SCHAEFER FINANCIAL MANAGEMENT LIMITED
CHARTERED FINANCIAL PLANNERS

1. Special Update – 9 December 2011

The primary objectives of the Wealth Management Service are:

1. to protect the capital you have built up, and
2. to provide long-term growth ahead of the rate of inflation.

When there is a conflict we sacrifice growth in favour of protection.

"Never was so much owed by so many to so few"

Winston Churchill on August 20, 1940.

This great statement if often quoted around 11 November and Remembrance Sunday. Sadly, it is also true in the financial World, which is why we are faced with such serious problems.

The volatility in financial markets at the moment is unlike anything I have seen in 28 years of involvement in investments, but my study of past economic collapses shows extreme volatility is certainly not new and has been experienced several times before in history. Our technology increases the volatile movements in markets, and the media thrust this in our faces causing more panic. However, the large trend changes are happening no faster than in previous collapses like the 1930s and 1970s.

Some of the biggest political and economic changes since the ending or World Wars I and II are now in prospect, or so we are led to believe.

The Wealth Management Service primary objectives, set out above, have never been so important.

In what is a special Update, my aim is to reassure you about your capital and the future.

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2. 2007 and Beyond

If we have been managing your funds since 2007 then you will be well aware that I have been saying from the outset of this crisis that there would be a second major downleg. I have also talked of potential losses for the FTSE100, and other World share indices, of more than 75%, possibly even 90%.

Having spoken to some clients in the last couple of weeks, it is clear than our clients are in the same boat as everyone else - WORRIED!

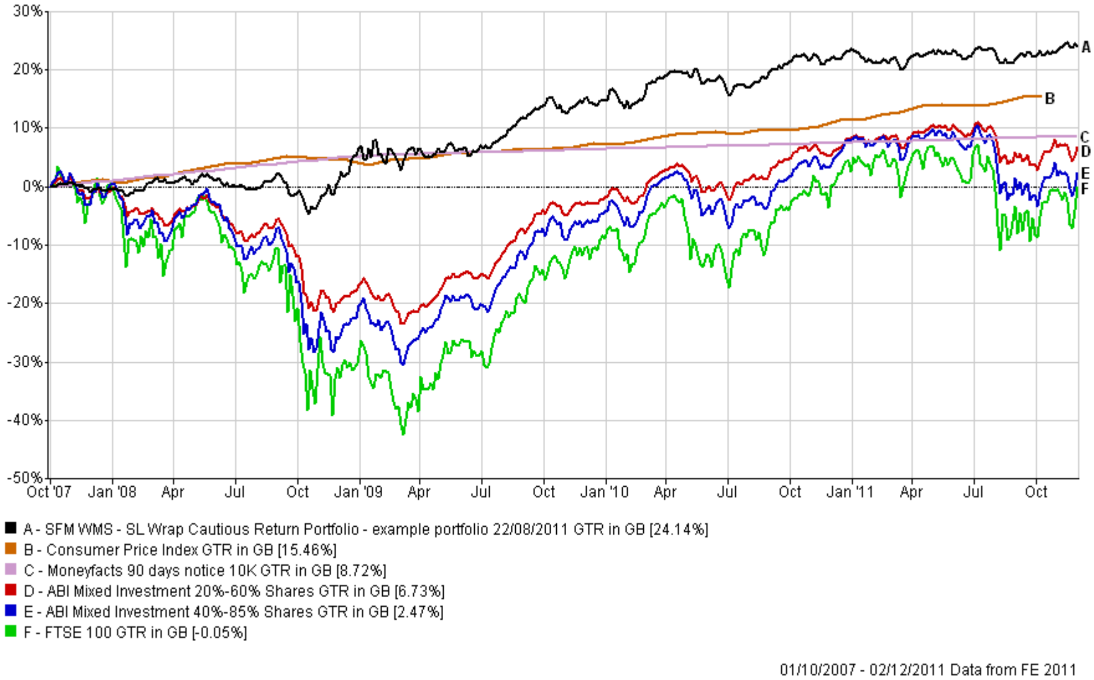
The aim of this Update is to take a broader look at the crisis, the timescales, and the potential for losses and gains.

When this crisis began in 2007, my historical studies meant that I quickly realised just how serious it would be.

My aim in 2007 was to get to the end of the crisis, however many years that might be, and that our clients would have at least the same amount of capital as they did in 2007. The goal wasn't growth; the challenge was to get to the end with the capital still intact. History shows that this will be a major achievement.

To date we have not only preserved your capital but have exceeded our target having produce growth of around 20% since 2007. So far so good!

I keep repeating this chart in Updates and Reviews but it is really important as the key to profits is not to make losses.



3. Where are we now

The current situation is as polarised as anything I have seen. I have major market commentators convinced markets are about to rocket with massive gains on the back of monstrous money printing. Other commentators are insisting we prepare for financial meltdown.

Gone are the days of steady 7% growth in a year – we have had a staggering 12 moves of 7% or more in the last 5 months alone. As fast as markets collapse, they rebound, only to collapse again and then rebound.

The share markets are slightly down on where they were at the beginning of the year, but they have certainly travelled a long way in going nowhere! The zigzag chart above demonstrates this.

> The markets are trying to cleanse the system and write debt off so that we can start to recover, but the politicians fear losing their jobs because of the impact on people's finances, and are trying to prevent the markets from doing this. The chart above shows this monumental battle between the politicians and the markets. History tells us that the markets will win – eventually.

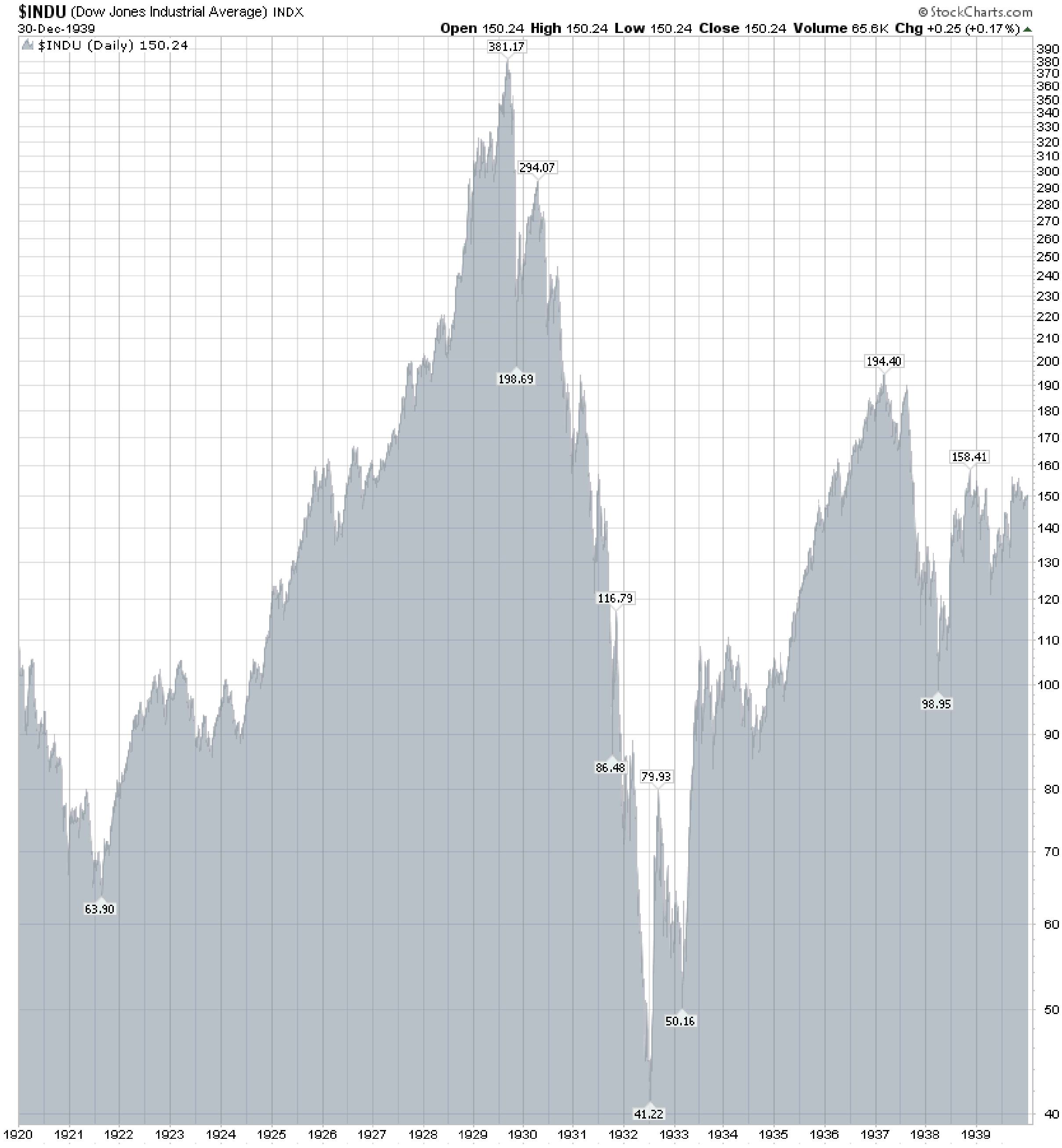
4. Is There A Future?

Most definitely yes, and a very bright one too!

Remember my target – ‘get to the end with the capital intact’.

If we can do this, and markets have fallen as I expect them to, then the first few years of recovery will produce stunning returns. I have included below a chart of the 1929 Wall Street Crash. Note the steepness of the falls, money printing is currently preventing a repeat of this steep collapse in the current crisis but collapse may be unavoidable if we are to truly cure our debt problems.

Look at the recovery. By 1937, less than 5 years from the low point, the market had risen 36% pa compound. It virtually doubled in the 12 months after the low – that is 94% growth.



5. What Do We Have To Do?

After presenting my current views on the long-term position to one client they said “what you are saying Phil is that we need to trust you to get us through this”.

My answer to this is “YES”.

Given my study of past economic collapses I believe I have the knowledge to get the major decisions right. I’ll accept that my extreme caution has meant we have not delivered all the gains we could have and I do need to work on this. But if you look at our performance you see a pretty straight line with a few kinks in it. You certainly do not see a graph with massive zigzag sweeps up and down.

6. Possible Future Scenario

Set out below is a brief summary of the situation from 2007 and what I think could happen over the next 2-3 years.

2007-2010	We made good growth with relatively little investment risk and stayed well ahead of the markets.
2011	Small losses this year of around 1-3% with the markets down around 8%. The range markets have traded within, and the speed of the moves up and down, meant it was too risky to try and trade the moves.
2012-2013	Unless the politicians come up with something brilliant – unlikely given the individuals involved - I suspect that the general direction for assets will be down. If the falls are big enough then we can make good gains. If markets move largely sideways then it will be extremely hard to make gains.
2014 onwards	This is the time I expect the real recovery in the economy and the markets to begin. Get this right and the prospects are mouth watering.

We have made around 20% growth from 2007 to the end of 2011. Even if we lost say 2% pa for the next two years (I still expect to make gains by the way) and then made 50% in the year of recovery then the compound annual growth from 2007 would average 8.0% pa.

I wouldn’t be surprised to find markets in 2014 still more than 25% below their 2007 levels, needing future growth of 33% just to get back to where they were.

In the above scenario Schaefer's clients would have around 130% more capital than if they had been invested in the markets through managed funds.

Clearly, we can guarantee nothing. In the next week the whole problem might be solved, in which case we react to that situation.

7. Current Position

We are currently poised on a dividing line between two highly polarised outcomes:

1. Massive money printing aimed at hiding the debt problems for a few more months – this will drive share markets strongly upwards.

2. A failure to solve the Eurozone crisis will lead to a slump in equities and possibly strong rises for UK and US fixed interest investments.

We can try and guess the outcome and back one particular scenario but we simply have no way of knowing which way it will go. Get caught on the wrong side of the fence and the performance damage could be significant.

The situation is likely to be resolved in the next few weeks.

I held off sending out this Update until the end of the Europe Leader's Conference this week. Nothing worthwhile, in fact nothing at all emerged.

David Cameron effectively vetoed any new Treaty but the papers and commentators are simply ignoring the implications of this.

I include a truly excellent quote: *"UK, as isolated as somebody who refused to join the Titanic just before it sailed"*, says Terry Smith of Tullett Prebon.

The markets were supposed to be shooting upwards right now, buoyed by an historic European accord and massive amounts of newly printed money. None of this happened so the market is currently heading upwards, I suspect because the computers were all programmed to buy, and nobody has an alternative plan yet.

With no solution to Italy and Spain's financial problems, the next few weeks could be really rough. They may be able to fudge some kind of half-hearted rally up to Christmas using US Fed money, but the New Year show expose the insolvent southern Euro nations. This could leave markets highly exposed.

The current portfolio, selected in August 2011, has steered us well through the violent gyrations of the last few months. However, it is quite loaded in favour of equities falling and fixed interest rising.

The next change to our portfolios is going to involve boosting the equity holdings and cutting back on the fixed interest holdings. We are currently working on this and will forward an Investment Update shortly.

8. Conclusion

If history teaches us one thing it is that we do not learn from history.

I’ve made a special point of trying to learn from previous collapses. I fervently believe that knowledge is the key to getting through this crisis intact, however long it takes!