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the BENEDICT REPORT

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BILLIONS AND TRILLIONS

I'm so tired of hearing the terms billions and trillions.

I don't know why the stock market is in the tank?

You must have noticed that almost every economic news story tells us how "this is worse than the Great Depression."

And, how about watching our biggest brokerage firms grovel and beg foreign governments for money? Wasn't that a pretty picture last October?

I get a little frightened every time Congress gets ready to pass anything. But, it got really stressful watching them confronted by the President, the Secretary of Treasury and the Chairman of the Federal Reserve who stood there predicting an end of the world as we know it if they don't do something...immediately! What in the world does a typical representative know about the world of finance anyway? For one time in my life I almost felt sorry for that group.

Add to this the words ***bail-out***. Since when did this term become part of our daily conversation? I really don't know if our *bail-outs* are/have been/will be good or not, but I'm pretty sure they are going to cause us a lot of pain in the future. We are *bailing-out* banks, brokerage firms, states, manufacturing firms, mortgage holders, etc. Makes you proud to be an American, doesn't it?

I just don't know why the stock market is in the tank?

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My Friend!

It's late November and I see him for the first time in over a year. "Phil, how do your clients like this market?" he asks. "Oh, they like to feel pain!" I respond (It was meant to be a joke folks, really!) "Well, I don't." he offered "I called my broker this morning and told him to sell all the stocks and move to government bonds. I'm glad I've been putting all my money, the last couple of years, into remodeling the house and not the stock market. At least, when real estate prices settle down, I'll double my money in my house."

He then went on to explain how well his one stock has been doing and how I should buy it for all our accounts.

I didn't respond other than shaking my head. Investing is very much a battle of emotions. My friend says "that *when real estate prices settle down"* and he really means when they get back up to the ridiculous level that he thought his house was worth at some time in the past. Real estate prices will settle down at some point, but it is very unlikely they will start rising rapidly to the level of a couple of years ago. He thinks the prices of two years ago were real and today's prices aren't.

He sells all his stocks at what may be the lowest point in this cycle. You just cannot own stocks as the market loses almost fifty percent of its value and then sell them. That's like selling your beach house during a hurricane.

"Move to government bonds" he said. Oh, that's another good move...at the time interest rates are literally zero.

Investing is very emotional and my friend just let his emotions wreck any financial plan he may have had. We have to learn to manage our financial emotions.

Inside:

WHAT CAN WE LOOK FORWARD TO?

For the economy, it appears that the first few months of 2009 will be ugly. We are expecting to see a rush for hand-outs at many levels. It appears the auto industry will need more, homebuilders want a big gift, other industries will want their share, many states can't pay their bills and several cities are broke. Congress will feel like a tourist walking down a street in Haiti.

I doubt all this begging will make us feel good about anything.

Banking and Credit Availability

The news is full of articles chastising banks for not lending out all the money that the government has given them, money that would help get the economy moving forward again. But, think about it. First, several banks/brokerage firms were literally shut-down or threatened with the same because their *reserves* fell below specified limits. What would you do with the new money...build up your reserves is my guess. I'm not saying it's right or wrong, but I believe the natural tendency is to survive.

Secondly, if you are a bank and you see lending rates falling and falling and you see small business owners and consumers having more and more problems paying their bills, would you be anxious to lend out money?

Thirdly, government intervention is a two-edged sword. While it may help someone in need, would you be anxious to invest your money in mortgages if you thought the government could casually come in and all of a sudden say that your mortgage is now worth only 50 cents on the dollar?

What will solve all of this? Time tends to heal the wounds of lack of confidence, but no one seems willing to wait. Lending will begin flowing again, but our guess is that it will come from the non-giant banks....the ones that didn't do stupid things before. But, these bankers will only loan to borrowers who have the capacity and history of moral responsibility of repaying their debts, thus lending will seem much more subdued than in the past.

Confidence in the System…What a difference a year makes?

- He works in the financial division of a large public local corporation and tells us how his company has over one billion dollars in cash (about three times the amount they usually have, but they are worried about the economy). A year ago, it would have been invested in thirty day *commercial paper*; however, now the money is sitting in Treasury Bills earning absolutely zero. This same money invested in *commercial paper* would earn the company almost twenty million dollars annually. This money would essentially fall directly to their *bottom line* as sheer profit. They are afraid, they don't trust, they are frozen in place.

- She finds a nice two-year old car for sale that fits her needs perfectly. One year ago she could have financed the purchase through her home equity loan, but not now because the bank lowered her available credit due to declining real estate values. So, she asks the bank for an auto loan. "Not without twenty percent down" they offered.

- Last year many hedge-funds were making money by borrowing short term money at low rates and investing in commodity futures. The more money they made the more new investment money they attracted, thus the more money they borrowed and the more commodity futures they purchased pushing the commodity prices higher and higher. It was a great cycle, until they could no longer get new loans and the existing loans were not renewed. Suddenly, the cycle reversed…sell commodity futures to pay off loans. Sell stocks to pay off loans. Sell anything. Prices of almost every asset class dropped dramatically.

Jobs

The industries that are hurting the most are the industries that flourished on very easy credit... finance, housing and automotive and retail because of credit card purchases. Job losses in these industries have been tremendous and will probably continue to increase. I wouldn't be surprised if we don't see one-third of our domestic auto dealerships close and one-quarter of our shopping malls vacant.

We are an economy that is *unleveraging* (kicking the debt habit) and it is painful and likely will continue to be painful.

Employers started *hunkering down* last fall not knowing what to expect. They raised cash and cut expenses and employees are one of the biggest expenses for many companies.

And, to compound the job loss problem, many companies that are doing well will find this an opportune time to lean up a bit. Actually, if you are a shareholder in a company that doesn't eliminate a reasonable number of jobs in this environment, don't you question your management? This is the time to get lean-and-mean, this is the time to focus on your core strength and eliminate the unprofitable ventures and this is the time you can eliminate some workers. In many cases, it's not because the worker isn't qualified or isn't a good person. This is the time to refocus your energies to stay profitable and create new enthusiasm for the next era.

What will solve our jobs problem? Again, we need some time. In the past, companies frequently found they eliminated too many jobs and we had strong hiring as the economic recovery gained steam. But, the unemployed can't wait, thus the government will come in with some rescue programs that may put a band-aid on the problem, but keeping debt-laden, zombie companies afloat and bailing-out bankrupt households will not be the real solution.

The solution will come as it has in the past. In a few months, some companies will look around and say something like:

"Two of our competitors have gone out of business. Our business is improving every day. We don't feel the tremendous pricing pressure that hampered our profitability for the last several years. We can rent new space at a very reasonable rate. There seems to be well qualified, motivated workers available that we couldn't find in the past. Maybe we should expand?"

And some people will look around and say something like:

"We have always wanted a place at the beach and the prices seem to be about as low as they will ever be. Let's go beach house shopping. And, once we buy a place, we want to spruce it up a bit with some new flooring, furniture and window coverings. We are actually anxious to move in. And, since we will be traveling there frequently, maybe we should look into a new fuel efficient car."

INTEREST RATES

I was sitting at this desk in 1981 when the interest rate on the three month Treasury Bill was at an annualized rate of 15.3%. (For those of you who might be a tad mathematically challenged, this meant that someone with $100,000 in a Treasury Bill at that rate for a full year would earn a cool $15,300. Who needed to mess around with the stock market and its crazy gyrations or buying rental real estate and putting up with tenants who feel paying rent is optional when you could earn this kind of money for doing nothing? Those were the *good ole days*, at least if you were a saver. If you were a borrower, things did not feel quite as rosy. Why were rates so high? People were afraid. Financial experts were warning that our economic system would not survive. People were hiding gold coins in their basements. Home buyers were reverting to a popular new mortgage called a *reverse amortization* mortgage to keep their payments low. The stock market was terrible and the residential real estate market was worse.

As we enter 2009, twenty-eight years later, what are interest rates on the Treasury Bill? Zero, nothing...you invest $100,000 for one year at this rate and at the end of the year you have earned...nothing. (For you purists, on some days last week the rate was up to 0.1%, which I realize is better than zero.)

Why would anyone do that? Because they feel they will at least get their money back. People are scared. You see big depositors aren't helped much by the FDIC that covers the first $250,000 at the bank. So, where do they put their money when they don't trust anyone...short-term Treasury Bills. Thus, the huge demand has literally pushed the rates to zero. This is a crisis created by lack of confidence...in the banks, in the system, in the fear that government may intervene, etc.

NOTE: I truly believe I could have polled each reader of this *Report* in 1982 as to what they thought interest rates would be twenty-eight years later and not one single prognosticator would have given me a zero answer. Of course, I don't think many would have predicted that the Dow Jones Industrial Average[1] would be 9000 either…it was 873 at the end of 1981.

Where are interest rates headed in the future? Since they are literally at zero, our great forecast is that they are going up! How's that for climbing way out on the limb? Now, how much they are going up is a more difficult question to accurately answer.

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

BEWARE THE DINOSAURS!

I have always thought that 1968 was the year that heavy manufacturing peaked in this country. We were teaching *management* in our colleges and universities and we felt our theories and practices is what made us superior manufacturers. What we forgot was that we were about the only economy that survived World War II, thus what made us so successful was lack of competition. No bell rang in 1968 to declare the end to our superiority and our economy slumped somewhat, but recovered in a few months. It wasn't until 1973-74 that the real recession hit. Many of the companies and practices that gave us the economic boom of the 1950's and 60's became laggards after the recession of 1973-74.

It certainly feels like 2008 will be the year that *creative financial engineering* died. (Maybe I just hope so, but I think it may be real this time.) For many years the geniuses of Wall Street were able to manufacture profits with computer models that "hedged" all the risk out of a transaction. As it turned out, maybe those MBA classes missed the chapter on what happens when the poop hits the fan. When a cataclysmic event happens, there will be deep and long-term reverberations. But, these reverberations are like what happens in a drought compared to a tornado… slowly, but permanently.

Many of the companies that have been icons of corporate superiority may continue to look powerful but beware of the ones that are just dressed up dinosaurs.

Who will turn out to be dinosaurs? I'm not sure, but an easy guess is that some will look like Wall Street Investment Bankers, some will look like giant banks and some will look like real estate tycoons. These seem pretty easy to spot, but there will be others…maybe some credit card companies, maybe many retailers, etc. Maybe a dinosaur is a process or event…like the idea of buying a new car every two years whether you need it or not…just to impress yourself. Maybe our public education, especially our urban public education, will turn out to be an arcane way to train our youth. Only time will help us sort out the new and powerful from the camouflaged obsolete.

Let's Hope this is a Dino

> *Detroit and Wall Street were once best of friends. During the first five years of this decade the auto industry paid $1.75 billion in fees to investment bankers (Wall Street brokerage firms) to sell more than 1,100 new debt issues (bonds). Even in 2008, the auto industry issued $38.1billion in new* debt. [Source: David Weidner, Market-Watch, December 4, 2008]

What we had/have are auto companies, some of which probably won't be able to repay their debts, borrowing more and more with the help of investment bankers who just might have known some of these debts will never be repaid.

How is this good for the country? For the economy? For the retiree? For the shareholders? As an investment banker how do you look your client straight in the eye and say…this is a good investment for you?

It's not and I hate it.

> *During the first nine months of 2008, the auto industry spent nearly $50 million lobbying Congress. And, people tied closely to the auto industry gave another $15 million in campaign contributions.* [Source: CBS News, investigative correspondent Sharyl Attkisson, December 3, 2008.]

Let's see, these two amounts combine to be a mere $65 million. I wonder how much research into a new fuel efficient car that would fund. Or, maybe they should have used the funds to finance new car purchases. Or, maybe they should have given it to the new UAW VEBA so that organization would be spending their time, money and energies providing for their members instead of asking for a hand-out.

> *"The United Auto Workers organized a $55 billion VEBA for employees, with $15 million earmarked for lobbying efforts for single-payer health care." [Source: Health Insurance Underwriter, December 2008.]*

I'm not trying to make judgment on the auto industry *bail-out* or on the merits of some form of universal health care system. What bothers me is how these players have taken their focus away building great autos or making sure their members have good lifetime health care to asking for benefits and privileges from the system.

Am I the only one that senses that this is like a sports team bribing the umpires instead of focusing on improving their skills and execution. I just hope this industry is an isolated case and this practice becomes a dinosaur.

One of our favorite quotes from the banking crisis is by SunTrust CEO, James M. Wills, III upon receiving a nifty $3.5 billion from the U. S. Treasury. **"…we are pleased to support the Treasury in its ongoing effort to address dislocation in the financial markets…"**

Can't you just feel the patriotism in his voice?

LET'S TALK ABOUT THE FUTURE!

This is a very necessary recession. One, we have to get out of debt as a society. (We will talk, in the future, about the government has to get out of debt also.) Two, profit margins have been declining for years. In fact, many companies were creating their profits with their financing and not on the manufacture or sale of the products. This could not go on forever.

Mortgages may go down in history as the villain of this economic mess and, maybe, that is true. But, let's keep them in perspective. The headlines read something like ALMOST TEN PERCENT OF ALL MORTGAGE HOLDERS ARE BEHIND ON THEIR PAYMENTS OR IN FORECLOSURE. That seems to be true, but do remember that fifty percent of the homes in the country have no mortgage. So, ten percent of the mortgages is actually five percent of the homes. Subtract the mortgages that were speculations on beach condos or Vegas strip vacation homes and subtract the mortgages that were given to people who will never be able to make one payment and the True *troubled* mortgages is somewhat less than five percent. [Source of mortgage information: Van Eck Mortgage and Property Hotline]

The era of the deal-maker has certainly been muted. In the future we may see that we have to EARN IT, not SCHEME IT. GROW IT, not PRIME IT. WORK IT OUT, not BAIL IT OUT.

It's obvious economic conditions are bleak and will probably remain that way for several months. But, what's not so obvious is where the stock market is going. The stock market is a forward-looking animal, so be very careful using recent history to predict future results.

Where will the money come from to spark a stock market rally, isn't everyone literally broke?

Last week the Leuthold Group, a research firm, said investors are holding $8.85 trillion in cash, bank deposits and money market accounts. As a country our Gross Domestic Product, all goods and services created in this country, is about $14 trillion annually. I offer this so you can see the magnitude of the $8.85 trillion number.) This is equal to 74% of the market value of all U.S. Companies. This is one of the highest cash-to-market ratios ever.

According to the Federal Reserve's December 18, 2008 release, excess reserves of depository institutions have increased from under $2 billion in August to $774 billion at the middle of December. Excess reserves are what banks have available to lend.

Financial Times [December 30, 2008] reports that twenty of the largest companies in the world are sitting on a combined cash pile of $570 billion.

SHOW ME THE NUMBERS!!!

Million	1,000,000
Billion	1,000,000,000
Trillion	1,000,000,000,000

It doesn't get much better than this!

If you have been sitting on a pile of cash waiting for things to get *right* before you invest, you need to invest now or forget ever thinking about it again. There is no reason the next ten years of the stock market shouldn't reward investors very well. The key to successful investing…in the stock market, in real estate, in everything…is buying at a cheap price. If you buy at a cheap price, almost every investment works out. Today, the stock market is cheap.

But, that doesn't mean everything is perfect and your ride to the future will be without any bumps. Think of what it is like recovering after major surgery…one day you feel much better but then comes the relapse. And, this recovery could go on for months.

Also, we still have a lot of debt to get out of our system. Companies are going to go bankrupt. Households are going to go bankrupt. But, just like some of the most beautiful skies are after a terrible storm, it seems to us that a new stronger economy will follow this storm.

If you are not part of the storm, then sit back and watch it play out. If you are out there scrambling to overcome major set-backs, keep on scrambling for all you are worth…we are cheering you on!

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