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the BENEDICT REPORT

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WHY HAVE WE BECOME A NATION OF "MINORS?"

What is going on? **When did we lose our MOJO**?

The two gigantic pieces of major legislation of the last few years, health-care and financial industry reform, while very necessary looked like they were created in the 1930's, with layers and layers of new bureaucracy along with government mandates and penalties. We needed 21st Century ideas and we got early 20th Century laws. The "stimulus" program, did it start us on a new future electrical grid? Did we create a program of pre-schooling to reduce the gap among students entering the school system? Did it create a new way to transport goods across the country, efficiently and safely? Did it transform our ports into true 21st Century import/export facilities? Did we take on debt to fund projects that will benefit future generations? Or, did it throw most of the money at old problems, many of which are still with us?

I read about the desire in California to have a new bullet train…paid for by someone else, of course. Atlanta area voters recently turned down a proposed new transportation tax…certainly not because it isn't needed but probably because they didn't trust the politicians. And the money was mainly going to be spent on "yesterday" types of projects.

Where is our vision? Where is the John Kennedy who said we will have a man on the moon? Where's the Martin Luther King with "I have a dream" challenge? Where is the Abraham Lincoln who saw a country without slavery?

We sit and argue. One side says we need more taxes on the rich…to be fair. The other side says we need to cut spending…to save us. All I know is that they all seem to "say" a lot more than they do. And when they do, it usually is a "minor" and not a "major." We need some "major" thinking leaders.

We need vision!

What would I say? I would say we need more rich households, not fewer. The rich pay taxes, the rich hire people and the rich have money to spend. Better yet, I think everyone needs to be richer. That way they would pay more taxes, spend more money and, hopefully, save more for their own financial independence and not be dependent on a government that seems very fiscally challenged.

We have a battle coming up…actually we are already in it, but it has not been well documented. You read how some 10,000 baby boomers are turning age 65 every day. My guess is that about 9,000 of them are unprepared to live on their retirement income. Social Security will not be enough and most of the 9,000 have not saved enough. But, they still have a lot of wants and they will vote.

Thus, cutting spending on this group is not likely going to happen. There are way too many of these voters and they have too many needs/wants.

Right now our solution is to borrow, borrow and borrow some more. Oh yes, and tax the rich. It is obvious to me that there are a couple of problems with this scenario. One is that eventually we will run out of the ability to borrow, or at least the ability to pay the interest on the debt. The other BIG problem is that there aren't enough "rich people" to solve the problem. So if we can't cut spending and we can't keep borrowing and there aren't enough "rich" people, what do we do?

Let's make more people "rich."

If I had given the State of the Union speech, I would have proposed a new decade long plan. "Ladies and Gentleman of the House and the Senate, the current median income in the country is about $50,000 per household. Our job, starting tomorrow, is to create an environment whereby the median household income will increase to $75,000 (inflation adjusted) by the end of this decade."

You see, we have been concentrating on taking from the 1% to solve our financial problems. But that is a political desire, not a mathematical solution. The numbers just don't work out.

What we need is for the masses, the 99% to pay more taxes. Not by increasing their rate of tax but by increasing their income. If we can increase the average household income by 50% ($75,000 vs. $50,000) by the end of the decade, we substantially increase our tax revenues while at the same time substantially increasing the standard of living of much of our population. AND, wouldn't it be far more fun to watch the television news and see politicians arguing over how to increase our income rather than today's whining about this and that.

But how do we do this?

I don't have the answers, but we didn't know how we were going to land on the moon in 1961 and we did it. We need the strong, positive vision and we can do wonders. But, we have been whining and groveling about "minors."

I do not know how to do this, but here are a couple ideas.

First of all, we have to start thinking BIG. No more of this, "Oh my, so many people are out of work; we need to help them all we can," says one group. The other group whines "but we don't want to discourage them from getting a job."

Rather, let's create an environment where the economy starts growing rapidly again. Not more government, but a vibrant private sector. I believe most people want to work at a decent job. Once the economy starts growing, jobs will be created and people will be employed. And those people will pay taxes instead of living on the taxes paid by others.

We already have a tremendous tail-wind that is in place...abundant, cheaper energy. This is big, really big!

Next, a lot of new manufacturing is already happening in this country, partly because of the cheap energy.

We need the help of Washington, D.C. No, we don't need more of their programs; we don't need them to choose which industries to "punish" and which to "stimulate." We need them to pledge that they will pass no new laws or new regulations that do NOT promote growth of our Gross Domestic Product. Just for the next seven or eight years, all new laws and regulations **must** promote economic growth...PERIOD.

We need the politicians to pass some major tax law changes that simplify the individual taxpayer rules and encourage global corporations to bring their money back to this country.

There are so many other things that we can do, like major changes to the way we educate children or to the way to run our cities and states. There are millions of smart people in this country who will collectively think of way more than I can as I sit at the keyboard. But, without the VISION and the LEADERSHIP the genius of the public is wasted.

I see a "train" of the new autonomous driving cars that will be far cheaper with far more functionality than a bullet-train that goes from one fixed place to another fixed place. From fixed place to another fixed place, that's not the way Americans travel, especially not in the 21st Century. That is so "yesterday."

Don't think this is possible, try thinking much bigger. History is on our side. In 1903 Orville and Wilbur Wright flew the first airplane. Granted, it was only one step above someone flapping their arms. But just a few years later, in 1914, the first commercial flight went from St. Petersburg to Tampa. A couple years after that the first international flight went across the Atlantic Ocean.

I see houses with solar shingles, not because of some government subsidy, but because it makes sense. The list can go on and on.

I'm ready for some economic growth, strong economic growth. I'm ready to see the income of Americans once again surge upward. I'm ready for the "minor" thinking people to get out of the way. Big American businesses have the cash to expand, once they feel good about the future. Small American businesses will find the cash to expand, once they feel good about the future. I'm ready for someone to release the testosterone of the American Economy. We need growth; we need "major" growth. Growth will give us far more tax revenues. Growth will allow people to prepare for their own retirement. Growth will make us feel good about ourselves again.

We need to embrace "tomorrow" - not whine about "yesterday." We need leadership with big vision - not ongoing uncertainty.

TAX REVENUES ARE SO LOW...

I didn't listen to the Fiscal Cliff arguments nor did I hear any of the election rhetoric, but people keep telling me that income tax revenues are so much lower than in the past because of the "tax cuts."

My brain tells me that our federal and state revenues did decline rather dramatically during the depth of the recession, but I needed to check the facts for current information. Here's what I found.
SOURCE: www.usgovernmentrevenues.com):

Year	US GDP	Income Tax Receipts	Total Federal Spending	Spending as % of GDP
1980	$ 2.8 T	$ 308 B	$ 590 B	21.2%
1990	$ 5.8 T	$ 600 B	$1.200 T	21.6%
2000	$ 9.9 T	$1.200 T	$1.800 T	18.0%
2013	$16.3 T	$1.700 T	$3.800 T	23.3%

(NOTES: the "T" is trillions, the "B" is billions, "GDP" is Gross Domestic Product)

These figures do not show other federal revenues - just income taxes. We can see that total income tax (individual and corporate) receipts have risen about 40% since the year 2000. One would think that is quite impressive but when we compare it to the spending which rose over 110% since 2000, we can quickly see how government income and spending got out of sync.

But before you leap from the highest peak, look at our historical growth of revenue (GDP). If we could just hold our spending at today's less than austerity levels and continue to grow our GDP a lot of our fiscal problems would moderate by the end of the decade. Notice how income tax receipts have been approximately 10% of GDP over these decades. IF we can double our GDP over the next ten years, we end up with a GDP in the $32 trillion range. Income tax receipts of 10% of that figure will not completely solve our financial mess, but it will make up for a lot a government spending.

HOW DO YOU STAY SO CALM?

Between the election and the Fiscal Cliff, the media has inundated the public with fiscal and economic scares and predictions of some sort of financial Armageddon. One of the questions we get asked often, and even more often the last few weeks is, "How do all of you stay so calm?"

None of us wants to experience a repeat of 2008, or 2000-01, or 1987, etc. And none of us wants to experience a repeat of any of the hurricanes or tornados that have ravaged areas over the years. But dwelling on bad events does not make them less likely to happen. And, in most cases, when they do happen "next time" they will be different.

The question above probably applies to all of us, and I'm going to answer both for the office and also me personally.

You may not realize it but we feel that a big slice of what our clients pay us for is to remain calm. Here are some reasons we find it quite easy to avoid the hysteria:

- We are very confident of our overall investment strategy - it is full of common sense and has been proven over many, many decades
- We tend to think in decades, not days or weeks or months
- I have lived through multiple financial crises that at the time were "the worst ever"
- I have great confidence that, eventually, the American people will do the right thing

On an even more personal and practical note, the thing that keeps me most calm is that I do not watch television news. Television news has to provide intense emotional drama that keeps people watching so the networks can sell their advertising. To me, watching television news is akin to the sugar fix we get from eating much of the food that is advertised by the giant food companies. And this "fix" becomes quite addictive. Now, I don't want to make television news illegal, heaven's no! We already have way too many laws to "protect" us from ourselves. I just avoid it, much like I try to avoid soft-drinks and sugary cereals, etc.

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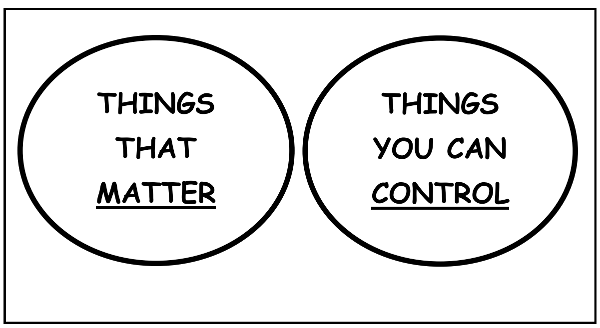
Now some will tell me that they listen for entertainment and "it goes in one ear and out the other." I have a different theory, I think it goes in one ear, penetrates the brain which sends a distress signal to our gut, and then maybe it goes out the other ear.

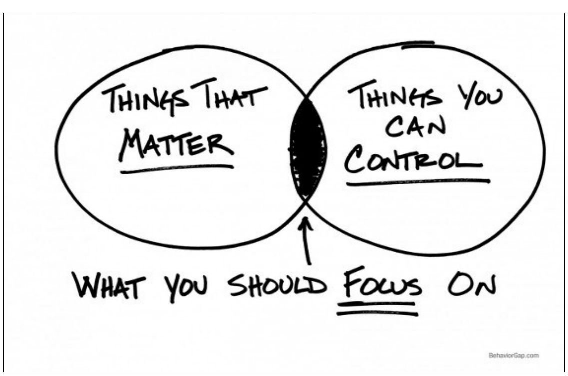
I'm really not trying to be too preachy here. But, it is very difficult to be a rational, good multi-decade investor if you spend many hours each week listening to scare stories.

HOW DO YOU KNOW WHAT TO FOCUS ON?

Part of staying relatively "calm" is to learn to try and focus on the right things. Let's look at this from the point of view of Carl Richards in his book, "The Behavior Gap."



Once you answer the two questions, then simply identify which things you are worrying about that are in both ovals. Here's a sample:



It is much easier to stay calm if you concentrate on only things that are important AND you can control. Think about it.

YOU CAN'T MAKE MONEY IN THE MARKET

"I got out of the 'market' in 2007 and I'm never going back in. All my money is safe," he announced as I was introduced to him as a *financial advisor.* I think he was telling me to either stay away from him or he was bragging a little. "I looked the other day and the stock market is still below where it was several years ago," he continued, "That proves I did the right thing."

Many of you have heard us preach incessantly about how the level of a stock market index has literally nothing to do with a successful retirement income strategy. But, let's use this gentleman's rant to explore this a little more. And, we are quite aware that most of you do not want to see many numbers, but bear with us here.

The middle of 2007 was near the top of the market so let's use that as our starting date. Since then one market index, the Standard and Poor's Industrial Average (The S&P)[1] is down by about 2%. This index is made up of 500 companies, but let's pick just three of them for our example:

Giant consumers products company (A)

July 2007 share price $61 July 2007 qtr div $0.35
Dec 2012 share price $68 Dec 2012 qtr div $0.56

Multi-state electric utility company (B)

July 2007 share price $63 July 2007 qtr div $0.63
Dec 2012 share price $62 Dec 2012 qtr div $0.80

Pipeline distribution company (C)

July 2007 share price $48 July 2007 qtr div $0.50
Dec 2012 share price $47 Dec 2012 qtr div $0.81

The first company has a higher share price compared to 2007 and the other two have lower share prices. Good retirement income account or not?

If we invested $100,000 in each of these three companies in July 2007 we would have earned total dividends of $10,400 the first full year (round figures). Now the same three companies, two with share prices lower than in 2007, are paying annual dividends of $15,400. That's an income increase of about 50% over this time period.

Retirement income investing is not about chasing a company's share price or the overall level of some stock market index, it's about trying to create a growing, sustainable income.

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

REQUIRED DISCLOSSURE: *This is a hypothetical example and is not representative of any specific situation. Your results will vary. It does not reflect the deduction of fees and charges inherent to investing. The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time.*

WHAT'S YOUR RIGHT NUMBER?

We were in an informal setting and they were talking about how they want to retire in a few years. Then they mentioned how they would like to buy a little place near the ocean. "This is a great market to be a house buyer, isn't it?" they asked. "We were thinking it could be a great investment, we have a great credit score and the interest rates on mortgages are at all-time lows."

Then it hit me, I hear this frequently, the two numbers that most people know about their finances are their credit score and the interest rate on their mortgage. IF they have a high credit score and a low mortgage rate, they feel like financial wizards.

My experience is most financially successful people don't know either of those numbers. For one thing they probably never pay any attention to their credit score. And, if they are somewhat mature, they probably do not have a mortgage on their home or if they do, it is by choice.

To this I can almost hear the couple responding, "Well they probably are rich or are misers and never enjoyed life or they had rich parents."

Maybe, but most financially successful people we know have their financial lives in some sort of balance. If they are thinking of retirement, here are some of the numbers that they probably think are important:

- How much of our income are we saving each year?
- How much income is our retirement savings currently earning and approximately how much will we have during retirement?
- When will the house mortgage and other debt be paid off?
- What cash-flow are we going to need during retirement?
- What will be our likely cost per month for medical/ health costs and insurance?

Our beach-house couple would probably insist that this is a boring way to lead one's life, that this is thinking like an accountant, that you really can't count on anything, so you may as well enjoy today. Or, they may think that their new beach house will skyrocket in value and they will be able to sell it for a huge profit and use that profit to fund their retirement.

This couple is already well into their fifties and have a new thirty-year mortgage on their home and only nominal amounts in any type of retirement investment. At this point their only retirement income will be two social security payments. Some couples can live quite well on that income, but it would be a very big reduction for this couple.

What if they were to ask me, "What do you think we should do to prepare for retirement?" I might respond, "The first thing is quite simple, deposit money into your checking account each month equal to two social security monthly checks and hide the remainder. Then see how it would be to live on that income."

"That's crazy, that amount of money wouldn't pay even half of our bills."

"Then it looks pretty simple to me, you either need to start reducing your 'bills' or creating more income, cash-flow, for retirement or some of both."

"But we can't"

"That's why I think you now need to experience living on just social security income."

WHO ARE THE MILLIONAIRES?

We just finished a national election where one of the overriding electoral strategies was to polarize our population among some sort of class lines...generally lines divided by strong emotions. The Good Guys portrayed the Bad Guys as the *millionaires,* those people who live in luxury while the rest of us grovel in our day-to-day lives. Whether that will be good for the country in the future only time will tell, but let's take a look at the *millionaires.*

[**NOTE:** Much of the information in this section came from an article by Graeme Wood in National Review. Other information added is identified by source.]

To the average Joe on the street I imagine a *millionaire* is a *millionaire*, there is little difference among them.

But, to those of us who work with people who have reasonable wealth, there is a big difference. The first distinction, a very big distinction, is the difference between having 'wealth' of over a million dollars compared to actually 'earning' over a million dollars. One has assets, the other has earnings. And, of course, after taxes a million is not a million, no matter what the politicians tell us.

But how much tax do these millionaire earners pay? (These figures are from the article and before the recent Fiscal Cliff law was enacted.) In this country the top 1% of households earned 19% of all income and paid 27% of all federal taxes. (State and local taxes not counted.)

What about households that have assets exceeding one million dollars? Boston Consulting Group notes that 4.3% of American households or 5.3 million households nationwide have assets over the million dollar plateau. However, we should also note that they estimate about a quarter of these million dollar households have a negative net worth. I guess that means they also have a lot of debt. That is so American!

The richest of the rich, those with over twenty million dollars of wealth, or less than .01% of households, tend to be the starters and owners of successful businesses. In many cases they seemed to make something out of nothing, lived frugally for many years and ended up wealthy.

The article goes further in identifying classes of millionaires as follows:

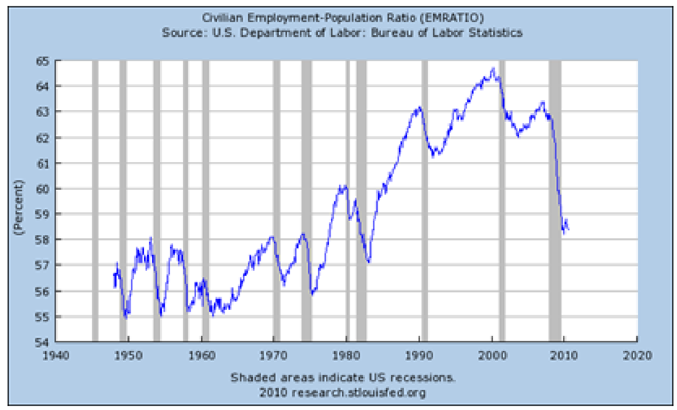
- Housing Millionaires - These folks became millionaires primarily because of housing appreciation.
- Savings Millionaires - These are probably what we think of when we hear the word millionaire…the savers who lived well below their means. Or as Ole Ben said a long time ago, "a penny saved is a penny earned."
- Inherited Millionaires - The *lucky* ones that most people envy.
- Pension Millionaires - We tend to forget that the recipient of a corporate or government pension of about $4,000, or more, who also has employer paid health coverage during retirement is the equivalent of a millionaire.

Are these millionaires happier than the regular folks? The article didn't address that question.

(NOTE: I (Phil) wrote most of these articles a day or two after Christmas thinking that this Report would be mailed in early January, before the next political circus season. That didn't happen…not sure if it was because of minors or majors, but that doesn't matter right now.

I realize it is now arriving during the middle of another very political environment and for that I actually apologize. I chose to send it out anyway because my objective in writing this has very little to do with the day-to-day political events and struggles that we seem to obsess over. I am really trying to look past the daily drivel. I just wish our leaders would to do the same. Thanks for reading.)

THE ANSWER IS A GROWING ECONOMY



Look at the chart above. The percentage of people employed in this country is about where it was at in the latter part of the 1970's. This means a lot of things…it means a lot of people are no longer paying into the system; it means a lot of people are drawing on the system that did not in the past. It increases our borrowing or burdens those who are still working with higher taxes, or both.

In my opinion the solution to most of our economic problems and many of our social problems is quite simple… strong economic growth.

Economic growth will create jobs; economic growth will increase tax receipts and economic growth will encourage businesses to expand. Economic growth begets more economic growth in a way that cannot be scientifically explained just as economic contraction begets more economic contraction.

I believe as our leaders strive to make life better for the masses, (assuming that is their goal and sometimes that looks like a very big assumption) they need to focus almost totally on creating an environment that fosters economic growth. Sometimes this means that government needs to get out of the way, which is a very difficult action for most people in power, but a critical one for the economy as a whole.

MOVING TO "TOMORROW"

We are still struggling with the idea that "tomorrow" will be far different than "yesterday." Actually, even more than that most of us have not accepted that "yesterday" is gone. Much of our thinking and our laws and our labor-relations and our educational systems were designed in an era and for an era of giant industrial companies. Once these giant manufacturing companies located in an area, we had them. We could tax them increasing amounts to fund our schools, our welfare systems and government in general. They were stuck, thus they paid the taxes.

But nowadays it is different. For one thing many industries and companies are much more mobile. They aren't as dependent on a river or a port or whatever. Also, we are competing with other countries for new manufacturing plants and until recently we have been losing. Other countries are not used to looking at a manufacturing facility as an unlimited local taxpayer; they look at it as a huge local employer and because of that literally "fight" to capture the new facility.

We are no longer dominated by the *industrial-age* and we literally skipped over the *information age* to what I call the *age of wisdom*. This transition is disruptive and painful to many. We don't have a blueprint that tells us what to do and if we did the inertia of government and the people would fight the plan. And by *wisdom* I don't mean some medieval monk contemplating his being, I mean the ability to take the information that is now so readily available and use it meaningfully.

In the *industrial-age* that started after World War II big dominated. The country was controlled by the leaders of big companies, the big union leaders and, of course, big government leaders. These leaders looked out for their members, thus security was to be part of a big organization.

Following the War we created a huge population of youth that grew up and paid the taxes that supported a growing program of social benefits.

That's not the country any more. Products do not last, almost unchanged, for decades. The services people demand change constantly. Employers now have to be nimble, adroit and visionary. The post-World War II youth are now becoming the beneficiaries of that social spending. All the taxes they paid into the programs either went to fund their parent's generation benefits or were frittered away by the government.

While all this is changing, our government policies have not. We still promise more and more benefits to more and more people…who just happen to be voters.

We are doing a terrible injustice to our younger people. We are racking up trillions of dollars of debt, not to fund projects that have a multi-decade benefit to society, but to fund current spending. We are encouraging a huge amount of student loan debt. We continue to create new government programs that may never be adequately funded.

Many of these hold-over ideas from the *industrial age* are holding back our transition into the new economy, the economy of "tomorrow."

Tomorrow's employee will not be tied to one company their entire career. Their industries will change/evolve/disappear in years - not decades. Their education needs to help them learn to think to gain the wisdom that will be demanded of successful people in the future. And this "wisdom" does not come from advanced degrees or rigorous metaphysical study; it means an understanding of what one is doing and what needs to be done. We no longer need people to carry around a big transmission - we need people with the understanding of how the transmission works, how to interpret the computer diagnosis and how it can work better or how to repair it.

Our economy can become vibrant again. But, we have to look at it from the eyes of "tomorrow" and we MUST shake lose the ties to "yesterday."

To make this happen we need more of the younger generation in positions of leadership. They are not restrained by *industrial-age* thinking. The rather strict hierarchy of the *industrial-age* is not understood or encouraged or desired by the young.

If we pay any attention at all as we watch the struggle in Europe we can see this hold-over *industrial-age* thinking and how it is severely damaging the social fabric of many of those countries. Those people clinging to "yesterday" are going to lose their fight to stop change. We just don't know how soon or how painful the struggle will be.

In this country, we are far ahead of Europe in the march to "tomorrow." But we need strong leaders who cannot just help us make it to "tomorrow" but to take advantage of the transition and make it an exciting and rewarding journey.

It's going to be an exciting action-drama to watch. Cheer on our new heroes…whoever they may be.

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.

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