

**AUGUST 2015**

Written by: Philip C Benedict, CFP®  
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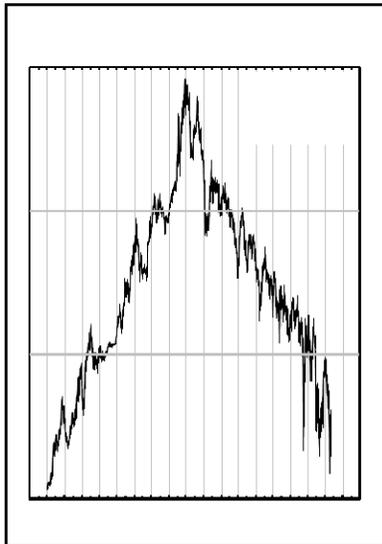
Philip C Benedict, CFP®  
Travis M James, CFP®  
Mark A Beaver, CFP®  
Ashley A Thompson, CFP®  
Jackie McAdoo

# the **BENEDICT** REPORT

6000 Lake Forrest Drive NW, Suite 550, Atlanta, GA 30328-5901 • 770 671 8228 • 770 671 0232 fax • 800 678 8227

## “Economic Crisis Fatigue” - The Ebola of the Investing World

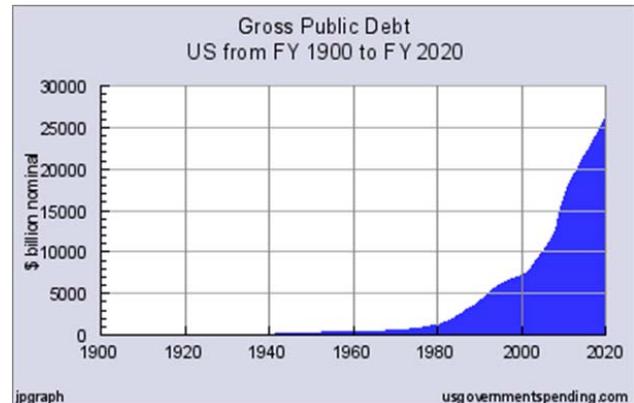
Look at this chart showing the yield of long-term Treasury Bonds since 1950. Do you see two distinct long-term cycles?



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The interest rate started somewhat over 2% and is currently at that same general range. But, as you can see, it has NOT been a smooth ride. The interest rates peaked at nearly 16% in 1980 and have been in a long downward cycle since that time.

During the declining interest rate cycle our government has taken on a tremendous amount of debt (see chart below) as have governments of many other countries around the world. Many of our corporations have taken on large amounts of debt. Many of our households have taken on large amounts of debt. Why not, at today's interest rate levels, debt seems almost free.



All this debt has allowed us to “enjoy” things today without having to pay for them until “tomorrow.” We even *subsidize* debt by allowing homeowners to deduct the interest, thus lowering their income taxes and we allow corporations or other businesses to also deduct their interest costs. Gosh, debt must be a good thing...MAYBE.

(*The Economist* - May 16, 2015) estimates that even in today's very low interest rate world the debt *subsidy* costs the equivalent of 2% of Gross Domestic Product in lost income taxes.)

Debt *may* feel like a good thing, at first, but it does add a great deal of economic fragility whether it is a government, corporation or a consumer (home mortgage debt, auto loan debt, credit card debt and student loan debt). Look at your acquaintances that lived through the 2008 economic down-turn...I bet it was easy to see which ones were burdened with a lot of debt compared to those who were debt free. And, any rise in interest rates would make debt that much more burdensome.

Is the interest-rate cycle about to change course?

There is much talk in the media about “when” the Federal Reserve is going to raise interest rates. It

may turn out that true market-forces have more impact on the level and direction of interest rates, especially longer-term rates, than the Federal Reserve.

But, it seems to me that interest rate increases may happen...UNTIL the next economic crisis, when the central bank jumps again to "solve the problem." I doubt that artificial manipulation of interest rates we have witnessed for the last several years is a healthy long-term strategy, but it will probably take some sort of crisis to get us over the addiction.

What does all this mean to all of us?

We don't know if interest rates are getting ready to start rising or whether they are going to bump-a-long in a sideways pattern for several years. We are pretty sure that the massive amount of debt that the government has accumulated over the same cycle has put a lot more money into the system...which probably helped support the stock market and the real estate markets.

The two events, the increased fragility of the system and the support of the financial markets, are part of the reason we believe we should plan for a volatile, mainly sideways stock market for many years in the future. This is why we want most of our accounts focused on a strategy that hopes to achieve growing dividends...which are not guaranteed and can be reduced or eliminated at any time, but are not dependent on the rise of the share prices. And, we want to own companies that have only reasonable amounts of debt.

## CAN WE INVEST IN DEBT?

The opportunists who read the previous article are probably thinking, "People, corporations and governments seem to be addicted to debt. There must be some way for me, as an investor, to profit from their addiction."

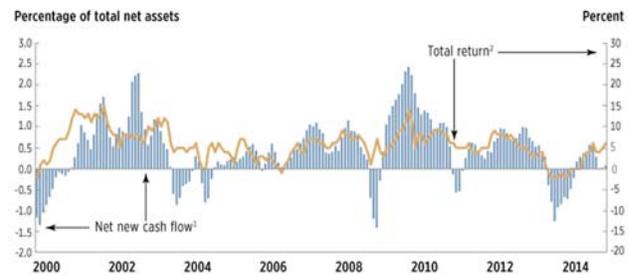
You can invest in debt; in the investment world this debt is usually called a *bond*. You can own government *bonds*...U.S. government or many of the other countries all over the world. You can own corporate *bonds*, which are backed by the revenues of the issuing corporation. These can be U.S. corporations or those of other countries. You can invest in various bonds that back the loans that are made to consumers to buy homes, purchase automobiles and pay for the college costs.

The *bond* you invest in is backed by the issuer. The issuer promises to pay you interest during the life of

the bond and to return your principal at the maturity of the bond. These are generally very predictable investments. About the only thing that can go wrong is that the issuer gets into some sort of financial trouble and is unable to honor their promises. Of course, that would be a BIG thing.

Well, another thing that can go wrong is that the market price of the bond can and, generally, will fluctuate in value. Because so many investors do not understand this or how this can happen, this becomes a major risk of bond ownership...maybe we call it investor ignorance or whatever, but it is still an issue.

Look at the chart below. The vertical bars show new money added to bonds. The line shows the "total return" (which is the *interest* the bond pays plus *the change in market value*) of bonds. Notice how often new money is added when the line is going up and how often money is withdrawn when the line is going down.



(SOURCE: 2015 Investment Company Fact Book)

Why, you may ask, if bonds are supposed to be so predictable, why does the market value of the bonds fluctuate so much? Good question, and if you don't understand this, do not invest in bonds.

Let's see if we can explain why bonds fluctuate in value. Today you could invest in a Ten-Year U.S. Government Treasury bond with a yield of 2.4%. What determines this interest rate? It used to be pretty much market forces, however, recently government involvement has also played a major role. In theory, if the Treasury Department offered bonds at 2.4% and no one would buy, the market is telling them that they need to offer a higher rate. Now that we have said all that, forget that 2.4% figure because once you invest in the bond it is not important. If you invest \$100,000 in this bond, you will receive \$2,400 interest each year from the U.S. Treasury for the next ten years, guaranteed. (That is 2.4% times \$100,000).

Now, let's say it is July 2017. The market forces are forcing the U.S. Treasury to offer yields of 4.4% on their new bond offerings to get buyers.

Wow, you think. I would rather have one of those new bonds paying 4.4% than the bond I acquired in 2015. I'll sell my bond and invest in the new bond. Can I do that?

Yes, but, no sane buyer would offer you \$100,000 for your bond that pays \$2,400 per year when he could invest in a new bond that would pay him \$4,400 per year. Thus, you have to sell your bond to him at a *discount*. In fact, you would probably only be able to sell your bond for about \$86,000. (You can go to the Internet and search for a "bond calculator" which will calculate the approximate price of a bond.)

The answer to the question posed in the title is, YES, you can invest in debt. Whether it will be a good long-term investment is more difficult to answer.

## What is it about human's ability to deny?

Greece is suddenly a crisis. Really? Hasn't Greece been in a financial crisis for most of several decades? It is like no one wanted to look at the situation and tell the truth.

*The modern Greek state has been in default for roughly half of its almost 200-year history. Athens has defaulted five times – in 1826, 1843, 1860, 1894, and 1932. And after the 1932 default, Greece remained in default for 30 years.*

(SOURCE: B&P Briefing, July 1, 2015)

Detroit had its crisis a couple of years ago. Really? Wasn't the crisis created over the three previous decades? Can you really promise people pensions and not provide the funding. Can you see the people of means leaving the city and not thinking that we need to make changes now...not decades from now?

She is a very successful business person. She can plan and execute in the business world like few others. She has a pet that eats only the healthiest food and receives only the best care. However, her personal health habits and money habits are a disaster. How does she not see this?

He earned a very good living but now in his seventies health problems, plus a declining ability to look valuable to the workplace, forced him to retire. His retirement savings...zero. He owes twenty-eight years on his mortgage and two more years on the lease of his expensive automobile. What was his retirement plan?

The President rails against them. Most financial advisors try to get their clients to avoid them. We have young people, and some not so young, that have tens of thousands of dollars of student loans. Is anyone doing anything to give our citizens an alternative? If the loans are so bad, why do we continue offering them? Is everyone just in denial? "Make all education free say some." "No way say others; anything we get for free has no value to us." What is the answer? I don't know, but just loading up on debt does NOT seem to be a good long-term solution.

We don't pretend to be in the business of changing people's bad habits or getting into their brain to help them face up to their denials. I don't know just who does this type of thing, but it isn't us.

However, if you are someone who knows...maybe only deep down...that things are not going right in one or more major parts of your life, what should you do?

**My advice: start writing it down.**

Look in the mirror and see yourself in ten or twenty years. Naturally, you will be older, but do you see how some of your lifestyle habits today may add much more than age to the image in the mirror.

Next, write down in your notebook what income you will have in ten or twenty years. No, don't waste your time thinking about the lottery, but really, what income will you have in the future...after you no longer have a paycheck.

If you are married or have someone who is somewhat financially dependent on your income, write down what will happen to that person's lifestyle after you die.

Don't just do this one time, make this a continual habit...writing down your thoughts, fears, goals and weaknesses...and your plan of correction/action.

I have been involved with people and their financial affairs, financial fears, financial successes and financial denials my entire adult life. Some people seem to understand how it works and others do not. It still amazes me how much some people literally lust for money and

if they get some money, it goes almost immediately...not to acquire assets but on frivolous spending...that doesn't seem frivolous at all to them, but it is gone no matter what you call it.

Think you may be receiving an inheritance in the future. Better start planning for it today...no, not how you will spend it, but how you will **NOT** spend it.

Think you may be receiving a sum of money from the sale of a large asset. Better start preparing yourself now to replace the asset that is sold with a new asset... probably an income producing asset. You have to prepare or you will spend the principal...your asset. And, if you don't spend it on yourself, your children will have some serious "financial needs" that only you can solve.

Most individual's financial problems are not the result of a stock market crash or the strength of the Japanese Yen or anything you hear from the media. Most can be seen by looking in your mirror...and it IS difficult for most of us to see our weaknesses, let alone develop a plan to correct them. However, it can be a very important step in creating a financially less stressful future.

### Write it down.

Too many countries, states, cities and people are looking for short-term, easy fixes to long-term structural problems. An election is coming up...let's vote for a candidate who rises above the denial of the masses.

## WHERE DID THEY GO?

"They were big and powerful and had tremendous influence over much of the world. Their presence seemed to be everywhere. And...then they disappeared."

You may think dinosaurs are the topic of the above paragraph, but it really is a quote from the June 2020 *Benedict Report*. And, the powerful beasts we are discussing are not the huge reptiles of the far past but the retail banks that used to be such a big part of everyone's life.

Now, I realize if your hair is white you probably still venture into a local bank to receive several services. But, I believe if you weren't alive when President Kennedy was assassinated, then you rarely see the inside of a bank.

The banks must recognize this; surely it is not a secret to them, but what are they doing about it. Oh, they created online banking. That's good, but even that now seems rather old school.

Where do you go to get an auto loan? Many people answer "the dealership," which may or may not be an agent of a local bank OR maybe not so local...who cares. Or you may go online and get approved for an auto loan from some far off bank or other lender. Some people still go to a local bank for a home mortgage, but probably just as many use the services of a mortgage broker or even an online service.

A rapidly growing service is what is frequently called *direct lending*. "Direct lending is going to be the biggest financial innovation since the automatic teller machine..." (Former Secretary of Treasury, Larry Summers) In *direct lending* people (lenders) go through an on-line site that matches them up with borrowers. These sites are usually called something like *peer-to-peer lending platforms*. If this becomes too popular, I'm quite certain the banks will be hollering "foul" and ask for government intervention.

No, I don't really mean that the entire banking system will disappear but I do believe it will change dramatically and have a lot less retail presence in the future. Time will tell.

## Step back a few spaces to see the changes

I read about a 2013 Gallop poll that showed that 55% of Americans turn to television news as their primary news source.

That doesn't surprise me. When my parents retired they would listen to the local radio news in the morning, turn on the television news at noon and again at five in the afternoon. They were frequently in bed by the time the eleven o'clock news came on, but if not, they generally watched that also.

I know, because when I was visiting them I would see it happen. Being a person who has literally never watched television news, I found all these "news" programs rather stressful. You get to hear about crime, you get to hear about tragedy and you get to hear about political corruption. Now we are so global we import crisis, tragedy and crime from around the world with the "news" focusing on the most heinous.

The financial world is just as bad. Some people seem to be focused on the afternoon financial news like a kid watching the cartoons. The focus is on the latest crisis or a projection of the direction of interest rates, the stock market or the economy. How can you be a good multi-decade investor with all day-to-day information being analyzed, extrapolated and sensationalized?

The Federal Reserve, the Eurozone break-up, crisis in China, oil prices, interest rates and the like come at you in a never ending spiel of information.

Instead of focusing on the crisis of the day, let's step back and try to focus on what may be happening in the longer-term future of the "news."

The "nightly news" that 55% of Americans rely on for their view of the world may be changing...and changing very rapidly. First of all my guess is that that the 55% who watch the "nightly news" are more likely to have gray hair than not. It seems to me that wireless technology is changing how people access the media and changing it very rapidly. In addition to the wireless connection, we can easily sort and filter "news" to meet our personal needs and likes. If we don't want to hear about the love lives of Hollywood starlets, we can block that "news." (I've got to figure out how to do this!)

One of the big cable companies and the giant sports content provider are in what will probably be a long, costly lawsuit because the cable company *breached* their contract with the sports group and offered "bundled" cable services that did not include their sports programming...because the sports programming was very expensive and the telecom company could offer a much cheaper "bundle" without it. It is what many of the customers wanted, they claimed. The sports programming was still available in the premium service.

But, such a move would hurt the sports programming company's revenues and guess what we do when our "turf" is threatened...in the business world...we sue or ask the government to help us because it is not *fair*.

Change is happening, it will happen fast and furious... there will be winners and there will be losers. The losers will sue and look to the government for protection.

Other areas are changing rapidly also. Have you followed the story of how the "ride-sharing" companies are growing like wildfire? I asked around our office to see how many of our small group has ever used a "ride-sharing" service on a regular basis. Three use the services fairly regularly. And, before the "ride-sharing" services were available, they seldom, if ever, used a local taxi cab. But, some of the cab companies are fighting this...asking the government to step in to save them...to be *fair*. Maybe this isn't *fair* to the cab companies, maybe the government regulators need to step aside and let the cabs operate more like the "ride-sharing" companies. Oh, but change is difficult and loss of power is hard.

## THE TERRIBLE STATE OF THE ECONOMY

There seems to be a lot of emotions floating among the American public regarding the State of the Economy in this country and maybe the world as a whole. There seems to be the fear that with the stock market near an all-time high it is about to crash downwards. There seems to be the fear that as soon as the Federal Reserve acts, interest rates will rise dramatically causing all sorts of economic harm. And, we are coming up on a national political election in which some of the candidates will court the "populist" vote with strong challenges to entire capitalist system. We will hear a lot of speeches about "fairness," "equality" and how bad it is to be successful.

But, what I really think a big factor that is causing the economic malaise is simply economic crisis fatigue. People have become so much more in tune to the economic happenings since 2000, but it comes at a price.

We have had stock market crashes, real estate crashes, wars and wars and more wars. We provided hundreds of thousands of dollars of *stimulus* that got spent on... I'm not sure. Tell me again, where did all those millions of dollars of *stimulus* money get spent?

In 2008 we created an all-time record in deficit spending of \$458 billion. But since then we have never had an annual deficit that *low*. (*Investors Business Daily*, July 20, 2015)

There seems to be a sense that *something is not right*.

But as Martin Wolf said, "We are bundles of emotions, not calculating machines." (SOURCE: *Financial Times*, December 17, 2014)

Politicians want to force wages higher and politicians want higher taxes...on the rich of course, not the every-day voting public.

What is the answer?

### Economic Growth is the only Good Answer

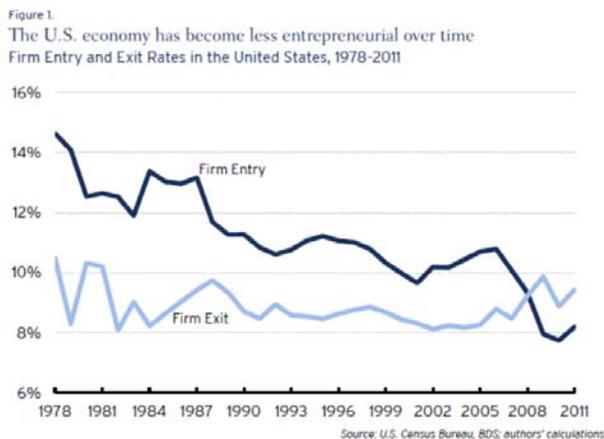
There is a group of people who truly believe that government spending creates economic growth. I am not part of that group. I believe government spending merely moves money around. However, I guess as long as you believe we can *print* a never ending amount of dollars, then maybe I should join that group. But, I don't believe the money *printing* is infinite. Thus, I believe true economic growth must come the old fashioned way... more production, higher productivity and more people working or working longer hours.

Since 2000 the average annual increase in Gross Domestic Product has been less than two percent per year. That is not high enough to create the dynamic economic environment that we want...and need. We need it to pay for our government promises, we need it to pay down our federal debt, we need it to pay people the wages they deserve and we need it to make us feel good again.

But, what can we do? I think we should take some bold actions.

**Here are some suggestions:**

A lot of our economic growth and employment growth comes from our smaller businesses and start-up businesses. Look at this chart, showing business being started and businesses being closed.



(This information is only updated every few years, thus the data is somewhat old. I could not find a more up-to-date chart, however, the *Chicago Fed Letter* of September 2014 was focused on this slowdown in new business formations and pretty much confirmed that the trends of the above chart are still current.)

See a disturbing pattern? Far more businesses are closing than are being created. I referred to this in the January *Benedict Report*, how so many of my small-business owner friends are not expanding and how others are staying a one-person business because they don't want to hire anyone and put up with all the things that come with an employee.

- ◆ We have to reignite the enthusiasm for starting a business in this country. Now, I don't believe the government can make this happen, but maybe the government should just get out of the way. I see a major trend developing with the individual entrepreneur using the digital revolution to create more

and more unique smaller businesses. These are businesses we have never thought of before. But this small entrepreneur doesn't have the time, the aptitude or the money to deal with the hurdles government regulations have placed on him.

- ◆ I suggest we eliminate almost all of the labor laws in the country, other than maybe safety laws. That probably includes a pile of laws far greater than we can imagine. I can hear it now, "That would not be 'fair' to the employees of this country." I probably agree...in a few cases the employees would be *taken advantage of*...and we will probably have to address that in the future with new laws, but what if we *wiped the slate clean* for a few years to see what happens. I believe the workplace has changed dramatically and I believe the workforce has changed dramatically. Great businesses...the growing businesses...will see sort of a *merger* or a *partnership* between the owners and the workers. It is in both of their best interests.
- ◆ Did we not go for decades without the *work week* being defined as forty hours? What if I, as an employee, want to work sixty hours one week and twenty hours the next and it works for my employer? Whoops, can't do that because of some labor laws. I say, get rid of all those laws for five years and see what happens.
- ◆ Currently profits of U.S. corporations that are earned abroad are taxed at the full rate when brought back to this country. When you factor in state income taxes, this figure can be as much as fifty percent of the profits. So what do many corporations do? I assume they leave the money in foreign countries, where it was earned. And guess where they are likely to expand? My guess is where their money is! We aren't collecting much tax now... because the funds stay over there...I suggest we eliminate the tax on foreign-earned profits.
- ◆ A Brookings Institute estimates that lifting the crude oil export ban will generate more than \$1.8 trillion in economic benefits to the U.S. over the next two decades. (S&A Digest, November 7, 2014) I say, let's do it!
- ◆ I've been traveling some this summer and it was easy to come to a simple conclusion...our Interstate Highways need repair and expansion. Let's do it! It will generate a lot of economic activity and make travel easier and much more energy efficient. Oh, how do we pay for it you challenge? I don't know, but we seem to find the money to do all sorts of things that don't make much sense to me. Highway construction makes sense to me; it is an investment that will provide benefits for generations, not a short-term *stimulus*. **When will the public finally demand better use of our tax dollars?**

We have created a lot of incentives NOT to work... unemployment compensation, disability social security and various sorts of welfare and the like. Maybe we need to create incentives TO work. What would the incentives be you ask? I'm not sure, but I think with some good leadership we could get people all over the country thinking about this and come up with some innovative solutions.

- ◆ The government is trying to force the minimum wage higher. Why we even have a minimum wage is beyond me. I do believe that whatever the government does is a *political* solution and not an *economic* solution, thus it will have many unexpected consequences.
- ◆ Maybe the problem isn't the minimum wage. Maybe the problem is too many people are not bringing meaningful skills to the employer. Somehow we need to equip the American workforce to succeed. Maybe it is to provide employers incentives to train workers or maybe some other solution. I think there are too many people out there that no one wants to hire. That is a real economic drag on our economy and an emotional drag on our society.
- ◆ We have one of those every-four-year circus events on our horizon. Maybe you should ask any candidate you are considering voting for two questions:
  - Why aren't we starting new businesses?
  - Why aren't our employers hiring more employees?

## What is happening in the housing marketplace?

During a conversation with a friend who is in the residential real estate industry in metropolitan Atlanta. She offered the following:

"We are selling new houses, nice new houses at a rapid pace, but there are problems.

"Last week we had five new home purchasers approved for their mortgages based on their applications...UNTIL, the rest of the facts were discovered by the mortgage company. Minor little things like:

"I guess we forgot to mention that the wife was no longer working."

"Oh yes, we are paying out several hundred dollars each month in child support. Does that make a difference?"

"Well I guess we haven't filed a tax return in several years. We didn't think that would matter."

"Or the couple that qualified under some government program as deserving special treatment. Their loan was approved, and...

"Their debt-to-income ratio was 62%. That loan will likely be in foreclosure in a couple of years."

Did the entire mess with the housing marketplace during the last cycle really lower the *standards* of people that much? Is it not almost fraud to not disclose major financial debts, fake work and tax non-filing on a mortgage application for a thirty-year mortgage of several hundreds of thousand dollars?

Stay tuned...maybe the "fix" to the mortgage crisis isn't really a long-term fix at all. Hope not. Maybe these are rare isolated cases. Hope so.

## ENDING THOUGHTS!

We may be going into a period of a global economic slowdown. The China economic miracle that fueled so much global spending seems to be cooling, Europe continues to have their problems and the relatively strong U.S. Dollar is a negative for many of the less-established economies of the world.

I doubt our economy can avoid being drawn into this down cycle unless we make some big changes within our system. As was mentioned in an article above, we really need to let the American innovator and entrepreneur create the dynamism that he/she can do. And, I'm thinking of changes to the non-tech sector that are as game changing as many of our technology innovations have been. But, what are they you ask? I'm not sure, but get ready to see it happen.

The last fifteen years has been a period of massive government involvement in our business and personal lives. We have passed massive new laws...Dodd-Frank and the Affordable Health Care laws being two all-encompassing laws. We have focused on a lot of things...maybe rightly so...at the expense of economic growth.

If we don't make big, powerful changes...not little incremental regulatory "fixes"...we may get sucked into the economic morass that could easily engulf much of the world.

We have too much debt, but economic growth will make it less painful.

We have too many people not working or under-employed. Economic growth will provide them opportunities...if they want opportunities.

Part of the employment situation in this country is the transition from the graying, baby-boomer population to the younger workers. They, the younger workers, don't want and they don't need the labor structures that were created in industrial revolution many decades ago. Get rid of those old regulations and create an environment for economic growth.

***I think it is time to go big on economic growth or get out of the way!***



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6000 Lake Forrest Drive, Suite 550  
Atlanta, GA 30328-5901  
770.671.8228  
[www.benedictfinancial.com](http://www.benedictfinancial.com)

## ECONOMIC CRISIS FATIGUE - The Ebola of the Investing World

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The primary author of The Benedict Report is Philip C. Benedict, CFP<sup>®</sup>, an Investment Advisor Representative and Registered Principal with **LPL Financial**, a registered investment advisory firm and member of FINRA/SIPC. Travis M James, CFP<sup>®</sup>, Mark A Beaver, CFP<sup>®</sup> and Ashley A Thompson, CFP<sup>®</sup> provide technical assistance. Jean B Wilson and Jackie McAdoo handle the layout and editing of the newsletter.

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