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# the **BENEDICT** REPORT

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## **I'M ANGRY AND I'M SCARED!**

*"I'm a little frustrated and a lot scared. It seems as though our entire world is falling apart. I'm angry at our politicians, big banks and almost everyone else. Is anyone looking out for "we the people" or does it just seem as though everyone in a position of power is hell-bent on destroying our system?"*

*"I had high hopes that things would be different, but they're not. This has been very disappointing."*

*"I read how the stock market came up way too fast and is headed for an ugly decline."*

*"It sure feels as though we will lose a lot more jobs before this recession ends and even then I can't see where the new jobs will come from."*

*"We are spending money like a drunken sailor and are told that we have to our world will end if we don't..! Do our leaders not accept that some day we will have to pay this money back? Or, are they just living for today like so many of our households were living for the last fifteen years? Does anyone care? Won't someone please listen?"*

*"I heard on television that Social Security is going to be broke in just a few years and Medicare will run out of money even faster. I guess that's not a problem for our leaders because they never mention it. Maybe it's because they are not dependent on these - **as they have their own special retirement and special health-care.**"*

*"They say the economies in countries like China, Russia, India and Brazil are strong and growing. What in the world did we do we shouldn't have done? Why are we now a beggar nation?"*

*"I read where the Federal Reserve Chairman said the recession is over. I don't know him, but I've gotten where I don't believe him or anyone else in Washington."*

*"I'm angry, I'm unhappy and I'm very scared and I don't know what to do! What should I do?"*

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Obviously, there is a lot of unease and tension among the citizens of our country right now. We are all looking for signs of the new beginning, a time when yesterday's trauma is forgotten and our focus is on the future, not the past. We want our leaders to come out strong and tell us that things will be much better, and soon.

However, I don't think our leaders have told us that, at least not in a way most of us believe and there is a reason they haven't...they can't.

I've never experienced being on a battlefield during wartime, but I can imagine it is a little like being in today's economy. We are relieved because it appears the last big battle (the financial melt-down) didn't kill all of us. But, as we look around, it is very obvious that we have a lot more battles (financial and economic) ahead of us before we can march in the victory parade.

Deep down we know we have to charge forward to victory - but the pain of the last battle is still so real we are very reluctant to act. We hope our Generals know what must be done to lead us to victory, but we are receiving very mixed signals from their actions. And, we are wondering if our inability to strike out right now, even when we don't want to, won't greatly hinder our chances for victory.

It is a dangerous time to be a foot soldier or a General.

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The big debt bomb has exploded and asset values in this country and all over the world have imploded. Most asset values have, or will, fall to about one-half of what they were valued at during the peak of the debt mania economy. This has created many, many problems, some of which we haven't accepted and don't want to accept.

When a big asset class goes into free-fall, nothing the government can do will stop it. It doesn't matter whether that asset class is common stocks, residential real estate, commercial real estate, oil, natural gas, gold, wheat or almost anything else you want to add to the list. Oh, the government(s) can take action, and they usually do, to try and stop the plummeting but, generally, all these actions do is prolong the pain and delay the recovery.

**Right now it seems as though most of our actions are doing nothing but prolonging the pain and delaying the eventual recovery.**

First, let me give a couple of examples of what I call "prolonging the pain." The government has guaranteed almost ninety percent of all the residential mortgages issued this year, many of which were given to buyers with minimal down payments and mediocre credit histories. What's the future of many of these mortgages...too many defaults, of course. But, we had to do it, they say, or housing prices would have fallen further.

I doubt anyone in the residential real estate field shares my opinion, but trying to prop up home values with phony low interest rates, minimal down payments and home buyer credits may give us a temporary feel-good, but it greatly prolongs the long-term healing. We have to let the prices hit bottom before the real healing can begin.

The cash-for-clunkers may have been a feel-good to the auto dealers in August, but didn't I read that sales fell 24% in September? I do not believe government economic band-aids heal broken economic bones.

The stock market is, generally, a quicker "heal" than the real estate market, because there isn't as much the government can do to stop stock prices from plummeting to whatever level the market forces decide is the bottom. The *liquidity* of the stock market is its greatest weakness and its greatest strength. Real estate does not have this liquidity, is much more

personal to most citizens and, generally, strapped with a large amount of debt. This makes for a long down cycle.

A massive number of commercial real estate mortgages are coming due over the next few years and the property values that support those mortgages will not come close to allowing most lenders to renew the loans. And, there won't be much voter appeal to bail out a strip shopping center. It will not be pretty, but it may heal much faster and much cleaner than the prolonged agony we will see in residential real estate.

As I said earlier, right now it seems as though most of our actions are doing nothing but prolonging the pain and delaying the eventual recovery. We are foot soldiers waiting for marching orders from our generals who can only see defeat if we move forward, they are playing defense.

**But, I'm not sure we have any choice!**

Americans, on the whole, have quit their excessive spending.

All of a sudden we have *supply* but no *demand*. Prices haven't fallen greatly, yet, but sales have declined for many industries. Lower the prices enough and demand will return...maybe! It will probably happen, but how much more do housing prices decline before solid demand returns? I don't know, but I guess it is considerable. Same thing with commercial real estate, cars and a lot of other things.

So, what our Generals see in the immediate future is what economists call DEFLATION. Economists don't like deflation, government leaders don't like deflation and asset owners certainly don't like deflation. And, it's even more than asset owners; wage earners don't like deflation either, maybe more strongly than the other groups. **Thus, deflation is to be avoided at whatever cost.**

And, it appears this is just what we are doing...avoiding deflation at any cost. Will it work? I don't know. Will there be consequences of our actions? I'm quite certain and assume rather severe consequences. But, will fear of severe consequences in the future help us make the right decisions today? I don't know, and that's exactly where I think the public is right now... **they can't see the signals that our Generals (government leaders) are doing the things that will moderate the pain today and not kill our golden goose in the future.** We know we are in battle, we know we aren't winning and we are fearful and scared!

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In case you think I'm bashing our leaders, I'm really not. I don't think their motives are wrong, I believe they don't know what to do anymore than anyone else does.

You may say that our leaders aren't the ones who got us into this mess and I would partially agree with that, although many of today's leaders have been in power positions for the last fifteen years. But, they are the only leaders we have. The fact that yesterday's Generals created today's war, doesn't make it easier or less important.

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I'm sitting here on a beautiful Saturday morning writing this feeling much like the pilot of a drone aircraft fighting a battle. I'm involved, but not nearly as involved as a real pilot who is hovering over enemy anti-aircraft guns.

## **WHAT WOULD GENERAL BENEDICT DO?**

We will not achieve victory until we have jobs and we will not create meaningful jobs until the private-sector regains confidence in the future. Thus, as General, it is my objective to move the Federal Reserve and the Department of Treasury from front page to second section news, much like what has happened to coverage of the war in Iraq.

The government stepped in and apparently saved us from economic melt-down; now the government has to ease itself out of the picture for the system to work. This is not an easy decision, nor is it without risk. If the government isn't spending money, who will? If the government isn't hiring, who will? If government leaders don't ease the pain of the voter, what happens?

It is frightening, it is not easy, it is also scary, but it has to be done! Without a strong private sector, we will not win the war. As General, here's what I will do: (Remember, I'm the drone pilot, not the one being shot at, so it's a lot easier for me to criticize previous actions and suggest alternative actions.)

First off, a government that appears out of control cannot be a strong leader. Our leaders must immediately talk and exhibit fiscal restraint. A General who is careless with the lives of his foot soldiers is never respected. A government that does not exhibit concern and caring for the future of its people cannot lead.

Fannie Mae and Freddie Mac are costing us billions every month in future taxes. Committing future taxes to a game of "bribing" people to buy houses is wrong. We risk "killing" the housing market of the future with higher taxes, higher interest rates and a rotten economy.

**We need to take our pain today!**

Freddie Mac just hired a new Chief Financial Officer (CFO). The pay...a "signing bonus" of \$2 million and an annual salary of \$2.9 million. [Associated Press 10-2-09] Is it showing respect for taxpayer's money when we pay someone ten times more than it takes to attract someone to be President to keep track of an agency that loses several billion dollars per month? I don't like that math. I think I could have made a couple of phone calls and found a top-quality person for a fraction of that salary. And, so what if his math is poor, he is only counting wasted federal dollars. **A General can't lead with this type of leadership.**

As General, I know its not the prima donnas (CFOs) who will win the war for us -- but the front-line foot soldiers who will make or break us in battle, thus we need to give all the help we can to this group and what they need are jobs.

## **We Need JOBS!**

We need jobs in this country. Without jobs we will need more and more government, which will cost more and more. Without jobs we will collect less and less taxes. Without jobs we will have more foreclosures. Without jobs we will not sell new homes. You do not need a degree in economics to realize that this trend is not sustainable.

**We need jobs!**

We will not get jobs by the government borrowing more and more and more. We will not get jobs by the government spending more and more and more. If that worked, we should have jobs everywhere by now.

## **Confidence in the Future means JOBS Today!**

Our leaders proudly recently announced that "federal pay raises will be limited to two percent." Hogwash! Almost every non-government employee citizen in the country is making substantially less today than two years ago and the government employees are going to get a raise? Those actions do not instill confidence in the government as a sound economic leader. If the troops don't get a raise, the General shouldn't get a raise.

As General, I need to take strong action to make the United States of America economically strong. We must live within our means and, if we need to reduce the number of federal departments, then I would eliminate them immediately. If it means across the board pay cuts, then I would make the cuts.

**There is never enough revenue if SPENDING is not under control. This applies to households, corporations and to governments.**

## **JOBS WILL NOT COME...**

Jobs will not be created when businesses are worried about new and higher taxes, new regulations and deflation. When business leaders and the world see our leaders are getting our house in order, good times will follow.

If we get our fiscal house in order, we will attract entrepreneurs from all over the world who will start businesses within our borders. Being part of America the Strong is where successful people want to be; however, **you don't get strong by being weak!**

Right now entrepreneurs and investors are afraid. People will not commit to the future if they fear higher taxes, higher inflation and higher interest rates. It is these same entrepreneurs and investors who will help create the jobs of tomorrow. The government will not create the jobs for the masses.

Some will say that it is these entrepreneurs and Investors who got us in the mess we are in. I disagree. I believe most of the mess was created by the regulations or lack of regulations from many of the same leaders who are in power positions today - combined with their very close relationship with the big bankers and brokerage firms. **It was not the businesses of Main Street that wrecked our ship, but too much power among too few.**

As General, I know America is the land where everyone has the freedom to pursue a better life. Boys and girls who live in remote villages can pursue a better life. Children of the ghetto can become leaders. If the government needs to act, it needs to act to give them more opportunities, not **things** like false affordable housing. We could create incentives to hire these

children, to locate jobs in these areas and programs to encourage their involvement to improve their communities.

Currently our employers have strong incentives **not** to hire!

Make it easy to open charter schools in depressed areas. Eliminate the bureaucracy of our educational system and allow administrators and teachers to experiment with different teaching methods for different areas. Give incentives to participants of successful programs. Develop programs where churches in some areas could use unemployed mothers to staff a day-care program and still receive their needed benefits. Listen and be creative. I don't have all the answers, because I've only experienced battle from afar. A good General would have a close ear to what his foot soldiers are telling him. But, remember, the foot soldiers we want to listen to are the ones who want a hand and not a hand-out, as they say.

## **What do we do to stimulate jobs?**

As General, I would give tax credits to business owners to encourage hiring, capital spending and research. To the average person these "tax breaks" to big businesses appear to be a hand-out, but I don't believe that is the case. First, I would aim the credits to smaller businesses as much as possible and secondly, if these businesses don't prosper they won't be paying a lot of taxes anyway. We WANT businesses to be very profitable, so they will hire a lot of people and pay a lot of taxes. **Success isn't the problem, lack of success is -** and sometimes we forget that.

During the 1970's we used something called the Investment Tax Credit to stimulate the economy during down times. I was involved in the tax preparation for business owners during part of that time and I saw how it would encourage owners to spend on big-ticket items. If you bought a new tractor for your farm, you reduced your income taxes by 10% of the cost of the tractor...that year, not spread over ten years. If you bought a new machine for your factory, you reduced your income taxes by 10% of the cost of that machine.

This Investment Tax Credit would create activity similar to the "cash for clunkers" and the "\$8,000 new home buyer credit" programs, but with a much greater *multiplier* impact on the overall economy, instead of merely moving unsold inventory.

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Offer a Tax Credit equal to 50% of the first year salary for each newly hired full-time employee. You might be surprised how many new jobs would be created almost immediately. Would it cost the taxpayers a lot of money? We are already paying that unemployed person benefits, why not turn it around and give the same amount as a credit for hiring taking that person off the unemployment rolls? I think everyone would win. Besides, creative entrepreneurs would use that extra employee to try and create new revenues which means more profits which means more income taxes. Besides,

**As an example, picture the owner of a trucking business getting a 10% credit for buying a new specialty delivery truck to expand his business into a new area and a 50% credit to hire a new driver. If he is successful, which he will try very hard to be, he won't sell the truck and fire the employee in thirteen months. Don't think it works that way? Then you've never been an entrepreneur!**

doesn't it make more sense to create incentives to work versus incentives to be unemployed? Give me soldiers who want to charge into battle, not hide behind in the shadows.

Americans love incentives. Did you ever read about building the cross-continent railroad? (I remember reading Stephen Ambrose's book, *Nothing Like It in the World: The Men Who Built the Transcontinental Railroad*.) Free land and money to the winning group had teams of men building more miles of track in a couple of years than the rest of the world had built in the previous ten. Using the same thinking the

government doesn't need to force car makers to make more fuel efficient cars, just give incentives for the creation of such a vehicle. We would probably find that some smaller, nimble company is the victor and the owners and their employees would benefit much like the early days of the tech companies. **Americans LOVE incentives...a smart General always remembers that!**

## Enough ranting by General Benedict!

We, actually our leaders, have some very difficult decisions to make and the next twelve to fourteen months will probably tell whether they will be successful in moving from the "panic containment" of the last fourteen months to the "new economy" we all want. If they/we are not successful, we will probably morph into a long term almost comatose economy similar to what Japan has experienced since the early 1990's.

## But, What Can WE Do?

It's one thing to sit and talk or read about what can be done to move our economy in a direction we feel will benefit us all, but what can we do, as our little part, to make it happen?

That's a tough question, what can us common people (foot soldiers) do to make a difference and to get our thoughts in front of the Generals?

An easy answer is to tell you to write your Congressman... "yea right, like he/she is going to read anything I write."

Actually, I doubt that if an elected official has a very different perspective about our economy and government than I have, it is very unlikely he will pay any attention to anything I say or write. In that case, I need to put my energies into electing a different official.

However, if we believe **strongly**, we can encourage our friends to **register AND to vote**.

I also think a very big "hole" in the electoral process is that many of our citizens who fall into mid-twenties to mid-forties age range, a group that may be impacted the most by the huge budget deficits of today, have been politically agnostic. It is understandable as it is the group that entered adulthood about the time the political process became a game of who could create the most whiney, childish television commercials and all the other things that have made up our election process the last twenty years.

Many in this group have been totally turned off by our election process. I don't blame them, but they must face reality and they **MUST** get involved. (It reminds me of how much most of the "tech" industry eschewed the political process...that is until Microsoft was slapped with an anti-trust suit. Suddenly, that entire industry realized they need to play-the-game or they will be losers.)

This last crisis is a wake-up call that we are hungry for new leadership; let's hope those not yet in middle-age become our saviors.

I have hope and I can end this and spend my afternoon riding my bicycle while the real "Generals" are fighting the real war for all of us. **I sincerely wish them well.**

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

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