a “willingness to take more risk if it means avoiding a sure loss and to be more conservative when given the opportunity to lock in a sure gain.”

Here is his experiment that examined this behavior:

Imagine that you’ve just been given \$1,000 and have been asked to choose between two options.

Option A: You are guaranteed to win another \$500.

Option B: Flip a coin. Heads and you win another \$1,000; tails and you get nothing more.

Which option do you choose?

Now imagine you’ve just been given \$2,000 and have been asked to choose between two options.

Option A: You are guaranteed to lose \$500.

Option B: Flip a coin. Heads and you lose \$1,000; tails and you lose nothing.

Which option do you choose?

According to research, people are more willing to lock in their \$500 gain with Option A in the first scenario but would take a risk with Option B in the second scenario. However, both present the same situation: walk away with \$1,500, or take a risk to get \$2,000 with the downside potential of only getting \$1,000.

People feel nearly twice as strongly about the misery of losing \$500 as they feel about the pleasure of gaining that same amount, according to research by Daniel Kahneman and Amos Tversky.

The Groupon Binky Effect

The Behavior Risk

This feeling or behavior isn't inherently bad, and being more conservative to not lose money can be a good thing - but having an oversensitivity to loss aversion can have negative consequences to your finances.

Take the recent market downturn for example. People who were overly sensitive to losses pulled their money out at the bottom and took years off their ability to retire and reach their goals. These people would rather not face the idea of taking on more short-term losses, even if that meant sacrificing long-term returns, because the pain is stronger than the gain.

These people risk their long term goals in order to prevent losing any more in the short term.

Risk is Financial and Psychological

One of the most important decisions we make with clients is evaluating their perceived vs. recognized risk tolerance. It's one thing to ask how much risk they will take while in a cold state of mind (financial). Put them in a heightened emotional state and see how their answers change (psychological).

That's not to say that we have screaming babies stress them out while asking about risk tolerance (although imagine how peoples' opinions of disciplining children change under such conditions). We simulate stressful market and economic conditions to gauge behavior and also evaluate how they've reacted in the past.

What We Advise Our Clients

Even after our portfolios rebounded, we went back to a number of clients to reassess their risk profile and make sure we adjusted for sensitivity. Since we know people are overly sensitive to losing money, we encourage them to take on less risk in order to stay with their plans and portfolios. Getting an extra percentage return isn't worth it if the downside risk would cause them to bail out.

On the other hand, some understand the irrationality involved with being overly conservative and take a more aggressive approach. Those with this risk tolerance are not the ones monitoring their portfolios daily, they are the ones focused on playing offense, and ultimately, benefitting from higher returns.

I Never...

We are passionate about staying intimate with our client's financial situation and emotional state, and our ability to help them bridge the two helps lead to financial success.

A Client recently complimented us and shared this with their friend:

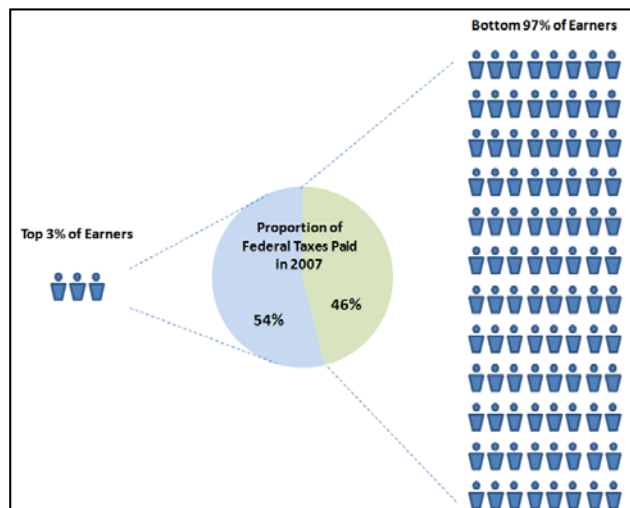
"I never would have stayed in the market if it weren't for these guys."

Now that's a binky worth holding onto.

Is it your patriotic duty to pay lower taxes?



In a recent IRS study, it was found that the top 3% of income earners in the United States pay more in taxes than the remaining 97% of taxpayers (see chart below).



Of course, this top 3% also earns a disproportionate amount of the earnings pie, bringing in approximately 20% of total earnings. Regardless of personal political leanings, this data illustrates both the wide income distribution of US earners, as well as the progressivity of our tax system.

Interestingly, a large majority of the individuals in the top 3% are small business owners who have traditionally been the engine of employment growth during economic recoveries. However, during our current recovery, they have not hired as robustly as in past recoveries. Some postulate that small business owners are not hiring because of uncertainty from the potential cost implications of the recently passed healthcare bill (payroll tax increases, premium increases, etc.), and the possibility of their portion of the Bush tax cuts expiring.

Digging deeper, a recent study out of Harvard (Title: Do Powerful Politicians Cause Corporate Downsizing?) points to the benefits of having larger amounts of money in the private sector versus in government coffers. This study analyzed 232 appointments to a chairmanship position in Congress across 52 years. In the year following a

chairman’s appointment, financial earmarks to his / her state increased by an average of 40-50% from the previous year. However, private firms in those states reacted by reducing capital expenditures by 8-15% and R&D by 7-12%. Additionally, total employment and sales growth for the state suffered as the private sector was crowded out. Interestingly, these negative effects tended to fully reverse after the chairman retired and earmarks were curtailed.

Similar findings have been reported by the OECF, concluding that a 1% rise in government consumption reduced private sector consumption by 1.9%. The more money spent by the government, the greater the economy suffers through larger private sector contractions. It should therefore come as no surprise that after \$850 billion of government “stimulus” by Republicans and Democrats, our unemployment rates remain stubbornly high.

Q: Is it your patriotic duty to pay lower taxes?

Whether you have a personal preference for reducing your tax bill or believe that investments are best made by the private sector versus government, there are a number of tax reduction strategies that you could be thinking about:

- Maximizing employer retirement plans
- Leveraging expense write-offs and super-sized pension plans within family-owned businesses
- Advanced estate planning techniques such as family foundations, charitable trusts, generation skipping trusts, etc.

If you are interested in exploring tax saving strategies, we are happy to take a look at your situation and provide recommendations.

Additionally, we are offering any of our client’s family members, close friends, or business associates a complimentary second opinion diagnostic review of their situation to see how they are doing both from a tax savings and/or investment strategy perspective.



Further Volatility (continued from page 1)

...fixed income funds, which have far outperformed equities in the last decade. However, we believe that the current retail investor's chasing of the past decade's performance will end in tears. A similar approach was taken by investors chasing equity performance from the 90's during the 2000's, with little to show ten years later. Choosing investments based on backward looking results is a "strategy" that has continually failed throughout history...and yet, it is the "strategy" that most retail investors follow, because it feels right and others are doing it. Excess 10-year returns tend to lead to overvaluation, while sub-par 10-year returns tend to lead to undervaluation and opportunity.

Looking Forward

Despite the resurgence of fear in country-specific credit markets, financial conditions are continuing to improve as measured by the Bloomberg Financial Conditions Index and TED spread. Additionally, asset classes are behaving in an uncorrelated manner as they should, which means the market is functioning properly. This evidence points to a continued healing process, albeit in a protracted and volatile manner that our media likes to pitch as a daily crisis because it captures audience attention.

More specifically, we believe that there are enough positives to support an upward move in equities through the year end and into the first two quarters of 2011. Thereafter, many questions remain in regards to continued growth, reduction of budget deficits, and potential distortions from the massive government stimulus provided. This evolving backdrop continues to lend itself to more active investment strategies versus a simple buy-and-hold approach.

Unfortunately, we do not see the employment picture improving that dramatically going forward, which is difficult for many Americans. However, owners of assets, and investors in markets, should be able to profit as inflation and private growth eventually kick in.

As always, we encourage you to pursue life's dreams!

Warm Regards,

Raphael A. Martorello

QUESTIONS

We are available to discuss any questions you have regarding progress towards your financial & investment objectives.

REFERRALS

We appreciate your referrals as they are the lifeline to our business. Please let your family, friends and colleagues know about our wealth management services.

We are accepting new clients through our sister company LotusGroup:
www.LGAdvisors.com

Contact Us

Raphael A. Martorello
415-793-8014
info@mmmwealth.com
www.mmmwealth.com