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What Is Your Family's Most Valuable Asset?

If you said your house or your car or your investments, you'd be wrong. Your family's most valuable asset is its members. It is your spouse, your children, your parents, your brothers and sisters, etc. who embody the spirit, passion and vitality that create the sense of family. It is a close knit group of people who share life experiences together and turn these lessons into a network of woven lives that get handed from generation to generation.

In determining a family's resources, we believe that there are three fundamental types of family wealth. They are financial capital, intellectual capital and human capital. Most families pay very close attention to managing their financial wealth. It is easy to measure progress in this area. You get specific numbers and you can observe incremental changes on a daily basis if you want to. The intellectual and human capital of a family on the other hand is more difficult to track. Its accumulation is not as easy to measure. Progress is more intangible. Yet the family's primary purpose should be to nurture and develop its intellectual and human capital.

For arguments sake, lets consider intellectual capital of a family as what it knows (its raw materials) and its ability to apply what it knows in capitalizing on opportunities. Also, let's consider intellectual capital as the effectiveness a family displays in resolving the threats that life presents. Human capital, as mentioned above, are the family's members who – hopefully – act productively on what it knows (its ability to execute its intentions) in its own best interest. The financial capital of a family provides the wherewithal to grow the other two.

As readers of my newsletters well know, wealth management is the ultimate goal of all that we do at Hoffman, White and Kaelber. Yes, we promote our services; yet, you will find that we always seek to present thought provoking topics that are relevant to our wide audience.

This month's newsletter is from my good friend and colleague, Dr. Dan Elash, who recently joined forces with us. Dan rounds out our wealth management business by focusing on issues that include coaching clients through lifestyle transitions, such as retirement, business succession or family continuity and governance matters. In this newsletter, he explores the concept of human capital and brings into sharp relief the benefits of caring for as well as the detriments of paying too little attention to this crucial element of a family's wealth.

Lastly, we will finish with a review of the economic and investing climate for the month past, the current market outlook and our investment performance.

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Human Capital

Let's look at human capital on an individual level. It is the yeast that causes the dough to rise. Take a moment to think about the personal traits and characteristics of highly successful people. The average person may assume that a child's character resides totally within his or her DNA, given (or not given) at birth and developing naturally as the child's life unfolds. This school of thought naively assumes that the essentials for success are either present or absent and we (as parents) can only watch, with bated breath, our children grow to see what personality emerges. More aware people understand that character can be nurtured and developed throughout a person's life. Wise parents can form positive associations with their children that help them develop their innate abilities to their full potential; to learn to learn from their experiences; and to help them to compensate for their weaknesses. Developing human capital requires close attention, on-going dialogue and a sense of trust by the child in the care of the parents.

It is generally accepted thinking that a child with a well-developed character will be better equipped to succeed in life. This doesn't guaranty a life that is problem free. Life does not work that way. What it does mean is that every challenge turns into a learning opportunity for a child to develop his or her abilities to understand, address and resolve those challenges successfully. Children afforded such experience will develop the personal resources to persevere through adversity. They learn to make constructive decisions. They have the interpersonal skills to develop rich and fulfilling relationships throughout their lifetimes. They have a sense of purpose and an ability to focus in a way that guides their choices and leads to a rich sense of competency and confidence. It is easy to see how a family that successfully develops the human capital in its members is richer than one that doesn't.

Ignorance Is No Excuse

Families that don't tend to their human capital either don't realize that they can affect its development or they just don't know how. We all want our children to succeed. We simply differ on our beliefs about how we can make that happen. There are some recurring themes in the thinking of families who don't place a high priority on tending their human capital.

We want to indulge our children: When you have the financial resources to indulge our loved ones, we are often sorely tempted to do so. We give them a sense of entitlement. We skew their sense of perspective and proportion. We do not allow them to practice developing the muscles that striving for what we want produces. We take from them the sense of competence that comes from overcoming obstacles and from using our internal resources to make things happen. Especially in childhood, it is the little struggles that stimulate these capabilities and lay the groundwork for the deeper skills required to handle more difficult, adult challenges.

We keep our children safe from the blows of life: I am continuously amazed at how many parents work so diligently to keep their children innocent, naïve, and ignorant about the real world. We delay their ability to cope by protecting them from the little risks of childhood. Yet, it is in learning how to cope and survive these disappointments that we begin to develop the ability to confidently face adversity. Making them strong is a much better strategy than keeping them ignorant.

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We devote most of our energy to work and expect that children will know that we “are doing this for them,” and that they will feel loved and appreciative in return. This is an erroneous assumption. Children never have the perspective to parse such a complex chain of reasoning. Rather, kids see themselves as the center of the universe, prime movers in their worlds and if they don't get the love and attention they need they will believe that the fault lies deep within themselves.

Failing To Tend Human Capital

What's the goal of a family? To my way of thinking, it is to launch competent, healthy and successful children into the world. Money alone is insufficient to accomplish this task. How many of you have dealt with your children's issues and been puzzled because you have given them so much, so many opportunities and yet they lack the character to handle themselves well? The fact of the matter is that it takes more than opportunity to raise a competent child. It takes directed experiences, life lessons well learned, and a family culture of love and respect. These things cannot be assumed or intuited, they have to be experienced. In order to create the circumstances for healthy development parent's actions have to align with their words. It doesn't matter how competent other people are in caring for your children, kids will always harbor doubts about themselves if their parents don't back their words with the actions, choices and priorities that give their words authenticity. This means that the parents have to be actively involved in nurturing the human capital of the family. Spending an inordinate amount of time tending to the financial wealth of the family won't allow the parents adequate time to do that.

The signs of poorly tended human capital are many but they are usually obvious. Children with low self esteem, feelings of entitlement, lack of appreciation, self-absorption, under achievement, corner-cutting, lying, acting out, disrespect for self and/or others, and the like are common symptoms of children in need. The reality is that these children, regardless of their other advantages, are showing that they are not prepared to face life successfully. They will continue to squander opportunities and dissipate the family's resources because they lack the skills to do otherwise. This is not to say that these kids are totally incompetent. It is simply that they lack the full range of skills to experience the pride and self-fulfillment that all people seek.

So, how do well intentioned parents wind up in such circumstances, you might ask? Good intentions are simply not enough. You must use the work of the family, its tasks, challenges and opportunities as the practice fields for building social competence in all of its members. Children need to be coached and mentored through the trials of life. They need to see their parents learn and cope. And, they need to experience the consequences of their actions in ways that are designed to teach them to manage themselves effectively.

Tending Human Capital

While there isn't room in a newsletter such as these to detail everything that families can do to tend their human capital, we can identify key elements in family life that will point the way for them to address this critical area.

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Spending Time – You can't coach and mentor children successfully if you do not spend time with them. It's not a distraction from more important things; it is the work of the family. You have to know what's happening in your child's life to be available to steer her or his development. Having quiet time to simply be together is more important than simply engaging in structured activities simultaneously. If this is difficult for you to do, if there is awkwardness or if conversation proves difficult, that is a clue that the family has work to do.

Family Purpose – A critical component for a healthy development of children is for them to develop a sense of purpose for their lives. One powerful way to accomplish this is for them to be a part of a family with a well-articulated sense of purpose. Taking the time to develop a family mission statement helps everyone develop the focus, sets the priorities, and embraces the values crucial to healthy personal development.

Fire-Testing Character – Overwhelming stress and challenges that are beyond us are destructive to anyone, particularly children. Yet stress and challenges, in manageable doses, are critical for propelling us to reach our potential. Parents must strike a thoughtful balance between keeping children safe and exposing them to situations that allow them to test themselves in the fire of experience. These experiences temper character and strengthen people for the inevitable challenges that will come later in life.

Experiencing Consequences – Bad choices and poor decisions come with consequences. When parents intervene (whether through love or pride) to protect their children from the natural consequences of their behavior they rob them of the ability to profit from their experiences. This is a difficult thing for parents to avoid, but it is essential to tending human capital. Don't rescue them. Do work with them to ensure that they draw the conclusions and learn the lessons that foster personal growth.

Launching Competent Human Beings

As stated above, this is the primary job of a family. It is as crucial to the long-term preservation of financial wealth as it is vital to the long-term well being of everyone in the family. In order to succeed at this task a family must have the deliberate intention to launch competent children into the world. The family must then deliberately and thoughtfully execute that intention. No one will do it perfectly. Children do not come with instruction manuals. It requires continuing attention for the job is never totally done. This takes time, energy and dedication. If you invest your energy in building your family's human capital you will be laying the foundation for the family's success in generations to come.

Concluding Thoughts

I hope you have enjoyed Dan's authoring of this month's letter. I've invited him to write for us once each quarter and I'm sure he'll continue to provide us an "out-of-the-box" view of wealth management.

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Hoffman, White & Kaelber Financial Services Investment Performance Update

Hurricane Katrina was the costliest storm ever to hit the United States, although thankfully, it appears the death toll will not reach the many thousands once feared. Not only was Katrina the worst storm ever, but its national impact will be much larger because of ripple effects on energy prices.

The impact on energy prices was immediate and dramatic. Oil prices were briefly pushed above \$70 per barrel and gasoline prices passed \$3 per gallon. Nevertheless, many of the economists we follow lead us to believe that energy market conditions will return to the pre-hurricane levels over the next few months and that gasoline prices will continue to ease. By year-end, however, consumers will still be paying 35-40% more than in December 2004, and home heating bills are expected to be 30-40% higher this winter.

Energy costs are now biting into consumer budgets more severely than at any time since the early 1980s. Economists believe that US households (even though our savings rate is projected to be less than zero percent at present) can absorb some of the shock, especially if the spike proves temporary. But it is unrealistic to suppose that consumers – especially lower-income consumers for whom gasoline forms a relatively high share of their budget – will simply carry on spending as if nothing had happened.

For the month ended September 30, 2005, our one-month performance is up 1.41%, our year-to-date return is up 4.20%, and our average annualized return since inception is up 8.71%. While volatility continues to increase its vigor in the equity markets, our risk profile continues further downward to +/- 5.60%. This conservatively low risk level remains consistent with our strategy. With our expectation that this statistic gains increasing importance, our Sharpe Ratio is more than respectable at 1.24.

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