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# the BENELECT REPORT

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## It's an Exciting Time to be an Investor!

If you are quietly wondering if there is some evil god of money that gets his jollies tormenting you, then you can come out of your closet because there are a lot of others who are wondering the same thing. You did what you thought were the right things, saving for years and years, investing for growth, paying down your home mortgage and dutifully handing over your fair share to the taxman.

Now, you feel like there is a bulls-eye painted on your shirt. The government wants more and more of your savings because, apparently, so many other people never saved anything. The interest you can earn on your savings is almost nothing because, apparently, the government wants to keep interest rates low to help out the giant banks. You were counting on Social Security being an important part of your retirement income and now it feels as though this will disappear because you have saved on your own. (As one friend commented, "it is called *Social* Security because it is there to help the people who need it, not those who were able to save a lot of money." Obviously, he has been one of the non-savers.) You are going to pay significantly more into the Medicare system and you know deep in your heart that the benefits you receive are going to be less and less over the years.

Countries all over the world have spent and promised way more than they can afford. States and cities have committed way more than they can pay.

He sat down beside me and commented, "I don't think I can take much more. How do you stay so calm? How do you know what to do?"

### "How do you stay so calm?"

"You look at your monthly statement and see a dollar amount" I suggested to my friend, "when in reality that dollar amount is sort of like the wind...it is temporary."

"I could tell that I lost \$10,000," was his immediate reply. "Obviously, you didn't lose \$10,000 or you would be upset too!"

*During a recent interview Mark Skousken asked Warren Buffet what does he collect, gold coins, art, wine, what? His response was, "I collect good businesses and good friends."*

Great businesses have proven themselves to be able to adapt to whatever happens to their playing field. Great businesses that are global have even more opportunities to survive and prosper. During inflationary times, they can raise prices and during deflation they can cut expenses.

"My monthly statement shows a collection of great businesses," I told my friend. "And, it seems to us that globally dominating, high-quality businesses is the asset-class that will outperform almost everything else over the next several years."

Most people have trouble owning these companies because their share prices can sometimes drop so dramatically. In the next few pages, we are going to outline a way that, if you can employ it, will allow you to invest in these companies and sleep comfortably at night - even when the headlines are filled with stories of economic horror.

### Let us explain...

#### Own the company and not the stock.

I realize we can only own the "stock" of a publicly traded company, so it is more accurate to say FOCUS on the company and not the stock price.

For a simple example, let's take a look at a giant consumer product company's actual history and see if we can focus on the company and not the stock.

### Let's look at the COMPANY over the last ten years:

- ◆ Revenues have more than doubled
- ◆ Dividends are almost three times higher
- ◆ "Free Cash Flow" is over eight times higher

### Would you like to own this company?

#### Let's look at the STOCK:

- It is currently selling for about \$60 per share.
- Ten years ago the stock was selling for about \$60 per share.

This company has been very successful. Management has done about everything an owner (shareholder) could expect it to do. It has increased revenues and profits and the amount of benefits to the shareholder (dividends).

What can corporate management NOT control? The share price, which is a function of the euphoria-and-panic of the financial markets.

If you are retired or planning to retire, your investment accounts are probably an important source of your retirement income. And, what do you really need in retirement? For most people it is the monthly **cash-flow**.

What has this company done for shareholder cash-flow over the last decade? It has almost tripled. There are no guarantees in the world of investing, but IF this company can triple its dividend over the next ten years, then the shareholder will be earning about 9% to 10% annually based on today's investment. That will be a nice retirement **cash-flow**.

**"I hear what you are saying, but don't you listen to the news? This country is in a giant mess and the mess seems to be getting worse every day."**

The original roots of this company go back to the year 1837. It has survived the war-between-the-states, two world wars, various terrorist attacks and all sorts of natural disasters and the leadership of a lot of inept politicians over the years. It was able to prosper during the terrible inflation years of the late-1970's and early 80's. Today most of its revenues are earned outside of this country, thus, it is not overly dependent on the domestic economy.

However, despite this resilience, the share price of this company has declined in value rather dramatically many times during its history. And, we would expect the same in the future. **Own the company and not the stock**; it is the key to your financial contentment.

**"But I hear that the U.S. Dollar is going to lose more and more of its value every year. Won't that hurt this company's performance?"**

A dollar in 1913, when the Federal Reserve was created, is worth about five cents today.

Do you see a pattern of the dollar losing its purchasing power in the past? Our governments have been promising more than they can deliver for many, many years.

**A tale:** Farmer McDonald owns a nice farm that includes many acres of land. He has owned the acreage most of his adult life and plans to leave it to his children when he passes to the big hayfield in the sky. Each year he raises various grains and animals and is able to provide his family with a good living.

Suddenly some "speculators" come into the community with big checkbooks and the value of farm land goes up substantially.

How does this benefit our good farmer? Oh, when he hops out of his pick-up truck in front of the local diner, he may hold his chest a little higher as he now considers himself "rich." But, is he any better off? He still lives on the sales proceeds of his harvest - only now his property taxes will probably increase. His **cash-flow** didn't improve.

The same thing happens when the "speculators" leave and land prices decline substantially. Our good tiller is no longer "rich" but he still has the same **cash-flow**.

What is really important to his family's standard of living is the **cash-flow** and not the asset value. **You retire on cash-flow and not asset values.**

**"I just can't get over the terrible shape our country is in and am really concerned if we have a future as we know it. It is hard to think about long-term investing when the long-term doesn't look as though it will be there."**

Your concern reminds me of the nuclear bomb threat that hung over our society in the sixties. I believe it is possible to totally destroy our economy; however, if that happens, like the nuclear bomb, I don't think it matters much what you do now.

From a financial stand-point, I suggest you allocate enough of your capital (money) to whatever assets you think will protect you from the financial disaster you feel is just around the corner. You choose the assets that you feel will survive the economic Armageddon. Maybe it is precious metals, gemstones, cash buried in the backyard, owning land in a foreign country, a stockpile of freeze-dried food or farmland so you can be self-sustaining. But, be very careful not to go overboard in this area as history has a way of telling us that it will not work.

I see a lot of current economic problems and I see a lot of future economic problems, but to bet that the entire system will implode might be a very dangerous bet, one which has no *plan B*.

We believe well-managed operating businesses have the best potential of protecting our **retirement cash-flow** during these volatile economic times. While there are hundreds of companies that have strong earnings and dividend histories, there are also many companies that will not prosper during the coming years. You need to focus on companies with modest debt, good operating history and, of course, you need to diversify because surprises do happen.

A lot of corporations survived the recent economic crisis and are very successful and very liquid. This liquidity (money) will get spent sometime...either to try and gain an advantage or they fear competition is gaining an advantage or they see opportunities for new sales or fear losing existing sales.

**“Don't the Corporations have all this money because they fired so many workers?”**

Many of these corporations had an aggressive Chief Financial Officer (CFO) who did whatever was necessary to survive and prosper.

**“I think we should pass laws making it illegal to fire these workers. What do you think?”**

I think: 1) most big companies would simply move more of their operations to another country. It is easy to underestimate how much more business friendly many countries are or 2) those that didn't/couldn't leave would eventually suffer the fate of General Motors.

Successful companies are like financially successful households, if they don't become almost paranoid in protecting their wealth, someone else will get it.

Many of us cry and moan because they can also *outsource* jobs and manufacturing, but they can also *insource* those same functions when the local environment is more beneficial to their interests. (Maybe we should focus our efforts and make ourselves more valuable to those firms.) None of us likes it when a business closes a factory or moves a distribution center but a great operating business has the ability to do whatever needs to be done to survive and prosper.

**But, our economy is so weak.**

Many of these globally dominating companies are located in the United States, but the vast majority of their revenues come from other parts of the world. Many companies earn over 70% of the revenues outside this country. Now, does it make a little more sense why so many of their employees may be overseas also? These companies are not dependent on the U.S. economy.

**“But, if my monthly statement shows I lost \$10,000 during May, are you saying I didn't?”**

I'm saying if you mentally treat your investment account like money in a bank account, you LOST \$10,000.

**“If it's not money, what is it?”**

I consider my personal account is a group of dynamic, on-going, cash-generating, money-making machines. These machines are earning considerably more than last year and many have far less debt and have increased their dividends. My account is similar to Farmer McDonald's farm...a collection of on-going valuable assets.

**“I still don't think I'm going to feel good when I lose \$10,000.”**

I don't think you will either, but if you get depressed every month your account declines and elated when it rises, you need to re-adjust your thinking. Let's do a little exercise: Do you remember what your account was worth on October 31, 2006? What about May 31, 2004? Or, July 31, 2009?

Quite frankly, if you do remember any of those figures, you need to get a life!

What I'm trying to illustrate is that whatever value your account was at some time in the past had no bearing on what it is valued at today. And, I think we can

[continued on Page 4]

extrapolate this to say whatever your account value is this month will have no bearing on the value in two years, five years etc.

**A Sample Utility Company:** Five years ago, could you have bought this electric utility stock that serves over five million households for about \$40 per share. It owns transmission lines and electricity generating plants that literally could not be duplicated. This is a long-term company. If you knew its earnings would double and its dividend would increase by almost 70%, would you have bought it?

What if we added that its current share price is about what it was five years ago and about one-half of its 2007 high? Would you still buy it? By the way, it pays a dividend greater than 5%. **Focus on the company, not the stock price.**

**The Giant Discount Retailer:** It's 1998 and if you knew for sure that over the next twelve years this company's earnings per share will increase 3.8 times, and the dividends would increase by about 8 times, would you buy it? Oh yes, I forgot to tell you that on three separate occasions this share price will drop by over 25%. Now, did you change your mind? And the share price today is about 30% lower than it was at the end of 1998.

Oh, what if I also told you during the next twelve years we would have a foreign attack on US soil destroying the World Trade Center, we would have two market melt-downs, our entire banking system would be on the brink of failure and Nancy Pelosi would become the Speaker of the House. We also will get involved in three wars. Now, did you change your mind?

Great companies have a way of surviving. **Focus on the company, not the stock price.**

Building real wealth in the market requires buying good businesses at decent prices and holding them until their value is reflected in their share price. Optimally, the value of that business should be growing over time, as management finds new opportunities and expands its base of profitable assets. We also prefer management share the wealth with a rising stream of sustainable dividends.

Keep in mind that the future always seems more frightening than the past because we know how the past turned out and we don't know that about the future. This is human nature.

## **A GREAT OPPORTUNITY!**

In times of extreme economic volatility we want our assets invested in things that can adapt and prosper and we believe that is globally dominating companies.

Over the next decade about one billion people will enter the realm of *middle class* in what we still tend to call the *emerging markets*. These middle class people will want more and more of the good life. They will buy everything from paper towels to chocolate bars to basic automobiles. This will be a giant wave.

Anyone who is serious about creating wealth and/or protecting existing wealth should have a significant position in high-quality, globally dominating corporations. Many of these companies are priced right, have very manageable debt, have a lot of excess cash and are positioned to take advantage of the millions and millions of people that are climbing the economic ladder in the emerging economies of Asia and South America.

**It's an exciting time to be an investor IF you own the company and not the stock!**

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## **History in the making**

For many of you under the age of about fifty-five, I think you will have a chance over the next decade to see real history in the making like you have never experienced before. Like most of our history it will not be easy to follow and it won't act out like a tightly choreographed Hollywood movie, but if you can be an overall observer, possibly as well as an involved day-to-day activist, I think you will find the real-life movie very interesting and will, hopefully, have a very happy ending.

Big change rarely happens in a democracy without an extreme crisis. And, extreme crises, generally, are the result of bad government policy. (Think of the early 1930's when the Federal Reserve cut the money supply dramatically to stave off future inflation. Think of the early 1970's as the bills started coming due from the monumental social programs implemented in the late 60's along with the costs of a long drawn-out war. Think of the recent sub-prime debacle which was ignited by some legislative leader's desire that everyone should have the right to a long-term mortgage no matter how unlikely they were to pay for it.)

We have a spending crisis now, but many of our people, many of our leaders are still in denial. Our various governments just plain cannot pay their bills. They cannot honor their promises. And, since our government leaders are, in most cases, elected by the public, they won't come out of denial until the American public demands it.

**I don't think the American public is really behind this yet, but the awareness is building. It will be very interesting to watch the drama play out!**

## The Family CFO

*They are living the good life. A truly American family living their dream with a large, beautiful home, a manicured yard and children in the best schools.*

*There is one little problem though...they can't afford their lifestyle.*

*The time finally arrived when they have to do something or their dream life is going to evaporate. Here again, they did the truly American thing, they went to Father for help.*

*However, Father apparently never bought into their dream quite like they did. "The way you two spend money I couldn't bail you out if I wanted to, and I don't. But, what I will do is hire you a Chief Financial Officer, your personal CFO, to get your financial life in order."*

*The CFO took charge immediately. "Let's do whatever we can to wind down the leases on your two gas-guzzling, overpriced vehicles," he told them. "But we can't," responded the wife, "We need all the room for when our children's friends ride with us." "You have no choice but to live within your means even if that means the passengers sit on each other's laps. Besides, my bet is that several of your friends are only months away from being in the same financial shape you are."*

*The CFO continued, "The children need to move back to the public schools." "Oh no, that's not an option. We only want what is best for our children."*

*What's best for your children is showing them how a responsible set of parents lives within their means. The financial example you two have been setting is almost a form of child abuse."*

*"The housekeeper, the lawn-guy, must go - along with the club dues," remarked the CFO.*

*"But I have to have the club membership," responded the husband, "I use it for business contacts."*

*"I really don't think anyone would want to do business with you if they realized you are putting your club dues on a credit card that is about one month away from being maxed out."*

*"And, all these monthly fees for television, telephones and Internet. I don't know the exact solution, but as a family you need to work it out so the total of all of these is cut in half by next month."*

*"But, I can't live without my unlimited minutes," offered the daughter, "My friends will think we are poor."*

*"You have two mortgages on your home totaling far more than you paid for the home; you have credit card debt equal to many months of your gross income; you have absolutely zero in any form of a savings account, or college savings account and your retirement account is non-existent. Tell me what part of that makes you feel so rich?"*

*The CFO continued, "You need to get your monthly expenses to the point where you can build up a savings account and be able to fund your retirement account in a meaningful way."*

*"There is no way we can afford to put any money in a retirement account at this time," offered the husband, "it just costs so much to live nowadays."*

*"You are pushing fifty years of age," countered the CFO, "do you think some Money Fairy is suddenly going to appear and provide you with a retirement income?"*

*"I just don't believe our government won't provide for us in retirement," countered husband.*

*"Grow up man and come out of your denial world for a few minutes. Our government is broke and getting more broke every day. What part of that broke do you think is going to provide you the retirement good life?"*

Many companies have taken charge of their financial affairs as have many households. The remainder need to get a tough CFO as does our government.

## WHAT WE DO...

We prepare financial plans, which are essentially blueprints for what our clients are trying to achieve in the future. Much of our planning involves creating a Retirement Income Plan for our clients. 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.

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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 James, CFP®, Mark Beaver, CFP® and Ashley Thompson provide technical assistance. Jean Wilson handles the layout and editing of the newsletter.

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