Whom Can We Trust?

Mary Rowland Personal Finance Column – March 2009

- A 60-year-old neighbor lost all the money her family had set aside for her when Bernard Madoff, the New York money manager, confessed to creating a $50 billion Ponzi scheme. "I'm a crook," Madoff said in explaining why all the money, including hers, is gone. She's left with a couple of thousand dollars in a checking account, a mortgaged house, and no work experience.

- The parents of my daughter's college friend lost 60 percent of her college account when the stock market crashed last October. She doesn't know if she'll be able to complete her last year of college.

- Another friend was part of the half of the workforce that got laid off from a nonprofit organization. The other half saw their salaries cut by 45 percent.

So the financial collapse of 2008 has moved far beyond Wall Street to touch everyone in the country, perhaps everyone in the world.

What now? Could another financial disaster this year top 2008 with its housing bust, bank failures, stock market crash, soaring unemployment and the Ponzi scheme whereby Bernard Madoff, a Manhattan money manager, allegedly took his investors to the cleaners to the tune of $50 billion?

Perhaps. The danger for 2009 is that fear, suspicion, and a sense of hopelessness, anxiety and distrust, cause us to give up, to abandon our goals, to trust no one. That could make this year even worse than 2008. No one was saved in the bloodbath of 2008. No matter what sector of the market you invested in—bonds, large-cap stocks, small-cap stocks, emerging markets, international—your portfolio is likely down 25 to 40 percent. That should relieve you of thinking that your ignorance cost you your savings. This one was inescapable!

The January issue of *Money* magazine carried this cover line: "Get Your Money Back," a "Special Crisis Report." But most of us are not fooled. We don't expect to find the answer to 2008 job loss, investment loss and the loss of home equity in a magazine. Still, we could learn some lessons to help us bring better financial management to our lives going forward.

Whom can we trust? The answer has two parts. First: How can we tell whether a particular person is trustworthy? Second: how can we trust any financial products in the 21st century?

First the individual. You must see and understand where your money is going. You need statements. Never give your money to someone who says: "Trust me. You don't need to know the details." That's exactly what Bernard Madoff told his investors. When the stock market crashed last October, my friend, whose family had invested with Madoff for years, said: "I don't know how he manages to keep providing these amazing returns. It's magic."

Now she knows that he was able to keep providing the returns because he desperately recruited new investors so he could send their money to earlier investors, like her. Securities examiners say now that Madoff may not have invested or traded any of the money but just collected it and distributed it.

One professional said he turned away from Madoff's offer after Madoff told him that he was going to give a larger return to new investors signing on than to earlier investors. It's illegal to treat new investors better than long-time clients. And how could you trust someone who tells you he's giving you better treatment than his loyal customers? That reminds me of going to a junk store where the owner pretends that he's set a special price just for me because he really, really likes me. I wish I could say I've never fallen for that line.

But can we ever trust the markets again? Will we turn out to be like Americans who lived through the Depression? They learned: Never use credit. Never trust banks. Never quit your job.

I hope we will take some precautions: Don't keep near-term money in the market. That means money that you'll need to use the next couple of years. I wish I had followed that advice. My son is a freshman in college. I had his tuition money in the stock market.

I also failed to keep a stable asset value investment in my portfolio such as bank certificates of deposit or Treasury bonds. One investment I plan to consider now is Treasury Inflation-Protected Securities or TIPS bonds. These bonds are free of state and local taxes, provide a government guarantee and also offer a hedge against inflation.

TIPS can help diversity a portfolio because they have a low correlation with other asset classes. Interest rates are set when they are sold, but the principal rises and falls with changes in the Consumer Price Index (CPI). At maturity, you will get at least the par value of the bond.

This is not a magic investment, of course. Nothing is. TIPS can be purchased in a mutual fund or an exchange-traded fund (ETF). We've been told for so long to avoid low-return assets like bank CDs and Treasury bonds. But the recent financial collapse revealed that many of us have less risk tolerance than we thought we had.

Certainly it pays to be cautious. But what we also need to do now is to call upon the traits Americans are known for: inventiveness, ingenuity, hard work, creativity, and, yes, even risk taking. A loss of trust, a loss of confidence in everything will take us all farther down.

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