

September 2, 2010

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Northstar Notes

*“Good judgment comes from experience,
and a lot of that comes from bad
judgment.” -Will Rogers*

A Look Back by Henry

In 1980, the Iranian hostage crisis was in full swing, a former B-list actor named Ronald Reagan was running for president, and Linda Ray and Henry Asher received their securities registrations. Though these last two events may not make the history books quite so readily as the first two, they rank highly in terms of their importance to the Northstar Group's existence. That was thirty years ago. That means we are now thirty years more experienced, thirty years more knowledgeable, and (hopefully) thirty years wiser.

Back then, streaming stock quotes could be found only in a broker's office, or in the middle of the world's busiest train terminal, where investors lined up at the Merrill Lynch kiosk to watch the ticker. My memory is that most of these men (and they were all men) looked either guilty or despairing. Such was the effect of a 13-year journey through a stock market desert of epic proportions.

Linda and I have witnessed the progression from that kiosk to countless, constantly updated financial news websites; from the data degenerates of the early 80's to data-overloaded commuters; from a trickle of financial information to the constant barrage and editorializing without end that we endure today.

The underlying purpose of this newsletter is to share a simple insight: With so many facts and figures being thrown at us, it's easy to look at investing as nothing more than a series of finely tuned calculations, when in fact the guiding principles behind a sustainable financial path are about the same as they've always been.

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Near the beginning of our careers, Linda and I spent some time in search of the holy grail of market predictions. We learned soon enough just how foolish that was. In reality, financial stability, the tranquility we and our clients pursue, is determined by habits, both productive and harmful. Anyone who claims to know the secret to investing, or to have figured out a simple, twelve-step process, is either a liar, delusional, or both.

Beating the market is not a goal; financial dignity is. For the most part, intelligent people, affected by some proportion of greed and fear, arrive at securities prices that seem to make sense. Yes, there are those anomalous periods, the “panics” and “bubbles”, where prices spike or drop to unreasonable levels. But even the worst of those times, the panic of 2008 as an example, are often over as quickly as they’ve begun, and a portfolio built with sensible principles and clear-headed thinking should weather the storm and emerge intact.

This brings to mind a favorite thought pattern of Charlie Munger’s: instead of asking how to plan for financial success, what would you do to plan for failure? One part of the plan would be to over-react to the dour news of the day. For example, consider the most recent large-scale panic of 2008 and early 2009: almost all of America’s largest companies experienced sharp declines in their share price. It is true that some companies followed their shares into oblivion and never made it out of the abyss (e.g. Lehman Brothers and a wide assortment of sub-prime mortgage entities). But what strikes us as noteworthy is the huge number of great corporations that have rebounded with impressive economic force.

We are reminded of a memo we wrote back in December 2001, when the market was still reeling from the effects of the September 11 attacks. As it became clear that American society as we know it was not coming to a halt, and the country was beginning to return to normal, we surmised that the same would be true of fundamentally strong companies. People weren’t going to stop shaving, so it was a safe bet that Gillette wasn’t going to go under, people needed gasoline for their cars, so Exxon and other oil companies would continue to exist, and so on and so forth. These companies, fundamentally strong, well-constructed enterprises, remain as building blocks for sensible portfolios.

Too Much Prudence?

A new quandary, and one we have been examining recently, is the risk that too many governments will rush to real fiscal prudence *simultaneously*. Many governments, such as Germany and England, are discovering the new “religion” of fiscal sobriety. Laudable as this process might be, we must at least confront the question of whether these collective actions will put the brakes on global economic growth. Think back to the fall of 2008, when modern financial systems were in a state of near-collapse. A major contributing factor was the

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synchronized shrinking of balance sheets at banks and insurers across the globe. This reduction of credit almost froze the “real” economy in place, and necessitated the introduction of massive government and central bank credit.

At the time, Warren Buffett expressed his view that only the U.S. Government had a balance sheet big enough to offset the reductions that the private sector experienced during the panic. While the ride has been bumpy, absolute calamity was avoided. But now, are we in some sort of replay? Do we currently have a global analogue to the Federal Reserve’s balance sheet, to re-prime the pump of economic growth ?

We believe the answer is simply, yes. With the crisis in Europe abating, and spending patterns in our economy resuming more normal levels, we believe the risk of crippling deflation remains low. Instead, we are prepared for several more years of gradual growth and recovery in our economy. This outlook has clear implications for our portfolio decisions, and we would welcome the opportunity to discuss these with you.

Back to the Investor

Interesting as these musings may be, most of these market patterns are outside of our control. Not so, our personal behavioral choices. That’s why it is so critically important for individual investors and families to spend and save sensibly as current conditions allow. And, finally we hope that’s where we come in.

“If a man had £20 a year for his income and spent £19, nine shillings and sixpence of it - he would be happy but..... if he spent £20 and one (penny), he would be miserable.” -Mr. Micawber in “David Copperfield” by Charles Dickens.

How do we as advisors confront the problem of overspending? What is our role when we sense that the simple arithmetic is becoming our client’s adversary? We don’t position ourselves as advocates for an ascetic approach to retirement. In fact, far from it; we love to know that our

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clients and friends (often the same people) are enjoying life to the fullest. But it is our responsibility to hoist warning flags when storms are approaching, and living persistently beyond one's means is a recipe for disaster. Our planning process focuses more than ever upon realistic expectations for portfolio income.

To use an extended metaphor, imagine that your portfolio is a car, and you're the driver. You make a (wise?) decision to take someone along with you, a sort of "human GPS" (that's us), to help you get to your destination safely. We can tell you where exactly you are, where to turn, and when to put on the brakes. We may even be able to grab the steering wheel to swerve out of the way if you're not reacting quickly enough. But, at the end of the day, you are the one in the driver's seat.

As your advisors, we believe that we're giving you expert guidance. But if you think we are wrong, you may decide to simply ignore us. After all, no one really has a "map," and every road is a part of a new journey. However, with thirty years of experience under our respective belts, we'd like to think that we recognize the road's patterns, and where obstacles are likely to pop up. We have done this before, and we will continue to do everything we can to lead you on a safe, sustainable and rewarding path.

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