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# the BENE<sup>DICT</sup>REPORT

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## What do You See? What should We Do?

"My wife and I are pretty scared, at least financially. And, it's not the Presidential election results that bother us. We just don't feel like things are going well, financially, for the country. We are seventy years old, we can't afford to take much risk. What is your advice?"

I can't attribute this quote to any one individual, but it is basically what I am hearing from many different individuals.

Economically, things seem pretty good in this country. Most people who want a job have one. People are buying houses, buying cars and filling the shopping malls and on-line retailers coffers with money. Why do so many people have such a sense of unease, is it justified and what should they do about it?

It's a few weeks into 2017, and I'm in the hills of Tennessee...what else is there to do but think about the future. So what you are about to read is just that... my thoughts. And, I'm going to try and focus mainly on the future and not the past, however, I will occasionally bring in the past to illustrate a point. I'm quite certain you will not agree with all my thoughts...many times I look at a situation from two differing perspectives and frequently do not agree with myself. The good thing is that I don't pretend to be able to accurately predict events of the future. This is just an exercise in thinking. Or maybe a better word is, pondering.

## Where are we now?

Are we on the edge of a financial cliff about to crash into an unknown ravine or are we on a financial spaceship that is about to propel us into financial nirvana?

## The Dark Hole. How did we get ourselves into this?

**The budget deficit.** The Federal Government, and many states, have borrowed and committed so much that can NEVER be repaid...at least with what we would consider "honest" money.

What does this mean? I guess it means we are going to experience inflation...to make the debts easier to pay, **OR** we will repudiate our commitments to honor our debts. Will we actually tell our creditors that they will not get paid 100% of what we owe them?

Will we actually tell our pensioners that they will not get paid 100% of what we promised them?

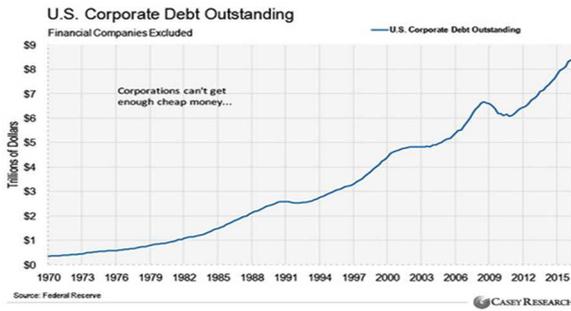
Somehow I don't think either of those things will happen. BUT, it is going to take a lot of financial shenanigans to make it look and feel as though we honored all our promises. Somehow, this feels as though it will create a lot of economic turmoil in our system. I actually feel this is part of the malaise that many people feel about the economy.

**Employment.** Yes, the official *unemployment rate* is relatively low. And, I see "Help Wanted" signs all over. But, look at the chart below. A smaller percentage of adults are in the workforce than any time since the 1970's. That is a smaller percentage of people to pay income taxes and a smaller percentage to pay employment taxes. What do we do to compensate for this? Raise the taxes on the people still working or cut government spending or keep on borrowing? Cut government spending? I'm not counting on this to happen.

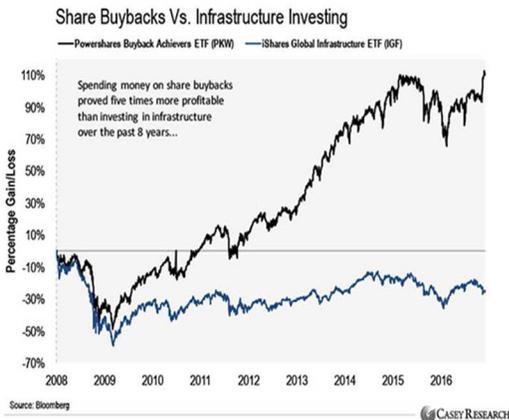
From: Bureau of Labor Statistics



**Corporate Debt.** Here is another chart showing the amount of U.S. corporate debt outstanding.



I don't have a chart to totally prove this, but from what I have been reading, a lot of the debt is going into *financial engineering* and not into productive ventures. Meaning, that companies are borrowing money to do things like buying back their own shares...which makes their earnings-per-share look better and not using the funds for new production, new markets or research and development. (This is apparently a lack of confidence in their economic future.)

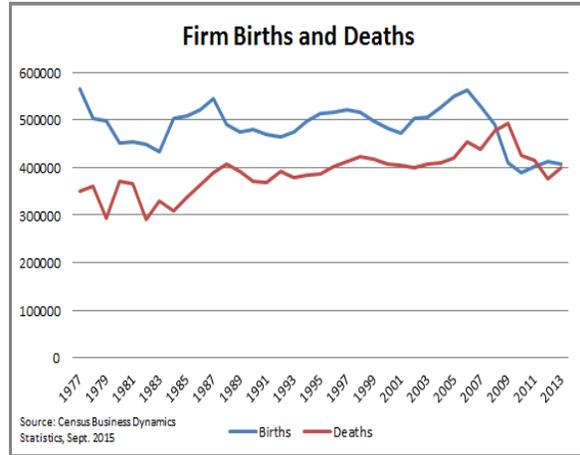


Here is the chart of two ETFs (exchange traded funds). The black line is the ETF that invests in companies that buy back a large number of their own shares. The blue line is the ETF that invests in infrastructure companies.

**Disappearing Jobs.** It seems as though everywhere I go I see someone doing some "job" that I think will disappear in just a few years. We will cover this topic more thoroughly in the future, but it is difficult to be overly optimistic if you think your livelihood is likely to disappear soon.

**Disappearing Small Business.** This chart is from the Census Bureau in September 2015 for data ending in 2013. As you can see, business deaths outnumbered business births during the Great Recession for the first time on record. And, since that time, business births have not come roaring back.

I assume these numbers will look better when the Census publishes updated data, but this trend is not good. Small and medium sized businesses are the lifeblood of the American economy. We need entrepreneurs creating new businesses, creating new jobs and bringing innovation to our economy.



**Easy Money.** For the last fifteen years, or so, the Federal Reserve has been conducting a money experiment...low interest rates, or easy money. This *easy money/low interest rate* environment has propped up parts of the economy, the stock market and the residential real estate market. It has allowed people, corporations, and the government to take on tremendous amounts debt. We must be nearing the end of this debt super-cycle. How will it turn out? Well, we just don't know.

**The Bright Future, I can't wait**

**Economic Growth.** If I were in charge of our economic future, I would pursue an aggressive program to create economic growth. I believe the solution to our economic problems, and many of our non-economic problems, is economic growth.

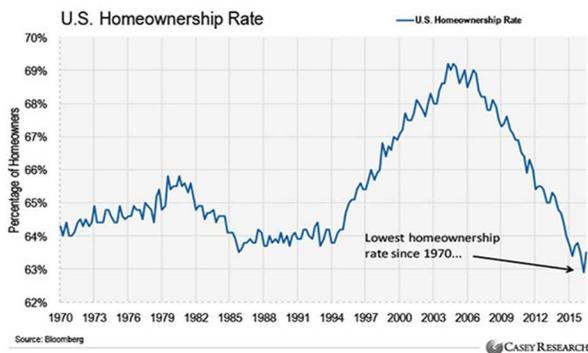
NO...not the "growth" promised by more government programs. But, true economic growth. Companies building new productive facilities and individuals starting small companies to serve a need.

This will not be easy. The aging of the Baby Boomer generation is a deflationary force. They are a very big generation that is transitioning rapidly into retirement. Also, the tremendous technological advances we are seeing can also be a deflationary force.

How would I do this? I would put lots of heads together...heads from all parts of our economy. One focus: economic growth. Every time someone brings up some other topic, I would re-direct the energies to economic growth.

NOTE: For the last twelve years or so, our national leadership has mainly focused on things other than economic growth. Maybe the new health-care plan was good, maybe the various wars or skirmishes were needed, maybe we needed to focus on the environment, maybe the focus on who uses which bathroom is important, etc., but there hasn't been a sincere focus on economic growth. Let's take the next several years, or so, and focus on one thing: U.S. economic growth. If it works, people will have jobs, wages will be higher, people will have a more financially secure retirement, etc. Oh yes, and the government will collect more taxes!

**Housing.** Here is another chart that at first glance may appear to be showing a negative trend...the idea that a smaller percentage of our households are opting to actually BUY a home



The idea of *home ownership* is so entrenched into our soul. We give income tax 'breaks' for home ownership. We give people who should never qualify a 'break' so they can get a thirty-year home mortgage. But, we are no longer living in an Ozzie and Harriet world. The idea of tying yourself down to a thirty-year mortgage seems almost unthinkable to me. The idea of taking thirty years to pay off a house seems almost as unthinkable.

Households are much smaller...what do they do with all that space? What if my job changes? What if the neighborhood changes? What if the local government changes? What if the school district changes? What if I see opportunities elsewhere?

I'm really not against home ownership. (I've owned and lived in the same house for about forty years.) But, the idea that not owning a home is bad, is not good. Some people's lifestyle just doesn't fit the home ownership mode.

**Education.** We will cover this more in the future.

Many people are going to see their "jobs" eliminated in the future. That is not good. However, learning new skills is becoming easier and easier. The idea of on-line learning is, in some cases, more effective, more specialized and more affordable than the traditional class-room learning environment.

Technologies like **virtual reality** and **artificial intelligence** will make learning much more fun and in many cases much more effective and more meaningful. It seems to me that for decades our formal education system was designed for a certain type of person. And, if you were not that type of person you were pretty much out-of-luck as far as the *system* helping you. (I was very comfortable in the typical class room structure with a focus on reading and memorization, however, a lot of people are not.)

**Bring the money home.** This may even happen before this newsletter gets in your hands. But, U.S. Corporations have hundreds of billions of dollars sitting in banks outside the U.S. Why? Because if they bring the money *home* they have to pay U.S. income taxes on the funds. Now, I am well aware that many people reading this newsletter would say, "that is only fair that they pay their taxes."

I might say that too, however, if I had a big stash of money in some other country, would I volunteer to pay federal and state government taxes on the money...at a rate of nearly fifty percent? Probably not. Especially probably not, if I am a big corporation that can build the next factory *over there* as easily as I can build it *here*.

If these funds are brought *home*, they are more likely to be used here.

### What should you do now?

If you are retired, you need a financial strategy and I would suggest that strategy should NOT be dependent on a rising stock market or rising real estate prices.

Your investment strategy should focus on creating income and that income should have the potential of increasing over time. If you are not retired and are re-investing that income, then you hope the markets do poorly so you can buy additional shares at lower prices.

But, your financial strategy should be more encompassing than merely an investment strategy. You need to factor in earnings, spending, life style and things that can go wrong. A good investment strategy will NOT solve the problem of spending too much.

It will NOT solve the problem of having to pay for an unexpected event. A well rounded financial strategy will help prepare you for life's unknowns.

## Big Predictions

### INFLATION

We...the U.S. government, the U.S. economy, the world economy...needs inflation to help mitigate the problem with all the debt that has been created over the last decade. Japan needs inflation, China needs inflation and the Eurozone needs everything, to help solve their debt problems.

I can't see how we can avoid longer-term inflation if the political powers of the developed world want it to happen. HOWEVER,

- A. I'm not convinced we, the U.S., and maybe the world, won't see DEFLATION first. Yes, a nasty round of falling prices and a nasty economic slowdown. This will escalate the problem of all the debt and encourage our political leaders to act quickly and decisively to solve the problem.
- B. I'm quite certain that whatever means our country and world leaders use to give us the inflation that **they** so desperately need, will turn out to have many *unintended consequences*. Most of which will not be good for their loyal subjects who are working to make a living and saving for retirement.

### GOLD

I'm not a real fan of investing in gold. I do realize it may be a solid *store of value* in a major world currency crisis...which would not be difficult to predict. And, I could think of gold having value as a multi-generational store of purchasing power.

However, to see gold being valuable during a social/political/economic crisis is more difficult for me. As I have said many times, if everyone around me is hungry and I have gold, I'm quite certain I will have to share my gold with them whether I want to or not.

And I'm equally certain if things are that bad, then the grocery store shelves will have been emptied by the hungry masses. But, I am opening my thought process to using some gold as a hedge in some cases.

**BUREAURACY** I'm a big believer in the capitalistic system. I believe if you will leave it alone, it will create a far higher standard of living for everyone. However, I am also quite aware that capitalism tends to *reward* the successful and *penalize* the less successful.

So society/government creates "rules" to make capitalism more *fair* for all. But, it takes a rather delicate balance to keep the strong spirit of capitalism alive and thriving while at the same time mandating the sharing of rewards with the less successful achievers. We see this same thing happening in the world of competitive sports:

- You can't use a golf club that is outside the norm because it may give you an unfair advantage.
- You can't use a baseball bat that is longer than what is 'allowed' because it may give you an unfair advantage.
- You can't dunk the basketball because some players can't jump that high and it gives the taller and higher jumpers an unfair advantage.

I haven't followed sports in decades, thus my examples may not be the most insightful thing I have ever come up with!

Coming back to our economy, it seems to me over the last decade or so, our *system* has really dampened the competitive spirits of the business sector. Why are so many companies buying back shares of their own stock instead of investing in new money-making projects? Is there too much bureaucracy involved to start a new project? Is there too much regulatory hassle involved to operate another business? Are the various taxes such that using profits to buy back shares of stock is more advantageous than expanding capacity?

This is not something that is easy to determine. We certainly need a degree of regulation, but what is the *right* amount of regulation and rules and when do they become *punitive*? Of course, there is no easy answer to this. AND, depending on where you come from, you will have a very different slant on this than someone else. If you have never operated a business, you probably assume that if regulation is needed, then it is good...no matter how much is involved.

However, in my mind, it is more like traffic control. We want and need our police department to keep the unsafe driving to a minimum and help assure us a safe journey. But, have you not seen in some cases how too much enforcement can actually impede traffic. (If you don't understand this, drive through some of the rural south and you will find several communities with their own Barney Fife ( the old Andy Griffith show deputy) waiting to assess you a "toll.")

In another part of the newsletter you will find a graph showing new business formations. We NEED small businesses. And, we are not getting them. Why? My best guess, too many Barney Fifes are out there.

### **Workplace Change: The State of What's Happening**

Successful people are in a constant state of re-inventing themselves. Sometimes this is forced reinvention and other times it is voluntary reinvention. Successful companies are also in a constant state of re-inventing themselves.

Individuals and companies who cling too strongly to the status-quo are greatly limiting their potential success. This has become even more pronounced in recent years as technology has created massive disruption in the workplace, in society, in global relations, in communication, etc.

And, it seems to me that these disruptions are just beginning.

If you read an article or watch a news program that wails at the idea that corporate CEOs are paid way too much compared to the average worker, please consider this before agreeing with that opinion: The CEO who can anticipate the changes needed and make the changes happen is worth millions to the corporation and shareholders. The 'worker' who fights and resists change is a negative to the corporation and the shareholders.

If a CEO or a regular "worker" can anticipate changes and improve their skills to adapt, they can become invaluable to their organization. The same can be true in your personal life and in your career. You need to think like you are the CEO of your career and anticipate disruption, anticipate change and be prepared to adapt. If you are an automobile mechanic, I encourage you to think like you are the CEO of your career. What changes are you anticipating and what are you doing to take advantage of those changes. Notice I did not say "what are you doing to avoid making the changes?"

This exercise applies to almost every career/job. Teaching...definitely. Truck drivers...definitely. Health-care providers...very definitely. The list goes on and on.

*I've listened to you talk about the future of work and read a few of your articles. What I know how to do is mainly physical labor. I think you are telling me that I am a dinosaur. Do you agree?"*

Partially yes and maybe no. Technology will continue

to disrupt the workplace and robotics will move rapidly to greatly reduce the basic, repetitive jobs.

As an individual told me several years ago. "I am seeing a tremendous shortage of skilled welders. But, I am seeing an abundance of guys who can "run a bead" who think they are skilled welders. They really do not have the skills the marketplace is demanding and they don't have any idea they are really un-skilled in this area."

The truck driver of tomorrow will probably be in a self-driving cab that is pulling four or five trailers behind. His rig will move on special lanes between major terminals. Will he need to be skilled? Definitely. Will he need different skills than he has now? Definitely.

You can look at almost any job/industry and see how things could change in the future. Of course, it is much easier to see the disruptive change when looking at others.

Be prepared to adapt and change. Teach your children to anticipate and adapt. I don't see the future of the workplace as bad, but I DO see it as different.

### **What if the Next Ten Years is a Zero?**

I hardly know him at all, but when he found out that I was in the *financial* industry, he started to talk. No, he didn't ask for free advice, he told me all about money and investing. He just retired and he told me he has moved all his investments into a general stock market index fund because he had read that index funds have low expenses. "That is the only way to invest," he boasted.

I interrupted to ask him if he will need to take withdrawals from his account to supplement his other retirement income?

"I sure will. My only other income is my social security check, and I can't live on that."

I asked him, "What if the stock market doesn't go up over the next ten years?"

"I don't think that is possible. I always heard that if I hold on the stock market will recover."

I offered that the future stock market will most likely follow the pattern of the historical stock market...a lot of ups and downs, but over the long-term probably an upwards trend.. However, the general stock market indexes in 1982 were at about the same level that they had been in 1964.

And more recently, the NASDAQ index took until 2015 to get back to the level it was at in 2000.

"But that's not going to happen now is it?", he asked.

I offered that I didn't know, but you are now retired and living off of your retirement account. You can't just invest blindly thinking everything will be fine, while you are withdrawing from the account every month to fund your standard of living.

"But, I can't just put my money in a bank account. It won't earn anywhere near what I need to withdraw each month," he replied.

I agreed that wasn't a good long-term solution and I offered that between him and his wife, they have to assume that they may need the account to last for thirty or thirty-five years. During that time, it is certainly possible we could encounter periods of rather high inflation.

"Inflation, you mean like we had in the 70's?"

It is a potential risk, although the reason for the inflation will probably be different than during the 1970's, the impact on your lifestyle will probably be similar.

"What is the answer?", he asked.

I suggested that if he is going to put all his retirement account into an investment that follows a general stock market index and withdraw funds to live on, then he must discipline himself to withdraw more when the market is doing well and not withdraw from the account when it is down in value.

If your account is not generating the income you need, then you should try to protect your principal when the market declines.

"That sounds like it may be difficult to do. I need the monthly income. Will that strategy work?"

I told him it would help if he reduced or stopped his withdrawals when the market declines. But, in a prolonged down or sideways market, it probably wouldn't prevent him from depleting his principal.

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## **What Do You See? What should We Do?**

### **WHAT WE DO...**

We prepare retirement income plans, which are essentially blueprints to help our clients pursue their long-term retirement goals.

We manage our clients' investment accounts on a fee basis with discretionary authority focusing on meeting their objectives rather than focusing on what the financial markets may be doing.

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The primary author of The Benedict Report is Philip C. Benedict, CFP®. Travis M James, CFP®, Mark A Beaver, CFP® and Ashley A Thompson, CFP® provide technical assistance. Fredda B Schwartz and Jackie Thompson handle the layout and editing of the newsletter.

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