



the Observer

Navigating Today's Storms & Currents

Are you feeling isolated, powerless and confused? If so, you have lots of company.

The current economic malaise reminds me of a stressful event experienced by my daughter 20 years ago. She had just started kindergarten. I picked her up from the babysitter one day and while driving home, the car radio reported a powerful F5 tornado had hit Plainfield, Illinois. Some 29 people ultimately died. Arriving home, I immediately switched on the kitchen TV for updates and, with my back to the TV, began warming up leftovers for dinner. Only a short time elapsed before I turned around to glimpse a completely flattened home in a Plainfield subdivision.

Suddenly I noticed my daughter staring at the TV images with a look of total fear and fright. She was shaking and very

upset. I raced to turn the TV off. She looked nervously out the window and then back at me, and asked when the tornado would reach our neighborhood to flatten our house. I felt miserable that I had inadvertently exposed her to something she could not yet comprehend.

For many years after this incident my daughter continued to react fearfully any time the news reported the possibility of tornadoes in our area. Fortunately, as an adult, she has learned to overcome this tendency toward an initial, frantic response. This family episode taught me a valuable lesson about the wide-reaching power of messages and the media. How many of us have reacted similarly to the recent, unprecedented series of negative financial surprises that have violated our trust in the stewardship of our economy?

In the fall of 2008, negative economic and market news triggered “flight or fight” instincts in all of us almost on a daily basis. Prior to September, we typically confronted one or maybe two big, negative financial stories annually. But during September and October, more than a dozen events worsened an already stressed situation. In retrospect, we have experienced an anxiety-ridden, category-five hurricane in the financial markets. Our underlying economy, however, is still functioning. What we see on the surface may appear fearful and frightful, but the strong underlying currents have not changed, meaning this storm, too, shall pass.

So how does one cope with today’s uncertainty? What skills are needed? Where does one start in breaking out of a “flight or fight” reactionary condition?

The worst sorrows in life are not in its losses and misfortunes, but its fears.

— A.C. BENSON

So, why was my daughter so terrified by a TV image, and why did it take my wife and me so long to help her see the Plainfield tornado for what it truly was? — an unfortunate, devastating, isolated event. Her over-reaction (and that of many investors over the past months) is indicative of the classic “flight or fight” emotional response.

First, it is essential to remember that there is productive worrying, and then there is useless worrying. Fretting about short-term shifts in the stock market and a chaotic economy is unproductive — one can’t do anything about them. — Far better to acknowledge this trying time for what it is, and remind ourselves of the historical real-



ity that markets go up and down sometimes drastically – Far better to manage chronic stress with physical exercise, fun and relaxation, balanced meals and by seeking out positive and supportive friends and family. – Far better to limit one’s exposure to media coverage, seeking balanced information but avoiding media saturation.

How can one possibly stay sane in such a topsy-turvy world, seemingly destined for never-ending economic turmoil? Try limiting TV news viewing and avoid checking on the stock market online. Remember, people who habitually worry tend to overvalue negative information. This is called “confirmation bias.”

In the past two decades, we have witnessed a disturbing trend in news gathering. The accuracy of what we call “news” is increasingly suspect. It has become less about the facts and more about opinion. The “buzz” is more important than credibility. Gone are the days of robust newspapers and national TV network news anchors such as Cronkite, Huntley and Brinkley – all trustworthy champions of detailed, credible, dispassionate, factual reporting. Now we receive our news from a cafeteria of sources such as network/cable news, newspapers, e-mail, blogs, newsletters, chat rooms, YouTube, Facebook and MySpace. Tom Brokaw, in a recent interview, acknowledged



“Those are the headlines, and we’ll be back in a moment to blow them out of proportion.”

that today’s strident, partisan news media coverage has polarized Americans into choosing sides. Does one watch “The O’Reilly Factor” with its claims of “fair and balanced” and where “the spin stops here”? Or does one read *The New York Times* that still trumpets its 1897 masthead logo of “all the news that’s fit to print”?

We want our information to be objective, truthful and accurate. The simple fact is, journalism is practiced by human beings, who have different life stories; different attitudes, opinions and beliefs; and work for different organizations. Today, partisanship is spilling over into all areas of reporting – from the selection of stories, headlines and visual images, to the amount of time given, voice inflections and facial expressions, all blurring the limits between “news” and “opinion.” More and more, we sense a purposeful “management” of the news. Viewers and readers are being subtly manipulated, by which others seek to control attitudes and actions.

For me personally, it is becoming increasingly difficult to identify and extract clean information from this clutter. Anyone

with a computer keyboard and access to the Internet can claim instant expertise on any subject. So we must now do our homework, independent of the traditional news media, to find the real facts. Recently I tried a simple experiment on Google. I typed

in the words “global warming facts for kids” and in 0.18 seconds, came up with 9,890,000 hits. Now I literally could spend the next year of my life reading through and verifying (or rejecting) the facts from these myriad of sources. Too much information. Too many sources. Too much opinion. Too many competing agendas. All too confusing.

Critical thinking skills can only be deployed when we are thinking rationally, not emotionally. Most of the current visual media that bombards us daily aims to provoke some form of emotional response. Just one example: Viewing the heart-wrenching scene of a forlorn young couple and their children standing in front of their foreclosed home. Both parents have lost their jobs and they have run through their entire savings. They tell the TV reporter that one-half of the homes in their neighborhood have “For Sale” signs in front of them. These parents were successful professionals, suddenly let go due to corporate downsizings. Watching the TV screen, we begin to visualize losing our jobs, depleting our savings, losing our homes,

facing devastating family decisions. We feel their pain and begin to question our personal financial security.

But back to rational, critical thinking: Do we really have all the facts of this story? Is this young family's tragedy the norm or the exception? What is the unemployment rate in their community and nationally? How many homes are on the market in their town and across the country? The key question that should – but frequently never does – get asked each time a new emotional “fact” is asserted: ***"Compared to what?"***

Ultimately, precise facts reported clearly and completely stimulate critical thinking. Being clear makes us courageous and empowers sound decision-making. Being clear enables us to identify problems, be proactive, and seek favorable solutions.

In the past three months we have sent out two Special Reports with the goal of providing you information on the “currents” that appear to be driving the economy. In the spirit of this Quarter's Observer topic, we thought it would be helpful to offer what we hope you find to be an objective assessment of a few of the perceptions and realities being debated on our Nation's airwaves. We are not trying to say there is nothing out there to be concerned about, but rather our current situation and prospects going forward might not be as bad as they seem. (Please refer to the inserts for more detailed background information).

The United States economy has not been healthy.

Perception – The economy has been in bad shape for several years due to poor economic policies and the failure of the Bush administration to focus on problems here at home.

Fact–America's Gross Domestic Product (GDP) growth over the period from 2003 to 2007 ranks 4th on the list of developed nations. (Chart 1)

China's economic growth will catch and overshadow the United States.

Perception – China is a country experiencing unprecedented, rapid growth. The Chinese are sucking up global resources and creating major modern cities in a fraction of the time that the United States took to create its economic infrastructure.

Fact – The growth of the U.S. economy since the beginning of the Bush administration (2001-2007) is equal to the entire economy of China. Said differently, the amount of GDP added to our economy during the six years between 2001-2007 equals the entire GDP of China in 2007. (Chart 2)

More spending and tax cuts for the rich have caused a disastrous budget deficit.

Perception - Bush's tax cuts and military spending have resulted in massive budget deficits. This will lead to a faltering economy and eventual economic ruin.

Fact – The average budget deficit from 2001 to 2007 was 1.8%

of GDP. This is below the average of the 1970s (2.1%), 1980s (3.0%) and 1990s (2.2%). Before treating the perception as reality ask yourself the question: ***"Compared to what?"*** (Chart 3)

Defense spending has exploded because of the war in Iraq and Afghanistan.

Perception – The dual wars in the Middle East have cost the United States a tremendous amount of money, causing our economy to slow, which is contributing to the overall problems in the economy we see today.

Fact – Defense spending averaged 3.8% of GDP from 2002 through 2007. This is below the averages of the 1940s, 1950s, 1960s, 1970s, 1980s and 1990s. There are approximately 2.8 million men and women in the U.S. military today. On average, approximately 150,000 to 200,000 soldiers have served in Iraq and Afghanistan continually over the past six years. That represents about 6% of all uniformed personnel. If these soldiers were not in the Middle East, they would still be in the military serving somewhere else. The cost of having military personnel in the Middle East is not zero, but it also is not catastrophic war spending. (Chart 4)

The Federal Debt is cause for alarm.

Perception – The budget deficit and government spending are completely out of control. There has been a steadily increasing

deficit that will ultimately result in economic failure.

Fact – The U.S. total federal debt is \$9 trillion. This is the largest debt of any nation. Approximately, 10% of U.S. government spending, or 1.7% of GDP, goes towards paying interest to service this debt. The total debt and total interest payments, as a percentage of GDP, are lower than in 1994. (Chart 5)

Overall, government and consumer debt is crippling the United States economy.

Perception – Consumer debt continues to increase year after year, along with government debt. Eventually, the combined debt of consumers and the government debt will destroy the U.S. economy.

Fact – One of the indicators of financial health of a family, a corporation or a country is its balance sheet. Simply put, what

are the assets and what are the liabilities? As the attached chart indicates, US Households own approximately \$70 trillion in assets (6/30/08) and owe \$15 trillion in debts. It would be nice to have no debt; however, in a capital society the proper use of debt generally creates more wealth. One of the reasons Mexico and most of Central America remain Third World countries is because the majority of their citizens have no access to credit. Without the ability to borrow, families, business people and countries as a whole have a steep wall to climb when trying to increase economic output, create wealth and increase standards of living. (Chart 6)

We are in a financial war right now. Henry Paulson and Ben Bernanke have pulled out all the stops. President-elect Obama's economic team stands ready to take the wheel. We are doing battle with a financial hurricane not seen in these parts for many

years. We will look back a few years from now and heap both praise and criticism for decisions made and steps taken by both the President and Congress. What is important to grasp are the economic "currents" that ultimately drive long-term financial "weather patterns". Of course, we feel unease about being tested, as we have many times in the past. Many years ago someone quipped to me, "What the people don't understand, doesn't exist." Lack of understanding only compounds problems. Sticking one's head in the sand – tempting as that may seem -- only makes matters worse. Our duty and task is to dig out the real facts, attempt to understand them thoroughly, then strive to make informed decisions and capitalize on the opportunities ahead. But the next time you feel yourself being pulled toward the financial cliff of doom – stop and check the facts. If they don't add up, then the conclusion isn't warranted.



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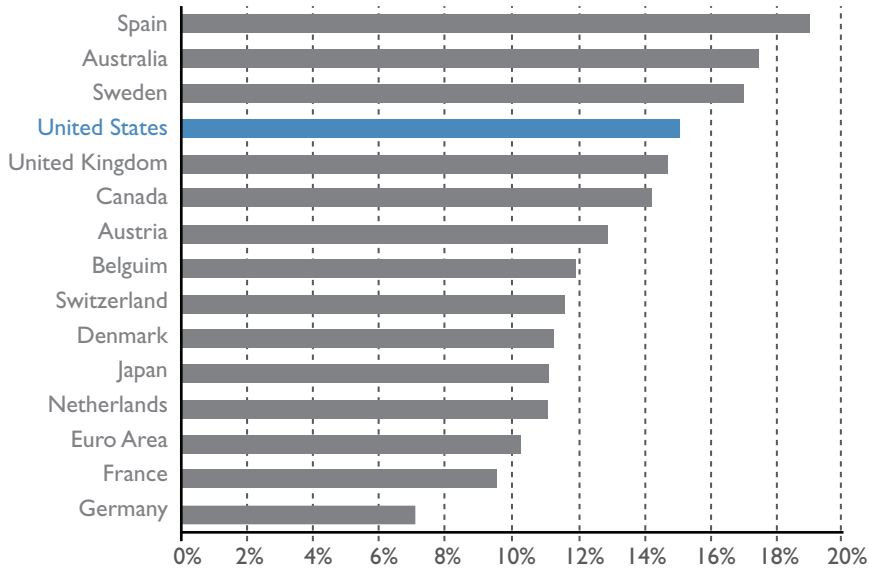
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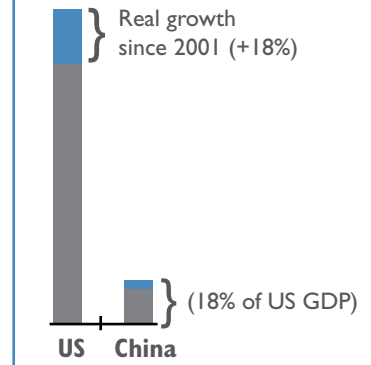
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Chart 1: 2003 - 2007 Real GDP Growth



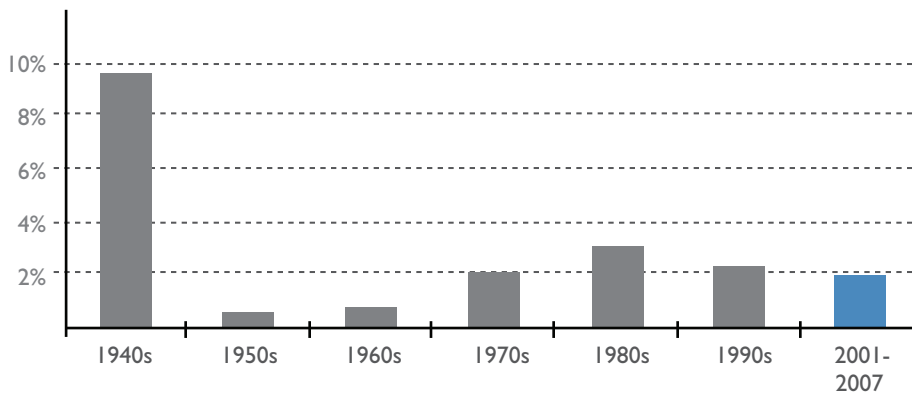
Source: Real GDP

Chart 2: GDP



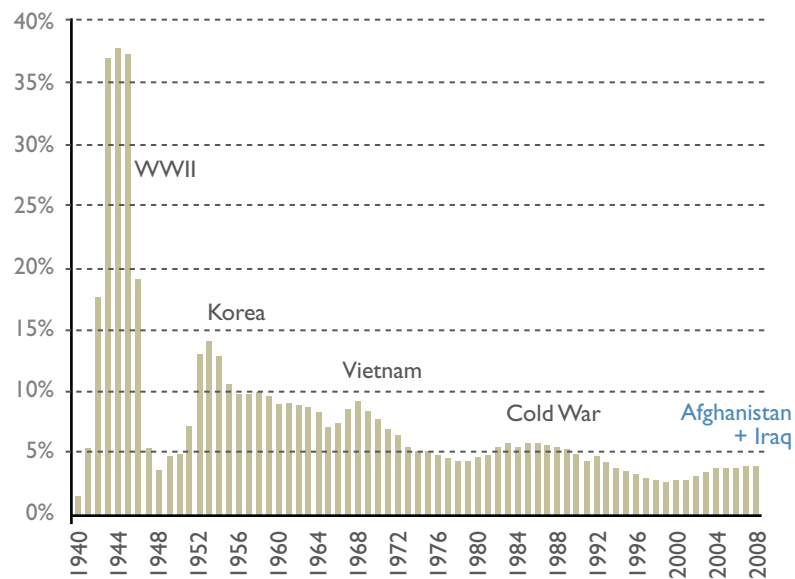
Source: *The Economist's World in Figures - 2008*

Chart 3: Federal Deficit - % of GDP



Source: <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=96679,00.html>

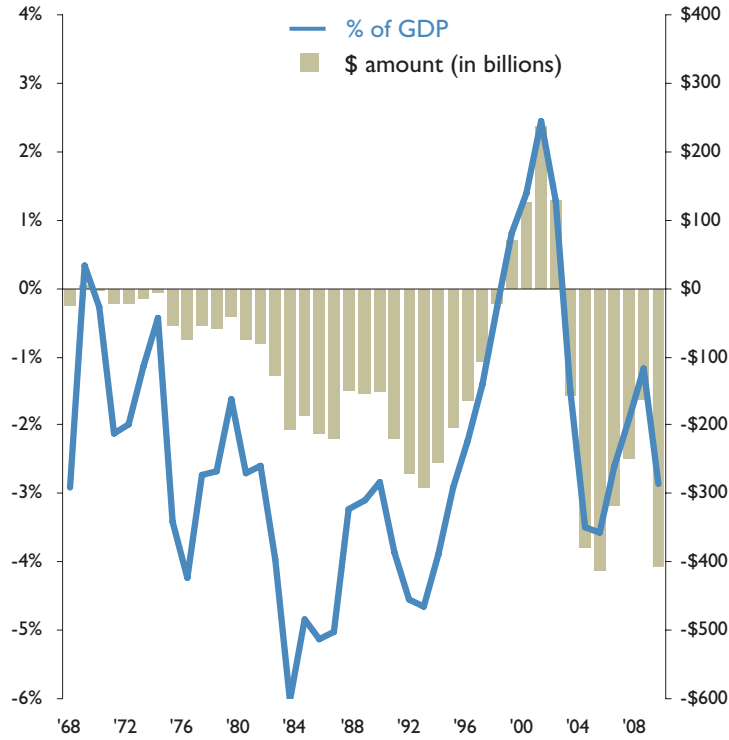
Chart 4: Defense Spending % of GDP



Source: <http://www.whitehouse.gov/omb/budget/fy2008/sheets/histo3z1.xls>

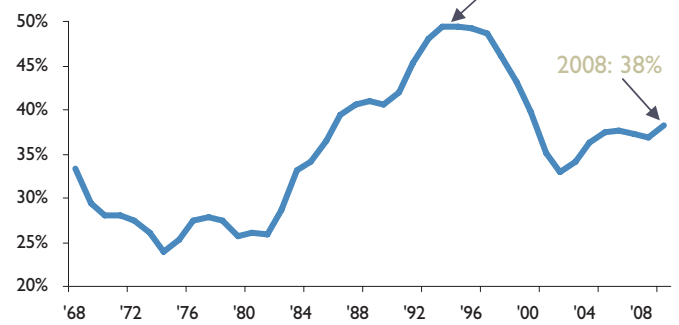
Chart 5: Federal Debt

Federal Budget Surplus/Deficit 1968 - 2008



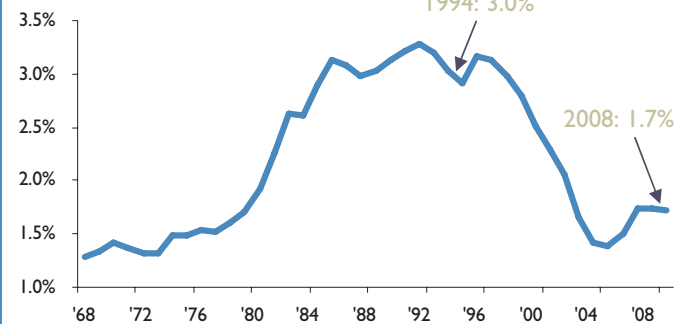
Federal Debt (Accumulated Deficits)

% of GDP, 1968 - 2008



Interest Payments on Federal Debt

% of GDP, 1968 - 2008

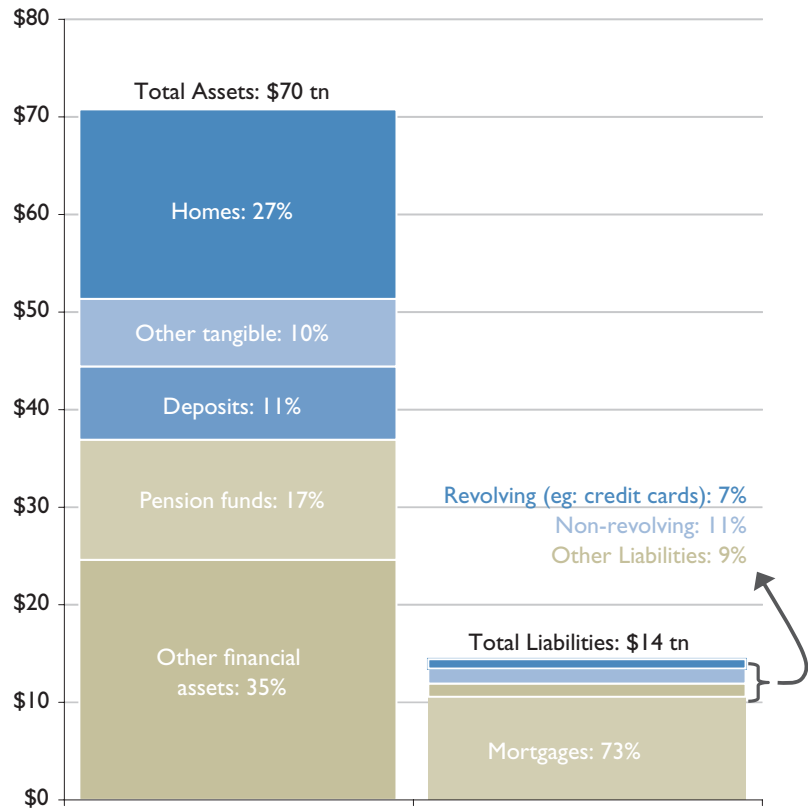


Source: Congressional Budget Office, St. Louis Fed, Bureau of Economic Analysis, JPMorgan Asset Management. Data reflects most recently available as of 9/30/08.

Note: Years shown are fiscal years (Oct. 1 through Sep. 30). All 2008 figures are estimates. Top right chart displays federal debt in the hands of the public.

Chart 6: US Consumer Balance Sheet

Trillions of dollars outstanding, not seasonally adjusted



Source: JPMorgan Asset Management, Federal Reserve.

Data includes households and nonprofit organizations. Data are as of 2Q08.