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the BENEDICT REPORT

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WHAT A SEPTEMBER!

IS THIS THE END?

I'm writing this on Tuesday morning, October 7th right after Monday's big market drop. The remainder of the *Report* was written on Saturday morning after the "bail-out" legislation was passed. I mention this because, during times like this, the mood of the markets and the public can change rather dramatically from one day to the next and, sometimes, what one says can seem almost out of touch.

You may have missed a big story last week…the Irish government agreed to guarantee all bank deposits. This was a very big thing because European countries have no government guarantees of their bank accounts. Thus, money started moving to Ireland like an avalanche in the Rockies.

The Germans had already publicly complained about Ireland's actions, but they agreed to a week-end meeting of the big wigs from the European countries. At the end of the meeting, it was announced all countries would provide some guarantees of their bank deposits. However, the announcement was vague and confusing, making the big European banks wonder if it had any real substance. Thus, the banks were hesitant to loan any funds to other banks causing considerable panic. And, the European stock markets reflected that panic as did the U.S. markets and Asian markets.

What's next? I really have no idea. I imagine those European big-wigs will be more specific about their "guarantees" and reduce the panic that is in their banking system. During times like this, the stock market falls primarily because there are few buyers. That is just what yesterday's market felt like…no buyers.

There are still a lot of unknowns in the world's credit and banking systems, thus we are guessing that we will continue to experience a lot of market volatility, but market panics do create bargains. Think about it for a moment…do you think some of the giant global corporations are any less valuable today than they were Friday?

Is this the end? Of the world? Of the "bear" market? Of our banking system?

Maybe it is the end of something, we aren't sure, but it does appear that we can now own dominate companies at very attractive prices…maybe it is a BEGINNING!

WHAT A SEPTEMBER!

September is frequently a volatile month for the investing markets, but this September needs an adjective much more powerful than volatile.

I spoke with many people during the last week, generally, about the "bail-out" legislation that was going through the sausage grinder we call Congress. Many had strong feelings that we should not be "bailing out" those people who spent wantonly on fancy homes and cars and ran up big credit card bills. Others railed against "bailing out" those fat-cats on Wall Street who live such luxurious lifestyles.

But, it now looks as though the "bail-out" is a reality and, with expectations so high, I'm sure there will be some disappointment. I really don't like to see the political process get involved; however, it looks to us that it is possible that Mr. Paulson's plan will pay off handsomely in a few years. Time will tell.

The one thing the "bail-out" legislation will probably do is help us avoid a literal run-on-the-bank. The public was getting scared, with good reason. Over the last few weeks, we have talked to people more about the safety of their bank accounts and the FDIC than we have the stock market decline. And rightly so. If the markets decline, history tells us in a year or two they will recover. If we lose our “safe” money that is in the bank, it is lost forever.

Now, some of you are thinking the FDIC did provide coverage for $100,000. If people had more than that, just put it in two names or divide it among different banks. That is good advice for the couple who have a pretty good chunk in one single bank, but what about the businesses that possibly have very large operating accounts in a bank? We had to restore confidence, or at least reduce fear, of our banking system.

Anger?

Like you, I have witnessed the turmoil on Wall Street over the last few weeks. I should be totally angry as I watched the arrogant bosses of those haughty brokerage firms. I should boil with anger when I think about the almost fraudulent doings at Fannie and Freddie - - right under the noses of our politicians.

I am very sad as I think of the employees who suddenly are out of a job and probably out of the industry permanently, because of the crumbling of the Wall Street way of doing business.

I am even sadder for the shareholders of companies and banks who believed in their employer so much that they had most of the wealth in shares of THEIR company’s stock. The dividends that were giving them a pleasant retirement disappeared almost overnight.

But, it isn’t really anger that I feel. It is that we are obviously not regulating the right things. I have to be careful here, because the same regulators who have kept a tight reign on Wall Street regulate our office. The problem is that their system of regulation is to focus on nit picky little things that are easy to measure - - while every few years some big thing happens that seriously hurts investors and the economy.

Am I going to be all right?

The question is phrased differently, but I believe the words out of most people’s mouths are “Am I going to be all right?” And, generally, that relates to the stock market and the performance of their investment accounts.

I think the answer, to the best of our ability, is quite simple…if your *financial plan* is solid, then you will be all right.

Now, most people mistaken a *financial plan* for an *investment strategy*, but they are very different. Let me explain with two examples:

- Person A is withdrawing far more from his investment account each month than it can possible earn in dividends and interest. He is counting on an *investment strategy* to make up for withdrawals that are too high. He will not be all right.

- Person B is looking forward to retirement in a few years, but hasn’t really saved enough to provide him with the retirement income he will need. He is counting on an *investment strategy* to perform so well it will make up for his lack of savings. He will not be all right.

You cannot count on an *investment strategy* to make up for a *financial plan* that is deficient. I realize it worked for a few years in the 1990’s and had many of us believing the fairy tale was real life, but we are now paying for those years of unrealistic high performance with years of lower performance…that’s how markets work.

Shouldn’t we get out of the “market” and wait for things to stabilize?

I can easily answer this question. No! You just do not stay in a market as it loses 25% and then move to a money market fund. Look at history and you will see that it is likely that most of the decline is behind us - - not ahead of us. You will also see big declines are usually followed by rather big advances. To get out of the market now is like selling your house during the worse storm in the last five years…you will get a lousy price. Get out of the habit of watching all the “stuff” that is happening daily and focus on the future!

I can see the Dow Jones[1] at 15,000 and at 20,000. That vision is very clear to me. The dates of these happenings are a little murky, however. But, it’s the future we are dealing with not the past.

[1]The Dow Jones Industrial Average is an unmanaged index that cannot be invested into directly.

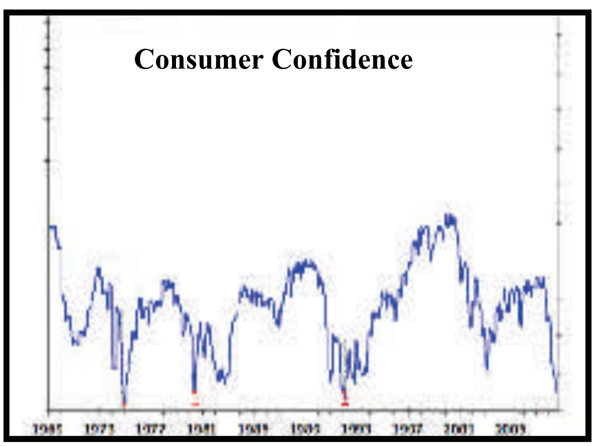
But, it’s different this time…they are comparing it to the 1930’s.

Ironically, I have just finished two books that dealt extensively with the 1930’s. About the only similarity I can relate to is what I mentioned above…the fear of a run-on-the-bank. Our banking system would collapse if a large percentage of the depositors withdraw their funds over a short period of time. It appears that risk has been avoided.

Beyond that, this is not the 1930's. Go talk to your grandfather or someone who was an adult during that period of time. We are not at 25% unemployment like the 30's. By 1934, almost one-half of all mortgages were in default. Today over 94% of all mortgages are current. [Investor's Business Daily, October 6, 2008]

We are in the midst of a normal cyclical market correction. The housing glut continues and cautious consumers have curtailed spending. More banks will fail. Unemployment will rise, but that is a natural cleansing process since we have added over 9 million new jobs since the end of our last recession in 2003. These are all normal signs of a recession. Actually, I think we have a certain segment of the population that feels if they are having trouble making their monthly Cadillac Escalade payment, then we are in a Depression and the government needs to fix whatever needs fixing so they will not feel the pain.

Look at this chart of Consumer Confidence (Confidence Board). Almost every time the confidence level got down to about where it is today, the stock market started a strong upwards trend. Now, I'm not saying that at some particular day after the confidence hits a low point, the market starts a rally, but I am saying about the time the public is most fearful, they should be most hopeful.



The recently deceased legendary investor, John Templeton, is quoted as saying, **"Invest at the time of maximum pessimism."** I don't know if we are at maximum pessimism right now, but if we aren't, it must be right around the corner.

"The way to make money in the stock market is not to get scared out of it!"

Peter Lynch—Magellan Fund

But, aren't we going into a recession?

As we have discussed before, many regions of the country and many industries are already well into a recession. The Great Lakes region that once prospered on the back of the domestic automobile industry is in a big economic funk. Talk to people in the real estate and related industries and I think you will find that they feel they are in their own depression. And, quite frankly, residential real estate cycles generally last several years, so hang on.

Other parts of our economy are slowing and, in some cases, slowing rather dramatically. We are de-leveraging, meaning being forced to pay back borrowings that fueled our lifestyles for the last several years. This almost has to create an economic slowdown...it's how the business cycle works. It is normal, it doesn't feel good, but it is inevitable. And, since we haven't had a real recession in several years, this may drag on for some time.

I think we have way too many banks. What if one-half of the banks in the country disappeared...hopefully, not with our money...would most of us miss them? We are over-retailed in this country. What if one-third of the strip shopping centers disappeared, would we miss them?

We have too many mutual funds, we have too many annuity salesmen, we have too many of almost every thing financial. These groups need to slim down and allow the productivity to be re-deployed into other industries that make real things, such as: high-end manufacturing, bio-tech and infrastructure upgrades. The mortgage broker who is sitting around moaning due to the loss of his profession needs to re-create himself as a mortgage work-out consultant. Think of how many people need someone who will help them make decisions about their current mortgage, not just try to sell them a new mortgage. A consultant could work with the bank and save the home for the owner and the loan for the bank.

A slowing economy and less attractive loans means that many people will be keeping their cars longer. The unemployed auto worker needs to re-tool himself as an auto mechanic. Go to where the demand is; don't just sit there and watch your ship sail away.

What a September, but what about October?

This month should be interesting. October is usually one of the market's wildest months...both good and bad. Most really bad markets, in the past, have begun in October...and most bad markets, in the past, have ended in October. This bad market started in October 2007... time will tell.

And do remember that, generally, the stock market starts to improve about the time the recession hits hardest.

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Tell me again…How Bad Is It?
If you want to measure the market by the Dow (Dow Jones Industrial Average), it was down about 30% over the last twelve months.

That's terrible, has it ever been this bad before?
Since 1948, we have had twelve significant market declines with the average decline being about 23%.

Shouldn't I get out of the market?
I would think it is way too late now. Let's look at history. After the twelve declines mentioned above, we had market gains each time with the average gain being about 125% and lasting almost four years. (Investment News, September 15, 2008) Markets go up and markets go down; that's what they do. (For those of you who are mathematically challenged, an increase of 125% of the current Dow would equal 22,500.)

How do you feel about the last twelve months?
This market decline reminds me of the 1994 decline. In both cases, our more aggressive holdings went down, which one would expect, but also our defensive holdings declined almost as much.

Why did the defensive holdings decline so much?
This market was anticipating an economic slowdown but it also suffered greatly due to the credit problems of the world banks. Thus, investments like corporate bonds and preferred stocks dropped significantly due to fear.

How can you live through the dramatic down markets and not be worried?
It's not that we aren't concerned or are oblivious to what is happening, but, when we make investments, we consciously or unconsciously accept the fact that we are going to encounter times when economic conditions, political actions and other things create strong emotions and market values decline. But, in our case, many of the investment accounts we manage are retirement accounts and we are just as concerned about five years from now as we are yesterday.

How can you say this decline doesn't matter to someone's retirement?
I didn't say it doesn't matter; I tried to say market declines are inevitable and thus expected. What isn't known is when and how severe. But, do remember that, if your retirement account was producing two thousand dollars of monthly income one year ago, it is probably producing the same two thousand dollars today, despite the decline in account values.

But, what if I have been withdrawing way more than the income from my retirement account?
Then a bad market like this inflicts serious harm on your financial future. Lower, or stop, your withdrawals immediately - - or you will be broke in a few years!

Shouldn't we have had more foreign holdings in our account to give it more diversity?
In the past twelve months, the Dow Jones has declined about 30%. Let's see how other country indices compare as of 10-6-2008::

United Kingdom	-40%	[FT Stock Exchange 100]
Japan	-34%	[NIKKEI 225]
China	-51%	[Shanghai Composite Index]
Taiwan	-42%	[TAIEX]
Germany	-39%	[Deutscher Aktien Index]
Brazil	-44%	[Bolsa de Valores]

Don't you think that this time things are worse than ever before, even as bad as during the Depression?
The current storm always seems more severe than past storms. I was sitting in this chair in 1980 (the chair was newer and my hair darker!) and I had people telling me they were thinking of buying property in the Bahamas because our entire system was crashing. One of my newsletters tried to compare the merits and disadvantages of MONEY MARKET MUTUAL FUNDS versus MONEY MARKET DEPOSIT ACCOUNTS, which banks had just been authorized to offer. I don't remember which one I thought was better, but I do remember the interest rate offered by each was 21%.

One of the best selling books of 1980 was Douglas Casey's CRISIS INVESTING in which he predicted a ten-year depression in this country beginning before 1983. Howard Ruff, the author of HOW TO PROSPER DURING THE COMING BAD YEARS, A Crash Course in Personal and Financial Survival, had his own television program. (He has a new book out entitled, HOW TO PROSPER DURING THE COMING BAD YEARS IN THE 21ST CENTURY.) Casey's urge was to buy property outside of this country. Ruff's was to buy gold.

During this time, the early 80's, I watched a building constructed on the east side of Roswell Road about one block north of Peachtree. I believe it was called The Vault. It had no windows and, reportedly, the concrete walls and the roof were lined with steel bars. Here, for a monthly rental <u>in dollars</u>, you could protect your gold and silver from government confiscation when the economy and banking system collapsed.

In the early 1980's interest rates were very high and mortgage lenders came out with what was called a "negative amortization mortgage." In the twentieth-first century, we had a catcher name for these loans called “Option ARMs.” During this time unemployment was very high, homes weren’t selling, kids were stealing their neighbor’s silver and taking it to the many store-front shops that bought gold and silver.

From *TIME* magazine, January 10, 1983. THE DEBT BOMB Never in history have so many owed so much money with so little promise of repayment. At stake is a gargantuan debt, a $706 billion lien held by banks, governments and international financial institutions around the world. It is a sum nearly the size of the annual U.S. budget and more than three times that of Japan's; it is $154 for every man, woman and child on earth. It has mushroomed from about $100 billion only twelve years ago, keeping borrowers in bondage and lenders in growing suspense. Much of it may never be paid off, and a major default somewhere, somehow, could trigger far-reaching political and economic reactions everywhere. The global economy is sitting on a debt bomb.

The risks, according to U.S. Federal Reserve Chairman Paul Volcker, are "without precedent in the postwar world." Says British Financier Lord Lever: "The banking system of the Western world is now dangerously overexposed. If lending abruptly contracts, there will be an avalanche of large-scale defaults that will inflict damage on world trade and on the political and economic stability of both borrowing and lending countries." The financial community says Rimmer de Vries, chief international economist of New York's Morgan Guaranty Trust Co., is "in a historic period. There is a lot of worry that things could get out of hand."

I was sitting in this chair during the 1987 market meltdown. Our recent *record* decline of 777 points was a decline of about 7%. Two consecutive days in October, 1987 the Dow Jones declined almost 30%.

Two years later we had the junk bond scandal which helped create the savings and loan crisis. During this period of time, over 1,600 banks and savings and loans were closed down. Bankers went to jail, politicians called special hearings and new regulations were passed.

But, we’ve never seen the really big banks and brokerage firms disappear like this time, have we?
Most people don’t remember Continental Bank of Illinois or the Bank of New England or E.F. Hutton or Drexel, Burnham, Lambert, and the list goes on. I imagine twenty years from now Lehman Brothers, Bear Stearns and AIG will be mere footnotes of history.

Is the economy really in such bad shape as we hear?
I imagine it is going to get a lot worse before it starts getting better. Two major factors are working against the economy currently:

- Worry about employment. And, when people are worried about their jobs, they don’t go out and buy a lot of new things.

- De-leveraging of the financial companies and households. Leverage is the use of borrowed funds and that is currently reversing itself all over the country. The headlines shout the problems of the banks but many Americans have their households just as strung out on borrowed money. High mortgage payments, high auto loan payments, school loans that are still unpaid, credit card balances and some people even owe on their television sets and furniture. These households have such high fixed costs they are very susceptible to any economic slow down.

You have written before that there are two groups of households…those who have no debt and those who are deep in debt. Don’t the people who have no debt still have plenty of money to spend?
Yes. But, generally, the people who have created the most wealth are the slowest to spend it. And, ironically, that group is probably cutting back on spending now more than their indebted neighbor. That is their nature.

Didn’t these events surprise you?
We actually wrote a newsletter in September 2007 entitled, 1987 REDUX? So, there was no surprise about the stock market going down and the economy slowing. The surprise is how severe the credit situation was. But, I’m always surprised when markets turn how fast they can go down and how much they can go up.

Now that I’ve said that I also will tell you that if all your neighbors are starving and you are sitting on your deck gorging yourself with the food and drink that you purchased with your gold, you may need some other things…like a lot of guns. Hungry people do desperate things!

“If you pray for rain, be prepared to deal with some mud!”
Mary Englebreit

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