

EXECUTIVE SUMMARY



Clarity amid the “Lehman crisis”

September 15, 2008

You probably know by now my sentiments about how the media tends to label every newsworthy event a “crisis.” Today I refer to this morning’s announcement of 158-year old Wall Street firm Lehman Brothers’ demise after its failed attempts over the weekend to attract a “sugar daddy” to come to its rescue. No other major financial institution could justify purchasing Lehman’s mine field of a balance sheet comprising complex structured investments and acknowledged bad mortgages in its portfolio. Even the short list of potential willing buyers requested guaranteed “bridge loans” from the U.S. Federal Reserve to assist in any deal. No sovereign wealth fund with deeper pockets came to Lehman’s rescue either. That tells me a Lehman purchase or merger would be a bad investment to any informed buyer with the capacity to salvage it. Lehman is another Wall Street firm that saw this coming, but got caught up in its own financial hubris.

From a 30,000-foot viewpoint, I see today’s unfolding events exemplifying “free market capitalism at its finest!”

Markets must make corrections in order to plod efficiently forward and upward. On a smaller scale, individual companies must be allowed to fail if others are to rightfully succeed. Artificial interference from government capital infusion does not well serve our economic system in the long run.

From a microcosmic perspective, your local bakery, hardware store, or other small businesses can not secure bank loans for “working capital” when they are struggling in their competitive marketplace; the banker’s role is gatekeeper of the capital, offering loans to companies that actualize competitive advantages in their marketplace, with management’s demonstrated ability to consistently make prudent financial decisions for the best use of their capital; a banker would NOT make a loan to merely finance a company’s eventual demise; that would equate to throwing good money after bad. In short, the banker is protecting the borrower from making a big mistake.

Let’s be clear about who is directly affected by this event – and who is not. Thousands of Lehman employees and managers will be displaced - forced to find new positions at other firms. And many of those employees who put all their eggs in one basket with over-weighted direct investments in the stock of the company Lehman (symbol LEH) will lose that investment.

That is NOT to say that investors with diversified portfolios that were merely “custodied” under the roof of the brokerage firm Lehman Brothers will have any noticeable impact. Brokerage accounts are

protected by the SIPC (Securities Investor Protection Corporation – created in 1970 with brokerage firms as members to preserve customer accounts on such occasions as this). Those investment accounts will be orderly transferred to another brokerage firm, virtually automatically. The SIPC only protects accounts with SEC-registered investments (it does not protect futures, currencies, or non SEC-registered limited partnerships).

The difference between today's Lehman event and the Bear Stearns event just a few months ago is THIS TIME the Federal Reserve, in its prudent consideration of all available facts, decided in OUR favor not to bail out a mismanaged company or the company's mismanaged portfolio (Balance Sheet) at taxpayers' expense. I applaud the Fed's hard stance to allow the free market to "cleanse itself," make its own corrections, and rightly place the responsibility and consequences on Lehman to bear its losses from a series of bad decisions regarding investments, leverage, and risk management.

Not to understate the short term knee jerk reaction in the overall market. Expect volatility, especially in companies in the financial sector suffering market price declines of their stocks – regardless of their ability to offer financial stability or prudent managers of their capital and portfolios. Today's market volatility is the personification of hysterical "behavioral finance" which I believe is mostly induced by media hype. Successful companies will rebound. For the savvy investor, these occasions give rise to unusually attractive opportunities to purchase great companies at exceptional values.

Maintaining a properly diversified portfolio, you can confidently shrug off today's events as well as the next guaranteed "crisis" which may rear itself in a different sector, involving different players, and sometimes without advance notice. Often, my most important job is to filter through the market noise, and prevent you from capitulating, and thus derailing your financial plan. Maintain faith in long term equity positions. Refer to the enclosed graphs illustrating that stocks beat every other asset class over time.

Expect cycles; Expect geopolitical events; Take advantage of favorable pricing opportunities; Do not allow market noise to derail your prudent pursuit of your financial goals.

Best Regards,

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