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WILL AN ADULT PLEASE STEP FORWARD?

I put off writing a *Report* until after the Great Debt Ceiling debate ended because the air was so full of political emotion I felt anything I wrote would pale in comparison. After all of that theater they finally agreed to cut spending, a little, and most of the "cuts" don't happen for several years, unless they change their minds along the way.

In reality what they finally agreed to is akin to a fat man saying he would try to limit his weight gain over the next ten years to 38 pounds instead of the 40 he planned to gain. Way to go leaders, glad you have a handle on our future.

But that didn't stop several Congressmen from wailing how the compromise was going to let old people die on the streets and babies starve. Why do we elect some of these people?

THE NEXT CRISIS – Mark your calendar! The date will be on or about September 30th. The issue will be the need to pass a Continuing Resolution by the House.

For more than 850 days the US has gone without a budget. The House passed one not long ago; the Senate tabled it. The Administration has not offered up one either. The absence of an approved budget means that the only way the country can continue to operate is through a series of temporary extensions.

The last time we went through a vote on a continuing resolution was just four months ago. That fight went down to the wire. At the time it was 50-50 that the government would be forced to shut down. In the end a deal was reached to extend things to the end of this fiscal year. That happens to be just six weeks from today.

Bruce Krasting, August 12, 2011

U.S. Credit Rating Decline . . .REALLY?

Now the Great Debt Ceiling debate is over and before we can change the channel we hear the U.S. lost its AAA bond rating.

If you were one of the leaders of the largest economy in the world would you sit back and allow the credit rating of your country to be downgraded? Would you not evaluate all of your spending and make the cuts that are necessary - if not popular? Where is the adult in the room?

In reality, I don't think the ratings "cut" will mean much of anything over the near term, but the fact that it even happened is certainly a signal to the world that we do NOT have our economic house in order and we don't need something this big to further dampen our loss of confidence in the future.

I really don't understand. Is there not someone who can step forward to lead the two warring sides into some common-sense economic sanity?

Maybe the public needs to take charge and let them know we do NOT want to be downgraded because we NEED our country to get its economic house in order before our economy can recover.

A BIT OF COMMENTARY . . .

We are slowly coming out of an ugly recession...not a standard *business cycle* recession but a *debt/credit crisis* recession. Any improvement is unnecessarily slow because our leaders treated it like a *business cycle* recession and thought that "stimulating" the economy in various ways would kick-start our economic engines. I believe when history reflects on the recent era they will say that we should have taken a much different approach, one in which we focused on reducing debt, eliminating unnecessary functions, thereby, instilling confidence in our people and our industries. Many large businesses reacted this way and are much stronger today because of their actions.

But, unlike your automobile, life doesn't come with a reverse!

Despite much of the recent news, it does appear as though our economy is showing signs of a decent recovery. As the weather breaks and, maybe, gasoline prices drop a little there is a good chance the mood of the country will slowly improve…that is until next year's election campaign starts…it appears it will be ugly!

Financial Times (August 5, 2011) had an article by Barney Jopson bemoaning the fact that even though retail sales showed a five percent increase for July most of that increased spending was by the *wealthiest* 25% of the consumers and not middle Americans. I'm not quite sure where he got this fact, but I take this as very good news. One thing that seemed to make this recession so severe is that even the people who were not significantly impacted by the economy quit, or dramatically reduced, their spending. I'm sorry Mr. Jopson, but it seems to me that we want the *wealthiest* people spending. Won't that likely benefit the rest of us? Do you really expect the *least wealthy* people in the country to pull us out of a recession?

The Real Economic Answer is rather Simple . . . GROWTH!

We have tried stimulating the economy, we have offered all sorts of tax credits and payroll tax cuts and nothing seems to be working. I think it is time we go back to the basics and focus on what will really solve our economic problems…GROWTH.

Economic growth will put more people back to work, economic growth will greatly increase the tax revenues of our hungry government, and economic growth will sweeten the sales tax revenues.

As we put more people back to work they spend more, they will go out to eat more, they have more confidence in the future and the positive compounding goes on and on.

But what can the government do to spur this economic growth? I think a truly meaningful ten-year plan to get our spending under control would be a giant step forward. Many other aspects of our economic lives are waiting for this to happen. Housing prices are now very affordable, many employees who a few years ago were demanding a wage that didn't make economic sense are now willing to work for a competitive wage and employers have a talented, hungry pool of new potential workers chomping at the bit.

To provide a giant *kick-start* I suggest we eliminate virtually ALL employment laws, rules and regulations for the next five years. After that we can review the situation and pass any new laws that we deem necessary.

We NEED Tax Increases to Eliminate the Deficit! ?

We frequently hear someone claiming that we need income tax increases to eliminate our spending deficit. The math does not work out until spending is reduced because the deficit is just too big. Besides, I would not vote for one dollar of increased taxes until we get our spending under control. What a lot of us see is a giant black hole under Washington D.C. that will consume any and all revenues that they can collect. Some of you have heard me say this before, ***no matter whether we are a household, a business or a government, if spending is out of control, there will never be enough revenue.***

While we are on the topic of taxes, let me provide a slightly different slant on it. Our leaders are fighting bitterly over income taxes. Most of us realize their fight has far more to do with their opposing political ideologies than any benefit to the economy. So, let's look at taxes a little differently.

Instead of income taxes why don't we focus on taxes that people enjoy paying? Huh? Think about it, many states have a lottery, which is a big tax. But, people line up to pay the tax. They tell me that on-line betting is one of the hottest things going, but do we collect any taxes on it? No, we spend precious government funds trying to catch the lawbreakers rather than focusing on fighting terrorists or serial killers.

We now have legal *medical* marijuana sales in many states. Is this not just a "wink" by saying marijuana sales are now legal? I'm for taxing it.

I wrote a piece a few years ago about a *Beverage Tax*. It started when I saw that the sales of soft drinks in this country are greater than the amount workers contribute to their retirement plans. The piece was really a tongue-in-cheek observation about how much tax could be collected with a *Beverage Tax*. But, I've now taken my tongue out of my cheek. Think about it, one of the disasters happening in the country is obesity, and it is going to cost us a lot, thus why not a *Beverage Tax* to help pay for Medicare and Medicaid.

Who is going to stop drinking their soft drinks, their fancy coffee, their imported wine and their pedestrian beer because of a few cents tax? Maybe we even need to extend the tax to snacks and fast food. We need to focus on taxes we enjoy paying.

We also need to focus some taxes where the tax rate is very small but the revenue collected can be huge.

How about a *Speculative Trading* tax? This would be a tax on short-term speculative financial trading. An article in *The Nation* (June 8, 2011) estimates a tax of 0.25% of each speculative trade would result in tax revenues of about $150 billion a year. This tax would quickly wipe out our social security underfunding.

I think we need an additional *fuel tax* specifically designated to highway improvements.

I would consider collecting *sales taxes* on Internet retail sales to provide local governments the revenue they used to collect from retail sales. Let me provide an example. Let's assume I spend $600 per year buying books from Amazon. The sales tax on this is $0. I like that, but before there was an Amazon, that $600 went to a local bookseller who charged me 7% sales tax. That is $42 per year that is no longer going to the local governments.

Here's a tax idea that no one seems to like. I would consider a small charge for every *email* that was sent. Oh, I can hear you hollering right now! But think about it, we all want our government to do everything it can to stop the hackers and other online fraud, so why aren't we willing to pay for it. Also, think about all those marketing groups that send out millions of emails several times a day filling my Inbox. I'd love to collect taxes from them or at least slow down the number of unsolicited emails they send.

Small taxes collected millions of times become painless taxes.

Is this the End of the World. . . at least as we know it?

It seems to me that the problem(s) we are encountering here in this country are far different from the problems that many countries of Europe are facing. Their problems are big-time financial problems...they cannot pay their debts and they cannot operate without incurring further debts, which is unavailable.

Our problems are far more political...the lack of will among our politicians to make the tough choices.
But, it is also a problem of many American citizens in that **they don't really want our leaders to make the tough choices** they need to make. Too many people also let themselves be overly influenced by the political opponent of someone who made the tough choices. It's going to be an ugly election!

WHAT ARE *WE* DOING?

Sometimes you have to step back and look at what is happening and how it may impact our future. Our leaders need to work diligently at re-organizing our massive government. This can be done and it can be done without putting "old people on the streets" and "starving babies." We have done nothing but continually expand the government's cost and influence for decades and it is time to review and re-organize.

For the first time, it appears we are at least talking about it. Congress is talking about it, news people are talking about it and we are talking about it around the breakfast bar. I think we are at the point where the vast majority knows we must take action. We are not yet at the point where we agree what that action will be and it will probably take a financial crisis to change that.

We don't know what the next financial crisis will look like or whether it will happen in months or decades, whether it will be dramatic or slow like Japan's two decades of economic stagnation. We do know our governments will be smaller either by their own actions or reaction forced by the crisis.

We believe that owning shares of businesses that make products and sell products all over the globe, companies that have negligible debt and high profit margins and companies that have decades of proven management are most likely to treat us well during the turbulent economic times ahead of us.

And, we believe the share prices of many of these globally dominating companies are at very fair levels.

We also believe we need to own energy assets to try and protect us from global economic turmoil.

Most important of all we need to **own assets that are expected to produce the income** that we need to prosper in retirement and not be overly dependent on government policies.

WHY MARKET VOLATILITY DOESN'T SCARE US!

If you are retired or plan to retire someday and the primary purpose of your investment account is to provide you with a retirement income, then what you need to focus on is the *cash flow* that is generated by your investments and not the account value.

Stock market values are not stable and have never been stable. So why would you expect them to be? The stock market value of a company can, and usually will, vary wildly even though the company may be experiencing regular revenue and earnings growth. You must focus on the *company's operations* and not the *stock price.*

Many companies pay out to shareholders a portion of the net profits and these payments are called dividends, usually paid quarterly. Many successful companies raise this dividend payment as profits increase. One more time: the stock value of a company may be falling even if revenues and profits and DIVIDENDS are increasing.

We try to focus a portion of each account on the *cash flow* (dividends) created by owning shares of great corporations.

Let's try and keep the math simple, so assume we invest $10,000 in a company's stock that costs $100 per share. We get 100 shares. ($10,000/$100 = 100 shares)

- Let's also assume the initial dividend is $4.00 annually, which is $1.00 per quarter.
- Also, let's assume that this dividend grows at the rate of 8% per year. (Note: no dividend or increase is guaranteed)
- Let's also assume we re-invest these quarterly dividends, thus our number of shares increase a little each quarter.

Here's what the first two years would look like: (Note: for re-investment purposes we are assuming the share price increases as dividends increase; in the real world it would never be this uniform)

quarter	shares	dividend per share	quarterly dividend	annual dividend
"Initial Buy"	100.00	1.00	100.00	
end of 2nd quarter	101.00	1.00	101.00	
end of 3rd quarter	102.01	1.00	102.01	
end of year 1	**103.03**	**1.00**	**103.03**	**406**
end of 1st quarter	104.06	1.08	112.39	
end of 2nd quarter	105.10	1.08	113.51	
end of 3rd quarter	106.15	1.08	114.64	
end of year 2	**107.21**	**1.08**	**115.79**	**456**

This will buy one additional share when reinvested

You can see that your original quarterly dividend of $100.00 increased to $115.79 by the end of the second year. This is due to the dividend increase and re-investing. This is a 15% higher dividend in only two years.

Let’s continue the chart by showing end of year totals only:

quarter	shares	dividend per share	quarterly dividend	annual dividend
"Initial Buy"	100.00	1.00	100.00	
end of 2nd quarter	101.00	1.00	101.00	
end of 3rd quarter	102.01	1.00	102.01	
end of year 1	**103.03**	**1.00**	**103.03**	**406**
end of year 2	**107.21**	**1.08**	**115.79**	**456**
end of year 3	**111.57**	**1.17**	**130.13**	**513**
end of year 4	**116.10**	**1.26**	**146.25**	**576**
end of year 5	**120.81**	**1.36**	**164.36**	**648**
end of year 6	**125.72**	**1.47**	**184.72**	**728**
end of year 7	**130.82**	**1.59**	**207.60**	**818**
end of year 8	**136.13**	**1.71**	**233.31**	**919**
end of year 9	**141.66**	**1.85**	**262.20**	**1,033**
end of year 10	**147.41**	**2.00**	**294.68**	**1,161**
end of year 11	**153.40**	**2.16**	**331.17**	**1,305**
end of year 12	**159.63**	**2.33**	**372.19**	**1,467**

End of year 5

This is a lot of numbers, but let’s look at the “end of year 5” and we see the quarterly dividend has increased to $164 and the annual dividend was $648.

In this example, by the end of year 12, your original ten thousand dollar investment would be generating $1,467 in annual income.

Get it? We invested $10,000, let the dividends grow and compound and by the end of the fifth year we earn $648 of dividends or *cash flow* that can be used in retirement. It hasn’t mattered if the stock price went up or down…it will probably do a lot of both. In fact, because of compounding, the more times the share price was low, the better our results, because we buy new shares at a low price.

But, wouldn’t it be a lot better if we waited until the share price was down before we invest? Maybe, but every year that goes by you are missing out on the compounding income.

See why we don’t fear market drops? See why we don’t spend a lot of time coming in and out of the market? See why when you focus on the income generated by your account, the market values are not a major factor?

No real company will have performance as perfect as the numbers we are using, but the concept is still very valid. We realize that companies do not have to pay a dividend and they do not have to raise the dividend, but many companies have done both of these things for decades. Add to this an experienced management team and a low amount of debt and you have the companies that we want to own and because of this we don’t worry much about the daily market ups and downs.

We are investing for decades of cash flows, not days!

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.

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 A Thompson provide technical assistance. Jean B Wilson handles the layout and editing of the newsletter.

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