

# Ω THE OMEGA FINANCIAL GROUP

OMEGA SECURITIES, INC. • OMEGA II • THE OMEGA FOUNDATION, INC.  
MEMBER NASD & SIPC INSURANCE AGENCY DONOR ADVISED CHARITABLE ORGANIZATION

## Opinions & Facts...

Early Spring 2008

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### Quote of the Month

“The medicine of volatility can be a bitter pill, but at the same time, that volatility produces opportunities for people willing to practice the patience that’s needed in all types of markets – good and bad.”

*Joe Hardgrove 2008*

**“The sky is falling... The sky is falling... Run, Run...!”**

As we’ve said before, “we’ve seen this movie and we know how it ends.” So eat your popcorn and enjoy it. (Of course, you have our permission to shed a few tears!) All we hear is how bad the financial situation is from the mainline media. One noted economist from NYU sees a recession that will be “ugly, deep and severe.” George Soros, the international hedging guru, calls the current situation, “the worse market crisis in 60 years.”

We wonder if it’s as bad as it was in the early 80’s when a thousand Savings and Loans disappeared into insolvency. During that same time major US bank stocks nosedived. Would it be worse than 1981 when the interest rate ran to 19% in order to fight inflation? We can remember the 1970’s, when the stock markets dropped as stagflation swept over our economy. Not only that, but our work memory reminds us when the NASDAQ fell by 78%, and corporations were bankrupting like flying pins in a bowling center.

**“Are you saying, the piper is being paid?”**

Let’s take a logical look: anytime you have an over production (“bubble”) of “things” (houses, apples, cows, steel) you are going to have some sort of a “bust”. In the last several years Americans were consuming beyond their means, buying homes using low cost money, and the risk was rising. The mortgages collected their beautiful fees, and the big banks packaged those bad loans along with credit card debt, and sold them to greedy hedge fund managers and whoever else. (These subprime bonds were rated AAA

by the rating agencies. How’s that for a laugh?) Finally when the time came for the interest rates on the ARM’s to increase, the piper began to take his share.

### Derivative:

A financial instrument whose characteristics and value depend upon the characteristics and value of an underlier, typically a commodity, bond, equity or currency. Examples of derivatives include futures and options. Advanced investors sometimes purchase or sell derivatives to manage the risk associated with the underlying security, to protect against fluctuations in value, or to profit from periods of inactivity or decline. **These techniques can be quite complicated and quite risky. (Emphasis, ours.)**

**“Hello, smoke and mirrors.”**

There are reasons for an investor to be afraid in the complex non-transparent environment of a rising number of derivatives with interesting names such as “Credit Fault,” “Credit Defaults Swaps,” “CDO’s,” “RMBS’s” and that ilk. Some of those derivatives have helped the banks to spread risk in a way that was never before possible, nevertheless the quest for easy profits have exploded in unknowing investors’ hands. That risk was certainly spread: on a global basis from Norway to London.

**“So where are we? Is the sky falling?”**

We believe that those who predict the demise of the world’s most productive economy are certainly premature. We basically have low inflation and low interest rates as opposed to Europe and other continents. The flexibility of our economy to come back and create new concepts which increase the productivity of our workers is unheard of in other parts of the world. In the 1970’s our economy was much smaller and the global markets were just beginning to

develop. Today, we have much more flexibility with liquidity available worldwide.

Ben Bernanke, Federal Reserve Chairman, has oftentimes pulled the interest-lowering trigger a little quick (and other times, too slowly), but he hasn't been at bat the number of times for us to call for a pinch hitter.

### “So what must we do?”

As we've told countless clients through letters and phone calls: time is a great healer. The economy has a way of working itself out and self correcting, especially when your money is being managed by some of the most experienced, well educated and committed managers in the world. The smart guys are buying undervalued stocks; they've discovered there's no way to know when the “bottom” will come. And thoughtful diversification has lessened the tension.

As we've said so many times before, the enemy of stability is *fear* and *greed*. We know that it's virtually impossible to do away with greed (some say it all started in the Garden of Eden). Fear however, is a controlled emotion. If you are knowledgeable of the culture of the organization and individuals managing your money, and aware that they personally are heavily invested in the same funds that you own, and that their first loyalty is to their shareholders, you will find that faith in these people and the resiliency of the capital markets will help to control your fears. One problem is that we here at Omega are probably more aware of our managers' virtues than our clients, since we've observed these things for four decades.

In many cases we sometimes blame ourselves for not communicating more with our clients. These letters and other written communications are what we feel are the best way to do that. However, anytime you would like for a one on one sit-down visit, please do not hesitate to call. Again, “we've seen this movie before and we know how it ends.”

John Wayne always wins!

### “Free dinner? Don't you believe it!”

Either you, your parents, or your grandparents have probably been invited within the last year to a Seniors Investment Seminar usually held at some steakhouse of little renown, where Senior Citizens are given 15 to 30 minutes of fear talk (“*you could outlive your income;*”

“*social security may reduce your benefits;*” “*the stock market will probably crash;*” “*you may end up depending on your children for support;*” ad nauseum) and of course, the advisor's prescription is always an annuity: either fixed or indexed, to solve all the ills of the Senior Citizen.

And as the dessert is being passed, appointments are set.

We have seen a number of individuals who have purchased these insurance indexed annuities where the agent had apparently neglected to disclose to the senior citizen some of the negative details of the “no load” annuity. In many of the incidents we have noted, the Senior is not told of the huge penalties she would face if she wants her money over the next several years (sometimes ranging up to 12 to 15 years). In fact, some of the indexed annuities that we have seen make it impossible to get *any* lump sum investment out. The only way it can be touched is to annuitize it, i.e., take it as a *fixed monthly* income for a lifetime. **This, of course, is economic suicide in an inflationary environment such as we will face in the future – the same inflation we have experienced for hundreds of years.**

The sad story exists today that was true when we started in 1964: **when you buy a fixed annuity, regular or indexed – you are simply loaning your money to an insurance company who borrows it from you at a low rate and invests it for a higher return. There is a huge difference in a loan and an investment. A loan breeds inflationary risk; an investment faces risk of volatility and/or loss. And there's nothing wrong with either, as long as the buyer has been given complete disclosure. The buyer should be made aware of the historical erosion of the dollar's purchasing power, as well as an investor's lack of guaranteed results.**

Oh well, as Phineas T. Barnum said in the 1870's, “There's a sucker born every minute.” And our advice to the Senior Citizen is to respond to the dinner invitation, “We'll be happy to have the meal, but please, we'll have the New York strip rather than the usual chicken-fried steak.”

### OUR OPINION

Well, here we go again. It seems like only yesterday that the media and our elected leaders were concerned with the wild spending sprees that Americans were on:

borrowing money at low interest rates and building up piles of debt. And while the Republicans successfully cut taxes, they also have not found the discipline to cut expenses at the Federal level. Now the government thinks that giving people cash “rebates” will jump start the economy.

It was only 7 or 8 years ago that Senator Joe Lieberman said that the Government should write a \$300 check and send it to everybody in the United States. Then before that, President Jimmy Carter, suggested a \$50 tax rebate. This was his method to cure stagflation by refunding tax payers \$50 each even if they didn't pay taxes. Of course, that notion was laughed out of Congress when people started comparing it to stimulating the economy by scattering \$50 bills from airplanes.

The Carter \$50 rebate came along when people still believed in the Keynesian “multiplier effect.” By putting money into people's pockets, the reasoning was that the Government would “inject” money whether from higher spending or lower taxes and it would be “multiplied” many times in the system. Since then, Keynesian economics stumbled, mainly on the sticky question of *where* the government gets the money it “injects”.

Now, here we are again, planning to drop \$150 to \$200 billion onto the public in “rebate” checks to taxpayers in the hopes that the people who receive those checks (none goes to people with more than \$150,000 in joint income) will rush out and spend that money on things they wouldn't buy with their existing income. A recent local survey which asked people what they'd do with their “rebate” checks revealed that the majority of people said they would either pay down debt or save the money. Another bad idea – down the drain.

This brings us to our point: the Government does not put money into our pockets; it takes it out of some pockets and puts it in others'. If the Government writes checks for \$150 billion in tax rebates as is planned by the administration and Congress, it will borrow \$150 billion more or pay back \$150 billion less on the debt. Would someone please explain to us how these offsetting transactions are supposed to stimulate anything?

**“So how do we handle the problem?”**

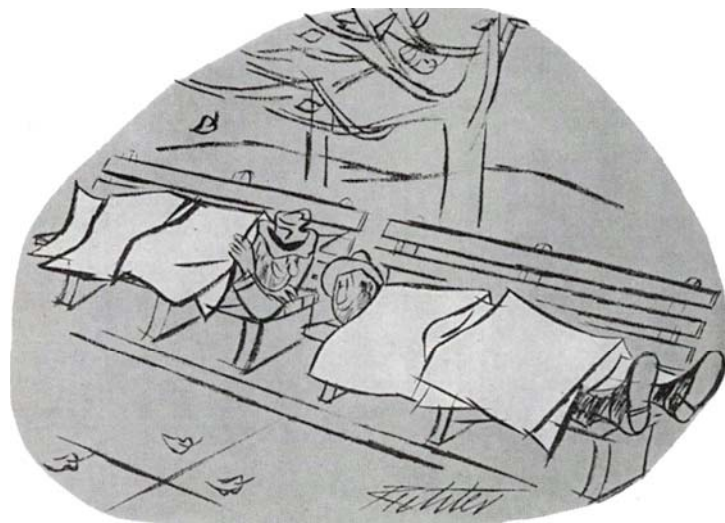
The only long-term answer is to build incentives for people to work harder and earn more money without

paying more taxes. These incentives are basically measured by marginal tax rates: that's the tax we pay on an additional dollar of earnings.

The Bush tax plan in 2001 cut the highest marginal rates. In a progressive income tax structure the highest marginal rates generally apply to taxpayers with high income. If you want economic stimulus you've got to cut the top marginal rates to increase the incentives for your most productive citizens. This, of course, does not play well politically, but if those tax cuts are extended and the incoming administration (Democratic or Republican) battles to cut expenses and tighten the budget, the next level of economic boom will continue into the next decade. As you may recall, the marginal tax cut in the 1980's set off a great financial and economic boom that continued on into the 1990's. Lower marginal tax rates have consistently helped to grow our economy and flooded the coffers of the US Treasury. While this is not the quick fix instant gratification that many voters would like, they would be wise to learn that nothing of deep value comes without patience – and vote with their intellect not with their emotion.

That's our take. Yours is welcome.

Joseph E. Hawley  
Tom Hawley  
John Dickers  
Jimmy Byrnes



“THAT FREE LUNCH WE HAD AT THE INVESTMENT SEMINAR? WAS IT WORTH IT?”