NOVEMBER 2012
Written by: Philip C Benedict, CFP®

OUR OFFICE:
Philip C Benedict, CFP®
Travis M James, CFP®
Mark A Beaver, CFP®
Ashley A Thompson, CFP®
Jean B Wilson
Jackie Thompson

the BENEDICT *REPORT*

6000 Lake Forrest Drive NW, Suite 550, Atlanta, GA 30328-5901 • 770 671 8228 • 770 671 0232 *fax* • 800 678 8227

THANK GOD IT'S OVER!

There seems to be little that stirs up such intense emotional conflict for the masses in the country than a Presidential election. Adding to the emotion is the immaturity of the television ads and the taunts and misspeaks of the candidates apparently catering to a relatively small slice of *undecided* electorates. Thankfully, it is over for another four years.

But, not twenty four hours had passed from the end of the silly season until the media was scaring us again with the devastating "fiscal cliff" that awaits us all.

So we get questions…"How can you sleep at night with everything that is happening?" or "I'm scared, what should I do now?" "What if we have a major market drop?"

THE STOCK MARKET IS GOING DOWN?

Let's move away from the television, turn off talk radio and spend a few minutes taking a little time to think. For the purpose of this article, let's focus our thinking on our investment accounts.

What most of us need from our investments is a regular *cash flow.* It may be a *cash flow* that we can use because we are retired, it may be a *cash flow* that we allow to compound for our future retirement or it may be a *cash flow* that will benefit our heirs.
[NOTE: This is different than a savings account in which you are building up money for a future expenditure…new auto, college expense or the like.]

If what we need from our investments is *cash flow* then we should make sure we focus on creating that *cash flow* – not on account volatility.

We basically have three general areas in which we can create this potential *cash flow* for our investments:

- Certificates of Deposit
- Bonds
- Stock Dividends.

[Note: You may argue that there are other ways to provide income but for the purposes of this article I want to focus on potential cash flows provided by income only from passive investments.]

Let's look a little further at our options:

Certificates of Deposit. Right now you can get about 1.0% per year if you choose a five year maturity. After five years your return is unknown.

Treasury Bonds. Right now you can get about 1.7% if you choose a ten year maturity. The earnings will not change over the ten year period.

Dividend Paying Stocks. Right now it is relatively easy to create a diversified group of common stocks that provide an expected yield in the 3.5% range and history would tell us that the dividends should increase over time. Let's look at a few examples:

<u>Giant consumer's products company.</u>
Current dividend yield is 3.5%. Over the last ten years the dividend has increased by 9% per year. There are no guarantees in the world of investing, but if that dividend can grow at the same rate, the dividend rate would look something like this:

Year 1: 3.5%
Year 2: 3.8% (Nine percent higher than the previous year)
Year 3: 4.2%
Year 4: 4.5%
Year 5: 4.9%

Thus, in five years the yield will be almost 5.0% annually if this company can increase its dividend by the same rate. After ten years the yield would be about 8.0%.

Large pharmaceutical company. Current dividend yield is 3.1%. Over the last ten years the dividend has increased by 10% per year. In five years the yield will be about 5.0% annually if this company can increase its dividend by the same rate. After ten years the yield would be about 8.0%.

Global software company. Current dividend yield is 2.7%. Over the last ten years the dividend has increased by 14% per year. In five years the yield will be about 5.2% annually if this company can increase its dividend by the same rate. After ten years the yield would be about 10.0%.

If what you need is *cash flow,* then focus on creating *cash flow.*

We have just finished an emotionally charged political campaign and now we have the "fiscal cliff." The news that is fed to you on a daily basis is likely to continue to be full of emotion and drama. To "sleep at night" or "survive a down market" you need a solid strategy, one that passes the common sense test. And, for most people, we believe that strategy must rely heavily on the earning and compounding of income. We also believe a major portion of that strategy must focus on owning the world's great money-making businesses and allowing them to compound your wealth.

But, if the market is going down, shouldn't I get out?

I guess the answer to that is yes if you know for sure the market is going down, especially if you know how far it is going down. We are reluctant to do this on a large scale for several reasons:

- Despite what the experts say, no one can accurately predict the markets. We can guess and there are times a "guess" feels like a sure thing, but life has taught me many sure things aren't.
- If we do get out of the market, even if we are so smart to get out at almost the right time, we now have to be lucky again by knowing when to get back into the market.
- Maybe the most important reason we seldom make major market "guesses" is that it goes against our strategy of trying to create a growing, compounding income within an account. Remember that the dividend a company pays is based on its operations, which has nothing, or at least very little, to do with the share price, which is determined by the emotions of the global traders.

In many ways things are rather positive for investing.

An often quoted statement of Warren Buffett is, "Be fearful when others are greedy and greedy when others are fearful."

Investors are scared. They are frightened by global events and they worry about governmental actions. They want security and to be isolated from all the bad things that are happening or they think will happen.

If you can think about "investing" in great companies with a longer-term time horizon, investing can be almost stress free. However, if you want to "invest" and not experience considerable volatility of account value, then you are probably setting yourself up for high stress. Investing, the ownership of assets, deals with constantly changing market values. That's the way the system works.

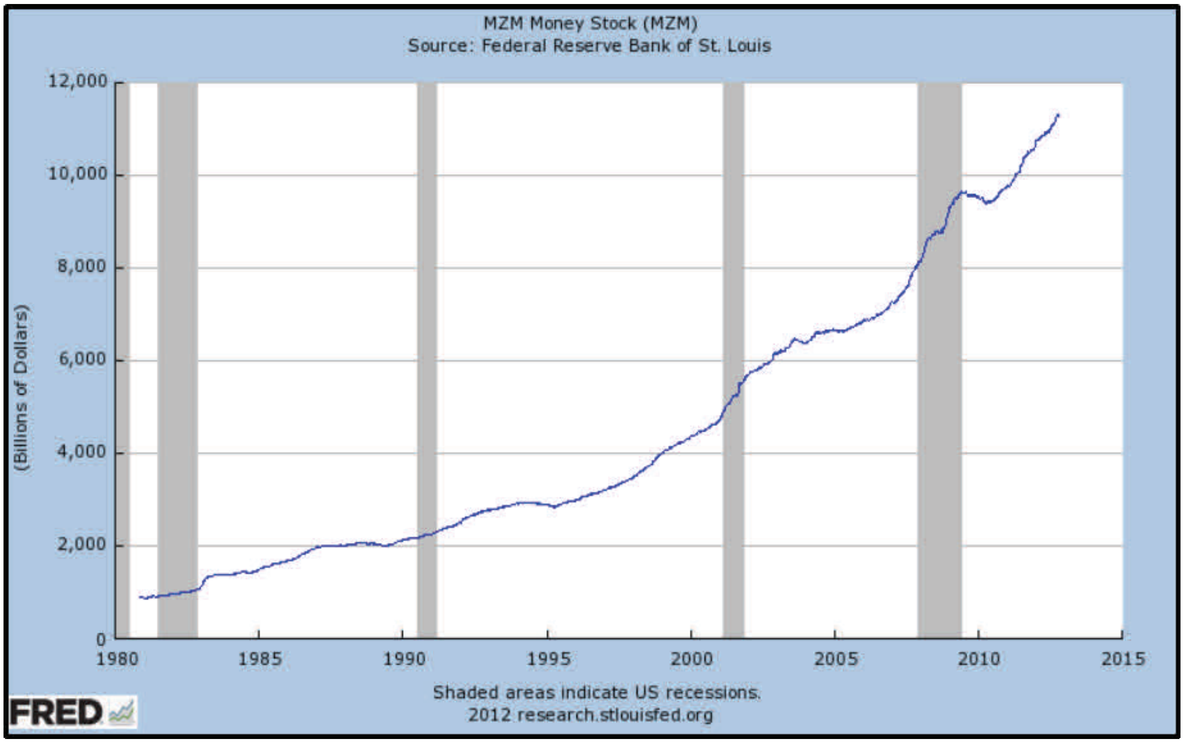
Let's look at the information below and see if it can calm your fears a little…at least your longer term fears.

#1: On the next page is a chart showing Money at Zero Maturity. This is savings accounts and money market funds and the like…money that is immediately available with no strings attached. Generally, we would expect this to gradually rise over time as wealth grows and inflation has its impact. But, look at the angle of the increase in growth since the market drop in early 2000.

There is now over $11 trillion dollars sitting on the "sidelines."

Let's help put that in perspective. The federal budget for 2012 is a little less than $4 trillion. The estimated U. S. Gross Domestic Product for 2012 is estimated to be about $16 trillion. The entire market value of U.S. stock markets varies considerably, but is currently in the $17 trillion range. (www.usgovernmentspending.com)

The "sidelines" with $11 trillion has a lot of money earning literally nothing. If people ever become a little more confident of the future, we may see some of this money move into other investments.



#2: Here is a price chart of a giant consumer products company for the last twelve years. Notice how the share price today is about where it was ten years ago.

What doesn't show on this chart is how the company did, operationally, over the last ten years.

Let's look:

- Revenues are 81% higher
- Net profits are 33% higher
- Free-cash-flows are 100% higher
- Dividends are 300% higher

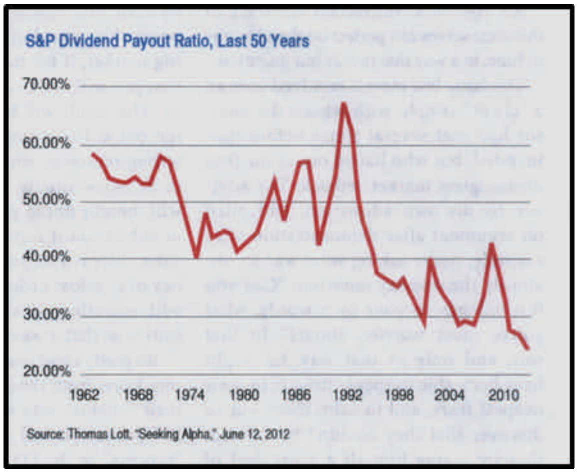
This company is over one hundred years old doing business all over the world. The dividend has increased on the average of over 14% annually for the last fifty years.

Last year the company had over $12 billion of free cash flow left over from operations and has about $32 billion in cash sitting on its balance sheet. (Statistics from Morningstar)

Can the market value of the company decline? Yes. Does it appear that it has the ability to pay its owners (investors) a nice *cash flow* for many years to come? It does to us. Does it appear this company can stay in business?

[continued on Page 4]

Here is a chart of the "Dividend Payout Ratio" of the companies in the Standard & Poor's 500 Index.[1]



Source: Thomas Lott, "Seeking alpha, June 12, 2012

A company earns a profit and then gives part of that profit to its shareholders in what is called a dividend. It is generally considered reasonably healthy for a company to reinvest about one half of the profit and distribute about one half to the shareholders as dividends. This is called the "payout ratio" or the ratio of profits that are paid as dividends.

Look at the chart above. The current payout ratio is at about the lowest in modern history. Doesn't it appear that companies have a lot of room to increase their dividends?

[1]Standard & Poor's 500 Index is an unmanaged index that cannot be invested into directly.

FEARFUL OR GREEDY?

I had been sitting behind this desk for only about one year in 1981, but I still remember how at that time the stock market values were below what they had been in 1966. In 1981 people were scared. Interest rates were high and climbing. The economy seemed out of control. Inflation was out of control. Leadership was weak. People were fearful.

Here we sit in 2012 with many stock market values less than where they were twelve years ago during a period when many, many companies are operationally very strong. But, people are scared.

I don't know if this is the exact time to be "greedy." I sort of doubt it, but I'm pretty sure this isn't the right time to be "fearful" about your investments if you have a multi-year time horizon.

#3: Focus on your strategy. Focus on the quality of your investments, not their market value. Focus on your ***cash flows***, in and out. Then sit back and enjoy the drama as it unfolds. Real theater can't have much more drama than this.

WHERE ARE THE NEW JOBS?

"Phil, where are the new jobs? Why aren't businesses hiring?"

How do you feel, personally?

- *"I feel as though everything is out of control. The federal government is borrowing about 40 cents for every $1.00 it spends. That doesn't feel right.*
- *I read where big companies are literally hoarding cash. That doesn't feel right.*
- *It appears that many states and cities and their pension plans are almost bankrupt. That doesn't feel right.*
- *I read where income taxes are scheduled to ncrease rather dramatically at the beginning of the year unless Congress can agree upon something. That doesn't feel right.*
- *I read where we are cutting our spending on defense by a considerable amount. That doesn't feel right.*
- *I have no idea what the new health-care laws are going to do, but right now it doesn't feel right.*

I heard that interest rates are being kept low to help people refinance their mortgages. As someone with savings, that doesn't feel right."

What are you doing right now?

"I'm afraid to do anything right now."

Don't you think that business owners and business managers are having the same concerns? I doubt they are feeling real confident about the future of the country, thus I doubt many of them are in the hiring mood. You are waiting. They are waiting. The unemployed are waiting and the economy is waiting.

"What is everyone waiting for?"

I sense we all feel that governments have done nothing but put a lot of Band-Aids on the world economy and have not addressed the real issues . And I am also quite certain that most people don't want to face up to the real problems. Maybe after the election we will see a sudden bipartisan cooperation in Congress. Maybe we will see the new Congress actually come with a sensible spending plan which will then make getting some tax increases easier. Maybe we will streamline our tax system. Maybe we will reduce some of the bureaucracy and regulatory morass to make companies WANT to do business in our country again.

I believe that when YOU start feeling better about the future a lot of employers will start feeling better too.

"Longshoremen strike would cripple East Coast port…"

This was the headline from a *Florida Union-Times* article August 30, 2012. The union members receive an average of $120,000+ annually in wages and benefits and pay little towards their health insurance, so it struck me as a little strange that they would be threatening to strike over compensation.

Some further reading indicated that the main contention between the two sides is over automation that would hurt jobs in the future.

"Ports criticized for inability to compete" was the article headline.(Financial Times, August 31, 2012) The article indicated that "port traffic was being lost to neighboring countries…because of the US's labor intensive, expensive ports." It told how some shippers were diverting shipments to ports in Canada and Mexico to avoid the inefficiencies and costs of the U. S. ports.

This is a classic struggle between *yesterday* and *tomorrow.* Obviously, the union members want to preserve their jobs. However, one could argue that society as a whole benefits from more cost-effective, efficient ports. In fact, one could argue that by trying to keep *yesterday* they may do serious damage to their *tomorrow.*

It got me thinking about some history.

I don't believe I have ever been to Erie, Pennsylvania, but my memory told me that some railroad history took place there many years ago. I found the "History of Railroads in Erie County, PA" by John Elmer Reed available to refresh my memory.

I'll try to make this readable and brief. Basically, in the early 1850's Erie was destined to be a railroad hub for the entire region. It was located between Buffalo and Cleveland right on Lake Erie which made it an attractive transportation link. There were three rail lines that merged in Erie, but back then the railroad was in its early stages and most rails were privately financed and constructed and the three railroads all used different track *gauges*. This meant that when a load of merchandise came into town on the Erie and North East Company line it had to be manually unloaded and put on a cart to be transferred to the Franklin Canal Company's rail west of Erie. This was extremely inefficient but it was a source of very secure employment for the loading crew.

When the companies got together and agreed on a uniform rail line width you would think that everyone would be happy. Apparently the loading crew members and their families and friends did not care if such a move would make rail transportation far more efficient; they wanted to keep their jobs.

Basically, after several months of a very bitter battle among opposing sides, the mayor got the city council to pass a law forbidding the use of uniform *gauge* railways within the city.

Unfortunately for the "winning" side, things did not work out that well for them or the citizens of Erie. It became far more efficient and cost effective for shippers to move their goods through Buffalo, which became the dominate rail hub in the region.

One of the challenges society must address is helping yesterday's workers adapt to tomorrow's jobs.

I WANT TO GET RICH!

"I want to be rich! That is my goal in life. I know I must keep my expenses low. I drive a truck that is older than I am and I'm teaching myself to be a day trader in the stock market to make a lot of money. Do you have any other advice? Is a house a good investment? Interest rates are so low and I could use the income tax deduction. Should I buy one?"

Slow down! You are still in your twenties, so you have a lot of time.

You certainly have part of the formula right to become wealthy and that is keeping your expenses well below your income. People who can't save generally have very little control over their financial destiny.

I'm not sure short-term trading in the stock market is the road to riches, but you can give it a try for a period

[continued on Page 6]

of time. I generally consider stocks and bonds as passive investments and over time you should be able to make a decent return on these investments, but I consider them more of a vehicle to maintain wealth, not create it. But, maybe you will be able to outsmart the world's traders.

As for buying a house I would consider it especially if you think you will be living in the area for many years. However, I believe buying a house is more of a lifestyle decision than an investment. Houses cost a lot of money over and above the mortgage payment. In many areas the prices have dropped a lot, but I'm guessing that the "depressed" price is probably a lot closer to what the house is worth than the price of it a few years ago.

It's likely the homes of tomorrow will come with technology that we can't dream of today. And, I believe that will moderate the price of older, non-tech homes, especially if energy costs remain high. But if you like the idea of owning your own home, go for it because for many people it adds to their quality of life

Low interest rates are nice for home buyers but I'm not sure I would count on the income tax deduction for the next thirty years. The government (taxpayers) are already subsidizing home buyers with low interest rates, thus this is probably the time to end the subsidy for the interest rate tax deduction.

Now, let's talk a little more about your goal in life…to become rich. I say, so what? Is there not something else you want to accomplish in life other than become rich? Rich is such a relative term. All you really have to do is to keep your expenses substantially below your income and over time you will become "rich," at least relatively so.

Or, maybe you mean "rich" like the people who are talked about on the television shows or are written about in the magazines, the people who have many homes and more wealth than they could ever spend.

I have no expertise in this area of the super-rich but my guess is none of these people set out in life with the sole goal of becoming rich. I believe most of them had a passion for something and they worked very hard at that passion. They are the actors who studied acting, music, theater and early on took any role they could find. Or they are the athletes who practiced throwing a baseball or hitting a golf ball for hours a day and the remainder of the time spent conditioning their bodies. Or, the business owners who started out delivering papers door-to-door as youngsters and then in college ran their own small businesses while their classmates were drinking beer and playing trivia.

I believe to have the singular goal in life to become "rich" is, quite frankly, rather shallow. I also think it has the potential to lead you to make a lot of poor decisions as not all of life's good decisions are the most profitable ones. Instead of spending the next few years trying to beat the stock market, maybe you should spend time finding something you really have a passion for. Then evaluate how you can follow that passion in a way that fits your natural talents to make it profitable. If you find your passion in something that is meaningful in life and you become really good at it, you will most likely be rewarded quite well, financially as well as psychologically.

I SEE A PHENOMENAL FUTURE!

"I have a new granddaughter and I'm so worried. I can see the future and I don't like what I see in this country," commented Harry as we sipped coffee during a break in the workshop.

Really. I wonder if that isn't short-term thinking in a long-term world.

I think I'm looking at the same future and it looks phenomenal. And, it looks to me as though the dominant global economic power will continue to be the United States of America. I think our diverse population will adapt to the changing world far better than any other group. We have the system in place to build a great future. But, we are in the middle of big changes and almost everyone feels fearful. Let me explain:

First, let's list the things we have going for us:

ECONOMICALLY

We will soon be totally energy independent. (Oil, Natural Gas, Coal, Solar, Algae, Geo-thermal, Wind) And, we may even become an energy exporter. And the energy will be less expensive which helps about every industry except the energy producers. It is good for manufacturers, transportation, airlines, farmers and individuals. It will be like a giant tax cut.

We are in the very early stages of a massive new-age manufacturing revolution. (Digital, energy, communications, computing, biotechnology, storage, robotics and more.)

Our big businesses are lean and ready to grow. While most of our governments have been hanging on to yesterday, the global corporations have embraced tomorrow. They are ready.

[continued on Page 7]

We will benefit tremendously from the rising global middle class.

POLITICALLY

I have felt for many years that as a country we would have to swing far to the "left" before we could settle back in the "center." Eventually even the masses, (the voters) will realize that supporting and subsidizing money losing ventures is not working. Eventually the masses will realize that the sprawling bureaucracy we call government is inefficient, very expensive and actually unnecessary. Companies that have survived and prospered over decades have had to reinvent themselves on a regular basis. They have had to refine and redirect their focus several times. They have had a strong focus on their customers.

At some point the masses, the voters, will start demanding similar actions from the government. A government should be there to serve the people, not the participants.

We will finally wake up and realize that more debt will not solve our deficit problem. We cannot spend ourselves out of debt and we cannot borrow ourselves out of debt. I'm not talking "austerity" unless austerity means living within our means. I'm talking common sense spending and promises.

We have a wave of younger people who are fed up with our present political system that limps along bickering and blaming. And they will change it…for the better. It's time for some of the old buzzards to get out of the way and let the next generation of leaders take charge.

GLOBALLY

The world seems to get smaller every day. And the world seems to get richer every day. In another decade or so there will be another billion people running around on this earth. More people who need more things and it will be the innovations, many of which originate in our country, which will make the world better for all. We will see energy efficiency we can't currently imagine; we will see innovative, unique food growing and handling techniques; we will get water from sources that today seems impossible.

But, you may say, "Haven't many of these other countries gotten way ahead of us?"

We did get fat. We got lazy; we rested on our past and maybe we had what one Russian called "winner's disease." But, I believe the cycle is starting to turn; it is still early thus somewhat difficult to see, but I see a lot of entrepreneurial spirits out there, I see minds from all over the world collaborating to create things we can't imagine and the driving engine of this change is coming from the people in this country.

It's really not about US vs. THEM or our country versus the other guys. It is a global world and we are all in it together. We still have a lot of internal problems, but look at the other countries. Would you rather have their problems? Would you want to solve Europe's problems? Would you rather be in charge of moving China from their current political system to an open people involved government? What about the problems in the Middle East as "political Islam" seems to be replacing "traditional Islam?"

Many U.S. manufacturing jobs moved to other parts of the world over the last couple of decades. They went there because the labor costs were much lower and business was welcome. That is a nice way of saying that our labor costs had gotten way out of hand and it had become rather difficult to do business in the country. Our labor costs are currently much more competitive, especially when you factor in our productivity. Currently ease of doing business in this country has not shown much improvement, but I believe tomorrow's leaders will guide us in that direction.

SOCIETALLY

It will be innovations and discoveries that we can't even dream about that will solve our problems and leap-frog us into the future. The things that are happening in the health-care field are totally amazing. And I believe the tide will turn and we will get the health care responsebility back on the shoulders of people, where it belongs.

The successful people of our future will have an entrepreneurial attitude and zest. They will move from opportunity to opportunity. Their "team" will vary from one project to the next, but the interactions among different individuals and groups of individuals will be the heart of the innovations that will drive the future.

Life will be very stressful and not very rewarding for the employees who want to work in yesterday. Tomorrow's employees will be involved in far more than simple physical tasks. They will be expected to collaborate, to engage, to lead and to follow. The employee who wants to show-up and work but not get involved or shoulder responsibility is becoming a dinosaur.

It is a future that will reward creativity; in fact, creativity may be the new *capital*.

[continued on Page 8]

So many of today's parents are self-obsessed with their *show-it* net worth while many of their children will be focused on what they actually accomplish. Many of tomorrow's leaders will be children of today's *wanna-be rich* but for some that may turn out to be their strength and not weakness. The children have watched their parents strive for tangible things, but their self-worth will not be dependent on their net-worth, especially their *show-it off* net worth.

We are a country of diversity, whether that is ethnic diversity, religious diversity, cultural diversity or economic diversity. The younger generation takes this diversity in stride. They do not expect to live in a community where everyone looks like them, thinks like them and acts like them. I doubt they would even like that. They accept people for who they are. This diversity of almost everything is one of our greatest strengths. Look around, much of the rest of the world is still fighting this.

PROBLEMS

All this does not mean I am not aware that there are problems. But, in this country most of our problems are of a political nature…differing ideologies, lack of cooperation, lack of vision, lack of backbone, lack of leadership, etc. In most of the rest of the globe their problems are political AND structural AND cultural.

We have been living through a "crisis of confidence" that has permeated our society. This has slowed down economic activity, increased the government involvement and has us doubting our future. There has been a break-down of trust in this country. We need leaders who can overcome this with vision, honesty and an emotional connection with the public. We talked earlier about the entrepreneurs; well we need leaders who are like entrepreneurs in that they have to be *fearless* in making decisions because they know the decisions are right and have to be made and they have to be *fearless* in dealing with the people. We the people, the voters, know we need to do the right things, but we aren't strong enough to do them without strong leadership.

Our economic model of stimulating consumers to buy more is no longer effective. They borrowed and they bought, but now they owe. We have an aging population and social promises that we cannot meet. We have a money system that is broken. We are following economic policies that don't work.

We need to get our immigration act together. We are a country of immigrants. We need immigrants. But common sense says we need rules and controls.

We need to deal with our illegal drug problem. How many more jails can we build?

A lot of damage was done to the American spirit of optimism over the last few years. And maybe too many of our leaders were either trying to enrich themselves during this time of defeated thinking or maybe they were simply trying to hang on to yesterday.

SUMMARY

We are in the midst of turbulent times. Things we cannot expect will happen all of a sudden and have a big impact on global events. But this is not new. Your grandchildren's generation will be able to deal with them just as your generation dealt with various wars, recessions, inept leaders, crooks and con-men. The future I see is one of amazing innovation, much more global collaboration, lean government and a new found optimism. The focus will be on doing good rather than looking rich.

However, I may have to agree with Harry, the next few years may not be pretty. We have to make changes as we evolve into tomorrow. That means we have to give up a lot of yesterday. But Harry, your new grand-daughter has eighty plus years ahead of her. And, she won't realize what is happening the next few years anyway. I think she will have the opportunity to live a prosperous, engaging, challenging and rewarding life.

Cheer her on!

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, CFP® provide technical assistance. Jean B Wilson and Jackie Thompson handle the layout and editing of the newsletter.

BENEDICT
FINANCIAL ADVISORS, INC

6000 Lake Forrest Drive, Suite 550
Atlanta, GA 30328-5901
770.671.8228
www.benedictfinancial.com

THANK GOD IT'S OVER!