



Letters to the Editor

January 19, 2010

Our policy on anonymous letters: We will not publish anonymously submitted letters. We will respect the wishes of writers who identify themselves and ask to remain anonymous.

The following letters are in response to our article two weeks ago, [Paul Krugman on Deficits, Taxes, Inflation, and Recovery](#), and to this [letter to the Editor](#) we published last week.

Dear Editor,

I could not let the above article go by without pointing out the obvious. Krugman says: "There is a pretty good case, at very high incomes, to have something like a tax rate in excess of 50%. We had a 70% tax rate for a good part of the 1960s and 1970s at the top end and survived with that."

What he has obviously left out of the history lesson here is that almost every expense back then was tax deductible, including interest on consumer debt. While marginal rates were relatively high, the vast number of available deductions brought effective rates well below 50%. As we all know, generous tax deductions, like balanced budgets, are a thing of the past, which means a 50% + tax rate is just that. Is this a rewrite of history, or just selective memory syndrome?

Robert Butera, CFP
Clarion Advisors, Inc.
Auburn, CA

Dear Editor,

Dr. Krugman may have received a Ph.D. in Economics, but he is a political pundit. The committee awarding the "Nobel" in Economics made a political statement in selecting Dr. Krugman to receive the award in 2008. In my view, he has done very little to advance the understanding or science of economics, but has instead chosen to use his education to launch a career as a journalist and as an apologist for socialism. He already has a forum in his *New York Times* column and uses it as a bully pulpit for his left-of-center political views.



It lowers my opinion of your publication when you include intellectual drivel from the likes of Krugman and Roubini in your newsletter, as they are not great practical economic thinkers in the vein of Peter Bernstein or Charlie Ellis or David Rosenberg, and their opinions do nothing to help me understand how to make money for my clients or understand the economics of our times.

Anonymous

Dear Editor,

Just to let you know, the numerous people who tend to agree with Paul (like me) did not need to write in, so perhaps your sample was not statistically representative.

I would add that the point made in the one you did publish – that “privatizing social security” has several flaws. First, if it were done like 401(k)s it would be terrible for retirement security as (1) studies show that participants consistently underperform the indexes; (2) we know from behavioral finance that the general public often makes the wrong timing decisions; and (3) the funds might be needed just when the market turned down – like just happened, twice. And this is even if we were to have effective safeguards – which is by no means a given, especially noting the recent subprime debacle.

I would really like to see this industry stand up and take a balanced, reasonable approach and not have these vituperative, knee-jerk reactions. “Socialism” is clearly NOT the answer and tossing that word around carelessly is not productive. I don’t believe that publishing that view as representative of our industry is accurate.

Anonymous



The following is in response to our article last week, [The Financial Crisis Post-Mortem: Suicide, Accident or Murder?](#)

Dear Editor,

This article makes several very valid points. However, two factors could have changed the huge increase in credit default swaps (CDS). First, AIG and others were allowed to call them contracts. CDS should have been called insurance, which is what they were, and should have been regulated at least by state insurance commissions. Then, firms like AIG would have been required to hold reserves against future claims. Those firms also would not have been able to flow 98% of payments received to the bottom line to increase earnings and thus bonuses. Why didn't the regulators stop this abuse by preventing AIG and others simply changing the name of what they were really doing?

The second item is tied to the bonuses paid by not keeping adequate reserves against potential future losses. That allowed bonuses to be paid immediately instead of paying them out over five to 10 years. This would have made CDS much less inviting and open to abuse. Of course, as Levine points out, if we had people in the Fed (are you listening Timothy? Alan and Ben?) and in the regulatory agencies that cared about what they are supposed to be doing instead of their next political appointment or favor, this crisis could have also been prevented. Americans' greed certainly played a role too.

Goldman Sachs got a pass and 100% of the counterparty payment from the American taxpayers through AIG. Could this be due to who was then Treasury secretary (hello, Hank?) and a former CEO of Goldman? Paulson didn't want to see his retirement money get decimated if Goldman failed. The continuous stream of Goldman people to the government and then government employees and members of Congress to Goldman jobs or representing Goldman as lobbyists assures a cozy relationship in determining outcomes in Goldman's favor.

James F. Watkins, Jr. CFP®
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The following is in response to last week's article, [The True Cost of Insuring the Uninsured](#):

Dear Editor,

I appreciate your point of view. And, as you point out, universal healthcare is a laudable goal. As you ask, at what price?

Well, is \$6,933.33 per person too much? (\$312 billion divided by 45 million uninsured) Oh, right, that's for 10 years, so it averages out to \$693.33 per year per uninsured person. Is that too much? I think not.

I know that in aggregate, these numbers are huge, and that it is these huge numbers that are scaring people like you and me. However, there are scarier stories.

Take a look at *Business Week's* cover story this week: permanent temps make up 26% of our workforce now, and that number will continue to grow at a high rate for years to come, for obvious (and stated) reasons. Of course, temps do not receive group medical insurance, and most cannot afford to buy their own. Think about the long-term implications of this trend and lay it against a totally private healthcare insurance scheme. Does that sound like we will continue to be a world-class financial powerhouse? Maybe, but at best with a huge under-class, a miniscule middle-class, and an incredibly wealthy upper class. That is a very scary scenario, and one that has rarely gone well for long for any of the parties involved. "Let them eat cake" indeed!

Certainly, the costs of acting now for universal healthcare are far less than the future costs of doing nothing.

Sincerely,

Thomas H. Zimmerman, CFP®
Zimmerman Wealth Management, LLC
Evanston, IL



The following is in response to Geoff Considine's article two weeks ago, [Risk Management through Costless Collars](#):

Dear Editor,

"Hedging and zero-cost cylinders"

In the early 1980's our company had a continuous stream of dollar income with about 75% sterling expenditure. We were concerned that with a historically strong dollar the risk was for it to weaken and risk our profitability. An examination of the oscillations between a rate of 1% and 2% over the last thirty years shows that there are always risks.

The Board did not like options that cost money, so a leading bank proposed a call and put option with zero net cost to protect the downside and give a little away of the upside. This was called a zero-cost cylinder. There were concerns about the mechanisms and risks and it was not easy to understand that the bank mostly did not take a long or short position and was matching equal and opposite counterparties. It was also not easy to see that the bank was making enough money on very thin commissions, but of course the secret was it was over huge sums of money every day for the bank.

In the end the Board preferred a simpler approach, which was to sell forward a percentage of the sales proceeds. Whilst this did not have all the advantages of the zero-cost cylinder, it meant that the monitoring and management of the options was not required, which would have relied upon good and regular communication between the company and the bank.

Rather like today, when long positions are easier to do for most people than taking a short position. Uncertainty about the real risks of these products meant the simplest approach was often taken. Better that than make a mistake.

When this company was taken over the new much larger international company matched these dollars with their existing liabilities. Later a new UK dollar revenue stream was an exposure in a situation where the possibility of a weakening dollar was an increasing possibility and which could have turned the project's return negative. A plan was eventually accepted to cover, but strangely delegated to the business unit. This unit obtained quotes for cover and thought cover had been made and passed that on to the Board. A month later it was clear there was some confusion and checking the system showed no cover had been contracted. Meanwhile the dollar had weakened and a profitable project was now just in a loss position. Not drastic for the larger company but not good for the UK unit.



Procedures were changed to ensure all hedging was centralized in the treasury and protection for future revenues could be made regularly.

Whilst today these hedging instruments are more widely traded and Boards and Treasury departments are more aware of the risks, many people find the concepts difficult and hence difficult to manage the risks. A portfolio of such positions needs some professional management within and outside the company, but also an expert or two preferably at Board level who understand the risks and can communicate those to other Board members.

It seems that with some of our banks recently, these risks may not have been understood by all Board members. It may even have been true that the multiple positions and multi-layered positions had become more complicated than the management reporting systems were designed for, so that the really risky positions were all mixed up or franked against less risky opposite positions. Most of the Directors of these banks would be receiving good remuneration packages, which would not in the main have been linked to the risks of these positions. Those Directors who did not understand the risks would perhaps have slept well. Those who knew the risks might have had some bad dreams. Presumably as things unfolded some dreams did not come true for all Directors.

Anonymous

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