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the BENEDICT *REPORT*

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A Market "Crash" is Coming?

"I heard this guy on television last night tell how a big market crash is coming in the next couple of weeks. I'm too old to lose all my money. Shouldn't you move all my investments into the money market account?"

One of the hardest things about investing is the game it plays on our emotions. You can almost feel the emotion in the above quote.

One of the easiest things to do is to predict the future. And, if you want people to pay attention to your prediction, then predict a terrible event. It puts the predictor in a position of power. It can get the right person a lot of media attention. And, if the predictor comes close to getting it right, he immediately becomes an expert and the media will come to him for future predictions.

Many reasonable predictions will come true. But, the timing may be off by days, weeks, months, years or decades.

(We were in the Tennessee mountains a few years ago and we felt a minor earthquake. Some locals said that they heard that one had happened sometime in the late-1800's. I guess with that information, I could boldly predict that the region will experience another earthquake in the future. But, my timing needs to be a little vague.)

Move out of investments into a money market account?

It is a very natural emotion to want to avoid pain, including financial pain. However, it is much more difficult to do than it seems. At least it is difficult to do without creating more pain. The downward risks of moving your investment assets to "safety" are much higher than you realize. History shows that most-of-the-time, investing works. But, we tend to remember the difficult times a lot more vividly.

Here are some of the obstacles of trying to avoid down markets:

- Our emotions tell us to move out of the stock market and into a safe account and after the market drops, we will simply re-invest back into the stock market. It rarely happens. I still run into people who *sold* their investments after the big drop in 2008 who have not re-invested.
- What if after we sell our investments the market goes up? Up a lot. What do we do then?
- If you are withdrawing four percent per year and move your investments to cash, which earns literally nothing, you are then withdrawing principal each month. In three years, you will have withdrawn about 12% of your principal…which is about the same thing as the account dropping 12% in market value, except you no longer own those assets.

If we don't plan to sell all your investments to avoid the down market, what do we do?

- If you are planning to withdraw a significant amount of your account principal in the next three years, we would encourage you to withdraw it now. It is short-term money and should not be part of your long-term investment account.

- Try to limit your withdrawals to only the dividends and interest. We DO NOT consider an increase in account value to be "earnings."

- For individuals who seem very market sensitive, we try to have about three years of withdrawals in short-term investments that are not exposed to stock market risk.

- We limit client exposure so that no single, undiversified investment is driving returns.

- We avoid allowing your portfolios to be over concentrated in any one industry or sector.

- If the market takes a big drop and your account value drops significantly, we will reinvest the dividends to try to "take advantage" of the lower share prices and start taking your monthly withdrawals from the shorter-term investments.

These are not perfect solutions, but we feel they are far more prudent than trying to "time" when to be in the market and when to be out of the market.

HOW LONG DO YOU PLAN TO OWN THIS ASSET?

When you acquire an *asset*, you usually have some sense of how long you plan to keep that asset. I bought a house about forty years ago. How long did I plan to own that house? That's easy, forever. For many people owning a house for forty years is forever, but in my mind, forever isn't over yet. Now, something could come along and make me change my mind and I would sell the house, but that was not my plan when I acquired the house back in the 1970's.

Ask yourself a few questions:

> If I buy a farm, how long do I plan to own it?
>
> If I buy an orchard, how long do I plan to own it?
>
> If I buy a copper mine, how long do I plan to own it?

I imagine most people who buy farms, orchards and copper mines have a very long holding period planned for their new asset. Now, I realize things can change. Maybe Wal-Mart comes to you and says we want to buy your farm land for five times what it is worth. You would probably answer, SOLD.

What if you own shares of stock in a globally dominating company that pays a good dividend and has minimal debt? You would probably consider that to be an *asset* and plan to hold it for a long time.

Not all companies share the same characteristics as the company mentioned above, but you would think that the owners of an *asset* would consider holding it for a meaningful period, to realize the value of ownership.

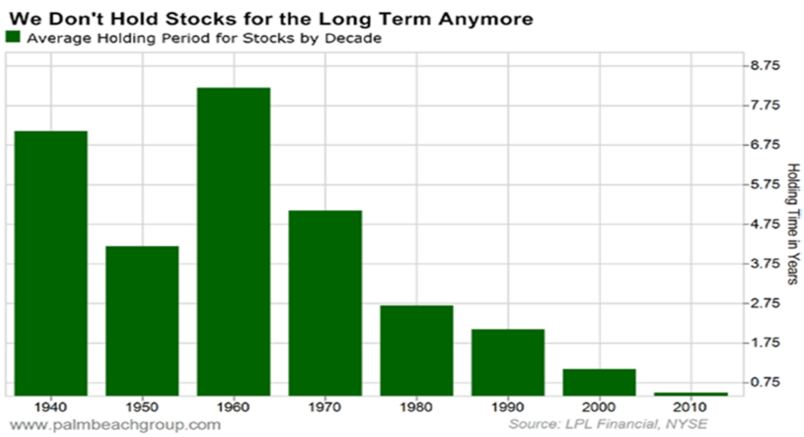
However, look at the table below. This illustrates the average holding period by investors in common stocks. You can see that in the 1940's the average holding period was about seven years. During the decade of the 1960's the holding period increased to almost eight years.

But, look at the decade ending in 2010. The average holding period is less than six months.

Obviously, since a lot of investors, individual and institutional, still own shares of a company's stock for many, many years, it means a lot of "traders" own the shares for only days or weeks.

Why is this important to us and maybe to you?

Almost everything you read, hear or watch about the stock market is geared to the very short-term holder, or at least the very short-term thinker. The next time you read or watch any financial news, ask yourself, is this story about an asset that will probably still be around for many decades or is this a story about guessing what is going to happen tomorrow? You may find yourself switching the television channel from the financial news to a baseball game or re-runs of The Ed Sullivan Show.



If you think in time horizons of five to ten years, or longer, investing becomes a lot easier.

The Illusion of Wealth

Ask ten people the definition of wealth and you will probably get ten different answers. Some definitions will be financial "one million dollars", some will be emotional "love", and others will be more pragmatic "good health".

The reality is that one probably needs all three of the above to feel wealthy, but we are a financial office, thus our focus will be on the money side of wealth and we will let you read other sources for suggestions on obtaining good health and true love.

And, most of the time, our definition of wealth is not having a great quantity of money, but having plenty of income during one's non-working years.

This focus on income is critical for your well-being during your non-working years. Most people would agree with that, however, it is also very important prior to the retirement phase of your life.

How many people do you know that seem to *hate their work?* Really? If you *hate* your job, quit. Oh, you can't because you are dependent on that paycheck that comes twice a month into your checking account. You should have created a passive source of "income" while you were employed, thus giving you the opportunity to find a career you enjoy.

Another common income problem is with our retirement savings. Most people are quite dependent on their employer retirement plan for their income after retirement. However, in many cases their plan is not generating any consistent income, instead it is very dependent of the ups and downs of the stock and bond markets.

If you have a choice in your retirement plan, start generating income early and focus on growing that income and re-investing that income. This will create a compounding income that will *benefit* from down market cycles by buying more shares when the share-price is lower.

A step further, for me at least, is that wealth has always equated to freedom. If you can't quit a job you hate, you are not free. If you can't leave a relationship you hate, you are not free.

No matter how you look at it, wealth is not accurately measured in dollars. Oh, I agree at any minute in time you may be able to measure your wealth in dollars but not over time.

If your wealth is in stocks and bonds, you will see your wealth be rather volatile when measured in dollars.

If your wealth is in farm land, you will see your wealth be rather volatile when measured in dollars.

If your wealth is in commodities, you will see your wealth be rather volatile when measured in dollars.

So, the dollar value of your wealth is somewhat of an illusion. What is more tangible is the amount of dollars your wealth will earn for you. Stocks pay dividends that are not directly related to the stock's share price. Bonds pay interest which is not directly related to the bond's share price. Farm land grows crops that are sold for a price which is not directly related to the land's estimated value per acre.

<u>A Story</u>: I ran across a couple that received a rather substantial inheritance. It was an amount that if invested until their retirement, could have generated a reasonable amount of additional income during their non-working years and given them a lot of financial freedom.

Instead, they converted the inherited *assets* into more tangible *assets.* They are now the proud owners of a recreational vehicle, a boat, two jet skis and two motorcycles. They consider these *assets.* But anyone in the financial industry knows that anything that makes a lot of noise and burns gas is not an *asset*, at least not a retirement income producing asset.

In our thinking wealth is the ownership of assets that produce a tangible benefit to you. That tangible benefit is important. Our friends in the story above would argue that their new *assets* provide them with a lot of pleasure. We would argue that their pleasure is not a tangible asset.

The dollar value of our wealth does provide a measurement, and sometimes a feel-good and sometimes a not so good emotional experience, but it is somewhat of an illusion.

What is the Cost to Purchase a Great Future?

Most people can answer, in a general way, the following questions:

- What is the cost of the home where you want to live?
- What is the cost of the automobile you want to buy?
- What is the cost of the two-week vacation you want to enjoy?

But what about this question? **What is the cost of a great retirement?**

Years ago, we would save to buy a home. Today most people borrow almost the entire purchase price of their home. They happily commit to paying for it over the next thirty years.

Years ago we would save to buy a new car. Today, most people borrow almost the entire purchase price of their car. They happily commit to paying for it over the next six to eight years.

What about your retirement? How much are you willing to *pay* for a great retirement?

- You don't know?
- You are planning to just see what happens?
- You think someone else will provide for you?
- You are willing to leave this to chance?

Oh, so you want to *pay* as little as possible and hope you will have a great future? I think you may be a little disappointed.

Retirement is Getting more Costly

If you have a bag full of one million dollar bills and you want to create a retirement income, what do you do?

Do you leave the dollar bills in the bag and take out what you need each month?

Do you take it down to the local bank and put the dollars in a money market account? This will earn you about $25 a month in interest. (The two biggest banks in Atlanta are currently paying 0.03% on their money market accounts.)

Do you invest in a five-year Treasury Note? This will earn you about $1,500 per month in interest.

Do you invest in a ten-year Treasury Note? This will earn you about $1,800 per month in interest.

Oh, you say, what about the *good Ol' days?*

True... twenty years ago, in 1997, your bag invested in one-year Treasury Notes would have earned you about $4,000 per month in interest. But, that was then and this is now.

What is the solution? How do I create a *Great Financial Future?*

> There is no easy answer on creating a meaningful retirement income. But, you must allocate a decent amount of your current earnings towards your retirement. In most cases the three or four percent we see so often, is not the answer. It must be much higher.
>
> Next you need to invest in income producing investments and allow the income to re-invest and compound. The income that most assets produce is generally much more stable than

the asset price. And, during retirement, what you will need is income, so invest for income and try to grow that income. These two things are about as simple as anything could be. However, it appears that many people fail at implementing them.

The "Divide" in Society

It seems so easy to find a "news" story today that proclaims how Americans are becoming irreparably divided. The story talks about income inequality or it talks about employment opportunity inequalities or it talks about unequal education availabilities. And the author of the story generally has a bias, sometimes a very strong bias, about one side of the story.

Well, I can't argue that some people have skills that make them very valuable to an employer and others lack the skills needed in today's society. And, I can't argue that a lot of jobs are disappearing and putting people out of work.

But, to some extent these trends have been going on for a long time with the difference being that today what used to take a decade or two now seems to happen in a few months. What does it take in today's world to be successful? Rich parents, private schooling, renowned college degree? What is the answer?

It has always seemed to me that being raised in an affluent household would be a real detriment to the future success of the child, UNLESS the parents worked very hard at keeping the child grounded. And, maybe private schooling is better than public schooling, but I doubt that is always the case.

My experience has been that many successful people come from middle-class families. But I believe it is more than that. It seems that the successful people are constantly challenging themselves. They are always looking for ways to improve and have an unstoppable urge to better themselves.

As a rather tangible example, look at sports. The great performers seem to constantly push themselves to be better. Isn't it interesting that not many "rich" kids excel at sports even though they have access to the best coaching, the best nutrition and the finest training programs.

What do you do to make sure your child, or grandchild, becomes successful? That's up to you to figure out.

Warren Buffett at The Berkshire Annual Meeting

(This is from Jody Chudley in *The Daily Edge,* May 12, 2017)

The first Saturday in May it happens.

Forty-thousand or so people book a hotel room, pack their bags, jump on a plane and come to the vacation hot-spot that is Omaha, Nebraska.

I know, it sounds crazy doesn't it? Nobody vacations in Omaha…

The reason that they all do this is even more bizarre.

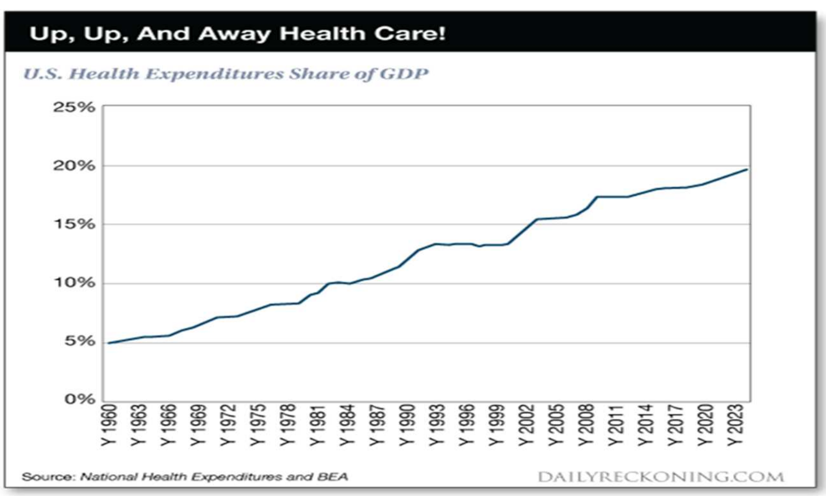
All of these people do it to sit quietly and listen to a 93 year old and an 86 year old share their thoughts and opinions! (He is referring to Charlie Munger and Warren Buffett at the Berkshire Hathaway annual meeting.)

President Trump's big proposed tax cut is obviously getting a lot of attention. For what truly is the number one drag on American businesses, however Buffett says that we need to look somewhere other than the current tax regulations.

According to Buffett it isn't the tax burden that is killing corporate America, it is rising health care costs…

On this issue Buffett didn't just provide opinion, he provided some data:

"If you go back to 1960, or thereabouts, corporate taxes were about 4% of GDP, I mean they bounced around some. And now, they're about 2% of GDP. At that time, health care was 5% of GDP, and now it's about 17% of GDP." (*Historical Data. Centers for Medicare and Medicaid Services, CMS.gov.)*



Obviously, this trend can't continue, but what will change it? I'm not sure, but I believe this disruption that is coming in healthcare will be a real mega-trend in the future.

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.

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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