



NORTHSTAR

FINANCIAL
PLANNING INC

OCTOBER 2008

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2008 Q3 Investment Letter

“IF”

The poem “If” by Rudyard Kipling, a great poet of the heyday of the British Empire, has some concepts that seem relevant today, in a world in which global financial markets are in meltdown mode, credit markets are temporarily frozen and the speculators are unwinding their hedge funds and highly leveraged investment models at a dizzying pace.

*If you can keep your head when all about you
Are losing theirs;
If you can trust yourself when all men doubt you,
But make allowance for their doubting too;*

*If you can dream - and not make dreams your master;
If you can think - and not make thoughts your aim;
If you can meet with triumph and disaster
And treat those two imposters just the same*

Integrity, Transparency and Due Care

How did it all happen? Complicated investment products, misguided investment practices, greed, and lack of due care. The bursting of the housing bubble was the boulder dropped into our economic pond, and now the ripple effect has impacted almost every corner of the world economy. A pervasive belief that housing prices could only go up emboldened buyers and lenders to reach financially in order to participate in the housing boom turned bubble. The “proof” that housing was a great investment was everywhere and escalating prices was self reinforcing. Our Government encouraged homeownership and Alan Greenspan publicly endorsed adjustable rate mortgages. For many years those who owned homes (the bigger and more expensive the better) watched with pleasure as their net worth rose dramatically. Those who didn’t own homes became convinced that ownership, as soon as possible, was a key contributor to their future wealth. Feeding that demand was a seemingly endless supply of easy loans, flexible in their terms, with many of these loans qualifying as completely irresponsible.

Unfortunately, borrowers were not the ones that “reached” the most. The lenders reached more. These bad mortgages had been converted into bonds, and then those bonds were converted again into Collateralized Debt Obligations with each step adding layers of debt to juice the expected returns to the investor. These complex instruments are now going bad, leaving huge holes in the balance sheets



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of some of our biggest financial institutions and inhibiting their ability to make new loans. If these banks aren't making new loans they are essentially out of business and not accessible to the everyday needs of our economy.

To give perspective on the magnitude of this crisis, Lehman had \$613 billion in liabilities when it recently filed for bankruptcy. WorldCom, previously the largest corporate bankruptcy, owed just \$34 billion. The Resolution Trust Corporation—the government entity that led the resolution of the S&L crisis in the 1980s—ended up shuttering over 700 firms, but the total assets of all those companies combined were still \$245 billion less than Lehman's assets alone. Yet, of all the firms currently in trouble, Lehman was judged to be small enough to let fail. This crisis clearly hits at the major infrastructure of our financial system.

Where do we go from here?

We are a country that overcomes challenges. Recall the 1980's when we saw double-digit unemployment, double-digit inflation, and a Savings & Loan collapse. We learned good lessons and built a stronger economy from those experiences. The market responded with the S&P 500 Index posting a 17.6% annualized return over that same decade. The financial crisis creates a pretty bleak landscape in the short term, but there are some positive factors that will help in the slow process of recovery:

- Unemployment has risen to 6.1%, but is still not high in historical terms.
- Inflation remains reasonably in check.
- Oil prices have retreated over the last couple of months.
- Government actions should continue to be highly stimulative.
- Weak dollar increases demand for our goods abroad.
- The Chinese economy is dependent on exports—China actually consumes much more than it exports, and the country's growth will continue to drive internal consumption.
- 1 billion people around the world are gaining middle class status and they will need goods and services.
- Equities valuations are historically low and have a higher expected rate of return than one year ago.
- An unprecedented amount of investable capital is sitting on the sidelines waiting to enter the markets.

It is in volatile times where we find it particularly helpful to keep a long-term focus and take comfort knowing that over time the market generally goes up. The market will rise again and you are well positioned to participate when it does.



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Northstar's Commitment

1. To help you stick to your investment strategy in all market environments. We have received many calls asking whether we should be doing something in this falling market and our response has been to hold tight if the conditions under which you chose your asset allocation remain intact. Our response has been the same in rising markets when many of you have asked whether you should increase your equity exposure. It has been proven that investments outperform investors every time largely because of the emotions of fear and greed that are part of the human equation. Market timing does not work over the long term and our job is to assist in your commitment to a long term investment strategy that will help you reach your goals.

The value of diversification and asset allocation is apparent even in this market where there is virtually no place to hide. Since its high in October of 2007, the S&P is down over 40%, the foreign equity markets are down between 40 to 50%, and diversifiers (energy, real estate and commodities) are down in the 25-40% range. Northstar's target balanced portfolio of 60% equity and 40% fixed income portfolio is down closer to 25%. While these negative returns are no picnic, it could be a lot worse.

2. To act prudently and in your best interest. We have been thinking about the apparent disappearance of prudent behavior among management at some large companies and the complete lack of a fiduciary standard or practice in the mortgage arena. The people actually writing the mortgages and nominally lending the money didn't bear the costs of writing bad mortgages. By separating the functions of mortgage origination, securitization and investment, incentives were created for agents to act in their own interest, to the detriment of the whole. At one of our most renowned financial institutions, greed pushed brokers to sell CDO's to individual investors while at the same time the firm was selling them. To our New England senses, the whole lot of these cheats and liars should be forced to spend a few weeks in a Puritan stock as atonement for their sins! At Northstar, we are a SEC Registered Investment Advisory firm and are required to act as your fiduciary and in your best interest in all matters. In these uncertain times, this is our commitment to you. We will:

- Communicate with you often, in good times and bad.
- Meet regularly.
- Continue to put your best interests first.
- Provide great financial planning with absolutely no conflicts of interest.
- Use low cost, understandable and transparent investment vehicles.
- Listen carefully and help you focus on what's really important in your life.
- Treat you with respect, professionalism and honesty.
- Be easily available to you by email, phone or in person when you need us.



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3. To help you focus on your financial life plan. We have talked to nearly all of you recently and find that there seems to be two major themes running through your minds right now: Will this terrible market destroy my life plans? What can I do now?

We believe that the answer to the first question is an emphatic “No!” Nothing remains constant in life, including previous financial plans and forecasts. This market event, which is transitory unless you believe that the clock on our civilization is being turned back 1,000 years, will have an impact on your life goals and plans in the same manner the sudden loss of your job, a family death or severe illness or a major terrorist event would have. Your life goals and plans may change but your life values can remain true and serve as the rudder for course adjustments along the way.

As far as the second concern, yes, there are things you can do to take more control over your life both personally and financially. As unsettling as these uncertain times are, they often remind us to focus on and appreciate the gifts we have in our life. What do you appreciate about your life today? What gives you your greatest sources of joy and satisfaction? It is never about the portfolio; it’s about our health and wellness, our family, the community, our work and our passions. We also believe that this economic environment has given us all an opportunity to realign our spending with what is truly important to us so that we may achieve our long term objectives. Does your savings and spending reflect your values and what’s important to you?

Lastly, if you are feeling stressed and fearful about the markets, we recommend asking yourself if the fluctuations in your portfolio are impacting your lifestyle today. Would an outside observer know by looking at your life that your portfolio is down because of a bear market? Did they know by looking from the outside when the portfolio was up in the last bull market? The likely answer to both of these questions is no. Your portfolio was designed so that your lifestyle today and in the short term future doesn’t have to change, regardless of the market’s direction.

Tax and Investment Planning

As we move into the last quarter of the year, two investment-related planning activities will move to the forefront in our activity. We will be reviewing your taxable accounts for positions that have incurred a capital loss since the original purchase was made and then “harvesting” that loss to apply against capital gains that may be realized thus far in the year. Tax losses are never great news but like so much else in life, they can have a silver lining. Long-term capital losses can directly offset long-term capital gains, dollar for dollar. The first \$3,000 of any unused losses can then be applied against ordinary income and any excess beyond that carried over to the following years.



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Secondly, for those of you who are over 70 & ½ years old and have an IRA or other tax-deferred investment account with TD Ameritrade, this is the quarter in which you must complete your required minimum distribution activity for 2008. The exact amount you must take out is a function of your age and type of beneficiary (spouse, child, trust, etc) and must be withdrawn before December 31, 2008.

Portfolio Performance Reporting

We are in the process of changing the provider of our portfolio performance reporting services to Orion Advisors (www.orionadvisor.com.) We expect the change to be effective for year end reporting. We will continue to use Advisormart through January 2009 and will let you know when your online access will change over to Orion.

We have enclosed the fourth quarter invoice for our services. Please call if you have any questions. Also, if there have been any significant changes in your financial, health or personal situation or a change in your life goals, please contact us to review the possible impact on your financial life planning and wealth management strategy.

Thank you for your calm approach and continued trust during this turbulent year.

Warmest Regards,

Robin A. Young, CFP[®], RLP[®]