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the BENEDICT REPORT

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## WHAT IS YOUR STRATEGY?

- "Stocks are ready for a big drop"
- "The government is setting us up for massive inflation"
- "The bond market is a giant bubble ready to pop"
- "When interest rates rise, watch out"
- "IMF chief warns of new crisis"
- "The Great Crash of 2013"
- "The new job numbers are weak"
- "Corporate earnings are set to fall off the cliff"

Recently, as I speak with people much of the conversation centers on the fact that the stock market is at an all-time high, thus, it is destined to come crashing down again. I'm quite certain this wave of fear is coming from the media and, of course, it is frightening to anyone who owns investments just as it is probably welcomed by those who have no assets and are envious of those who do.

What if you could accurately predict the future of the stock market? Or what if you listened to someone on television who…for free…can *accurately* predict the future, what would you do with that knowledge? Let's say you know for a fact that the stock market averages will decline by ten percent between now and November.

♦ Do you sell all your investments and leave your money in a money market account?
♦ Do you buy some kind of investment that someone claims will go up if the market goes down?
♦ When do you buy back your investments, the day the market hits the minus 10% you know will happen?
♦ Or, do you wait until November 1st and then buy back in?
♦ Or, do you wait until your instincts say it is time to buy back in?

Most people who have accumulated a reasonable amount of assets, or wealth, have done so to give them some additional retirement income and/or give them emotional comfort as they travel life's journey. Generally the "wealth" they have created is perpetual wealth in their minds…that is it will be there for their lives and the lives of their children or other heirs or friends. Some would consider this a boring way to invest or live life.

There are others however that look at their investment accounts differently. They may be trying to "grow" it to a certain number so they can spend it. Or, they may need their "wealth" to produce more than a reasonable person thinks it can produce, thus they need to make it do extraordinary things…in other words they need some magic and will try many things and listen to much *advice* to make that magic happen. The boring investors would call these people dreamers.

What is your investment account for?

- To spend over the next few years ?
- To provide a lifelong income for you and/or your heirs?

Retirement income investing needs to be based on a sound, disciplined strategy, not on guesses, hunches and projections.

The **income** and the **growth of that income** within an account is the critical number in retirement income investing. The short-term market value of the account is pretty much meaningless, unless you are spending large amounts of your principal and if so, you probably shouldn't be in an investment account in the first place.

If you find yourself anxious about whether the stock market is going to go up or go down, then maybe you need to re-examine your investment strategy. People who have no strategy may find themselves a puppet of the media prophets.

<u>What is YOUR strategy?</u> Do you *buy-and-hope*, or *listen-and-leap* or *buy-and-ignore*? Do you rely on your intuition or gut feelings? Or, do you rely on what some salesman is pitching? If you can't write down your investment strategy in a sentence or two, then my guess is you don't have one…you are *winging* it with very serious money. Be careful, be very careful.

<u>What is OUR strategy?</u> In most of our accounts, our primary strategy is to own shares of high quality companies that have historically generated growing revenues, growing earnings and pay the shareholders growing dividends. We look for companies that have a shareholder friendly culture and manageable amounts of debt. We diversify among many industries and many different companies. And, in general, we ignore the up and down cycles that are as normal in the stock market as storms are in our weather patterns. We believe that trying to avoid the natural down times in the market is unproductive to our strategy and about as easy to do as is avoiding the rainstorms of summer.

All assets, even great assets, go up and down in market value. You have to accept that to be a good investor. And, if you feel you can avoid the down times you are probably going to be disappointed to find yourself listening to the wrong advice.

## MORE ON TOMORROW

Last summer I wrote a *Report* titled FEAR OF TOMORROW and since then I have included an article or two in other *Reports* on the topic. I won't spend a lot of time repeating what I have written previously other than to say I believe everything changed in 2008. And I'm not talking politically, although that changed too, but economically and society in general. *Tomorrow* will not be like *yesterday*…not at all. This transition is, and will continue to be, disruptive, stressful and downright scary to most of us.

Most of our political leaders are clinging to the idea that we are still living in *yesterday*. Of course they are because they have to get elected and re-elected and the general population wants *tomorrow* to be like *yesterday.* It is not happening that way and it isn't going to happen that way.

Without going overboard in details let's look at some areas of conflict between *tomorrow* and *yesterday* that seem to be playing out right now.

Of course a really big *yesterday* is watching the government as it *stimulates* the economy. It is doing this primarily through the Federal Reserve by adding to the banking industry reserves…the media is calling it Quantitative Easing, where the Federal Reserve is actually buying about all the bonds that the government is issuing. It really doesn't matter whether we totally understand this right now. But, the idea is, if banks have a lot of money to lend, they will lend it to businesses and that will stimulate the economy. Oh my, how *yesterday*! Does that sound like old industrial-age thinking or what?

Did the tech industry go from almost nothing to become a giant industry with financing from bank loans? No. They received funding from venture-capital and stock offerings…money from private sources not related to the banking sector or the Federal Reserve.

You may have been reading about the oil boom in North Dakota and Texas as well as the natural gas wells that are springing up in many parts of the country. Is this new energy activity being funded by bank loans? Not from what I read. Money is readily available from private sources like venture-capital, private equity firms and stock offerings.

I spoke with this informal group of individuals who have come together and as a group are making loans to local builders. They provide the money for the builder to build a new home and get paid back their money plus some profit when the home sells. The builder said he used to use bank financing for this but that has become a nightmare to get and, besides, he feels a close partnership with these investors…like they are a team…it is much more fulfilling than an adversarial banking relationship.

Some entrepreneurs are finding a new world of fundraising…the Internet. "Crowdfunding" sites, as they are called, are expected to raise over $5 billion of entrepreneurial capital this year. [FORTUNE, May 20, 2013]

A story in the May 8th issue of *The Wall Street Journal* told how several pension funds are now considering direct real estate investments including construction financing and turn-around opportunities. In the past much of this financing came from the banking industry.

Is my crystal ball cloudy because it seems to me that many of the traditional functions of the large banks are no longer necessary? Are they really dinosaurs in modern clothing? Even the walk-up traditional banking functions are looking a little old and tattered. When do you think was the last time your grandchild walked into a bank? Young people don't use banks for the traditional services. Go in to "your" bank and, IF there is anyone else in the lobby, count how many do not have gray hair.

What do I take from this? I see a big government using *yesterday* thinking to stimulate *yesterday's* big financial institutions to try and solve the problems of *tomorrow.* John Naisbitt in his book *Megatrends* used the term "dinosaurs mating." Where is the **DINO** stamp?

## I'M SO NERVOUS!

*"I'm so nervous. I've never had this much money and the idea of part of it being in the stock market is very intimidating. You have been doing this a long time; doesn't the stock market scare you?"*

I've worked with a lot of individuals who, like yourself, received a 'lump-sum' from their employer's retirement account and it became their responsibility to manage the account to give them the retirement income they need. And, I don't know the exact percentage, but a large percentage saw the account go to literally zero in a matter of a few years. But, it was not because they lost it all in the stock market; it was because they spent it.

This happens to many people who acquire a degree of "wealth" that they did not actually save themselves. It may be a retirement plan distribution or an inheritance or sometimes a settlement of some sort. I guess if we go our entire lives without accumulating any savings…in other words, we spend everything…then that is what often happens to the new-found money…it gets spent.

*"That is not going to happen to me. I'm not going to go out and spend it on a lot of frivolous things. This is my retirement."*

My experience is that most people who spent their accounts to zero did not spend it on luxuries, but they did spend it. It went to pay off credit cards or maybe a new car that they had to have. And after those two items the money usually went because a "crisis" happened. Maybe it was a "crisis" in their life or a "crisis" with one of the children. "What choice did I have?" They couldn't see all that money sitting in their retirement account while they or their child struggled. "What choice did I have?"

This may sound a little cruel, but look at your history. You are sixty years old and were unable to accumulate any savings at all other than this amount provided by your employer. In fact, you are entering *retirement* with credit card debt, a fairly large car loan payment and you owe twenty-eight years on your mortgage. **This is not being ready for retirement.**

When new money just comes to us, we haven't learned some of the lessons that are critical to maintaining our wealth. We haven't learned that *if we kill the goose that lays the golden eggs, the eggs quit coming.* In other words we just do not understand that a retirement investment account is a monthly income and we simply CANNOT spend more than the monthly earnings without destroying part or all of our future monthly income.

I truly hope you have a successful retirement. But, you have to be almost paranoid about not spending the principal and I don't think you are positioned properly for that to happen even if you have the financial discipline. I believe your only chance of a successful retirement is if you get a job and work several more years. Get your debts paid off and allow your retirement funds some time to compound and then you will have a better chance of a successful retirement. **Good Luck!**

## OUR GRANDAUGHTER

"That's a nice gesture, but I'm not sure you can afford it?"

"But when she was in junior high we promised our only granddaughter that when it came time for college she could go anywhere she wanted and we would pay for it."

"OK, but back then your industry was thriving and you were making a lot of money; however, since then things are much different. The money you plan to spend on her schooling is now rather critical to your retirement."

"But we promised."

"Where is she planning to go to school?"

"The Private University north of here."

"Is she getting considerable aid?

"No, they said her scores and grades weren't high enough to qualify for any kind of aid."

"Let's see if I have this right. She is not an extraordinary student and she is going to a prestige school competing with other students most of whom are very good students. Do I see a train wreck in progress? Isn't she likely to fail in school - not because she is a failure but because she has a bad plan? Maybe she needs to find a school that caters more to students of her ability, where she can achieve some success and build up her study skills or other skills that are necessary to compete at the next level. And, maybe she needs to learn a little about economics and realize that you can no longer afford to pay the premium price for her education without risking your own financial security."

## WHAT DO YOU SEE TODAY AS THE BIGGEST RISK TO A NEWLY RETIRED COUPLE ?

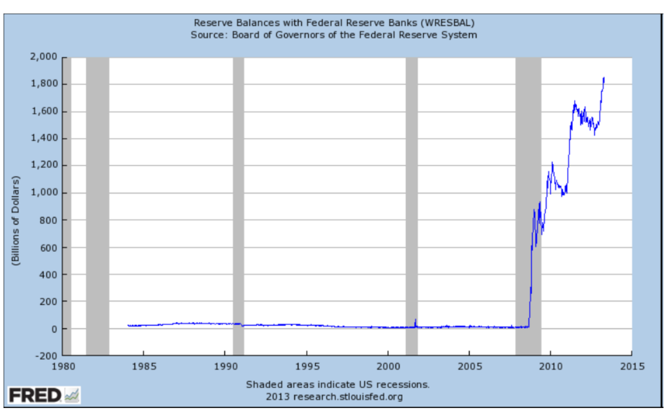
For planning purposes a sixty-ish age couple literally has to plan on living another thirty years. During those decades they most likely will experience many good and bad economic cycles, many stock market ups and downs and many world-threatening international crises. The couple will experience happy and sad family happenings and will also encounter several periods of ill health.

But, it seems to me that the thing almost every couple/ person can count on is inflation…or the reduced purchasing power of their income.

I'm not one of those business channel gurus who is predicting that we will become the next Zimbabwe or Argentina. I don't look for long cycles of hyper-inflation, but I do believe we need to plan for rather serious loss of purchasing power of our income over the next three decades. No, I don't think we will see the official government inflation figures to be in double-digits or even higher single digits, but it sure feels to me as though my personal inflation has been a lot higher than the government numbers for most of my life. And, what the official figures do not take into account are the new additional costs of things. As you peer into the future do you think we may see higher and higher medical insurance co-payments? Fuel taxes? Property taxes? Income taxes? Sales taxes?

Why am I seeing inflation in our future?

Inflation means there is more money chasing the same goods and services. Right now this "extra" money the Federal Reserve is creating is sitting as "Excess Reserves" in our banking system. Here is a chart of the "Reserve Balances" in the banking system. See anything out of the ordinary the last few years?




I'm not sure I know the full ramifications of this chart, but it does tell me something far out of the ordinary is happening…and I imagine this will cause us some real pain in the future.

I have always believed that we would never experience any significant inflation in this country until the people who were adults that lived through the hyper-inflationary times of the late 1970's were no longer in power. Those people are now the oldsters and no longer dominate the power positions in our political system and our current leaders seem far more focused on their short-term political issues than the long-term economic future of the country.

How bad is inflation on regular people? You have seen numbers like this from us before, but let's take a refresher look:

$1,000 per month of spending today inflated at 4% to 5% annually will require about $2,500 per month in twenty to twenty-five years.

It seems to me it is very unlikely that your social security benefits will increase anywhere near your real rate of inflation. Also, if you have a pension from a non-governmental source generally there is no increase for inflation. And from my perch it certainly looks as though many government pensions are already greatly under-funded.

That basically leaves your personal investments as the main defense against the reduced purchasing power of your monthly income. Think about this when you are developing your personal investment strategy. and I believe you will decide that a **growing income stream** from your investments is critical.

## IT'S A TOUGH TIME TO BE AN INVESTOR

In the first article we talked about having a strategy and let's end this *Report* with some further discussion about investing and maybe touching a little on the emotional part of investing.

Recently the stock market has been doing quite well, the mood of the residential real estate market seems to be fairly up-beat and even bond investors are feeling pretty good.

Shouldn't this be an easy time to be an investor?

[continued on Page 5]

Actually, it's not. It is a lot easier to find good investments when the market has just had a scary decline, when interest rates are high and peaking and everyone is scared to buy real estate. It's a lot easier to feel good about investing when the federal government seems to be in balance, not when it seems to be running around putting very expensive plugs in all the holes of the governmental dam.

But in the game of life and the game of retirement income investing, we have to *play the cards we are dealt.*

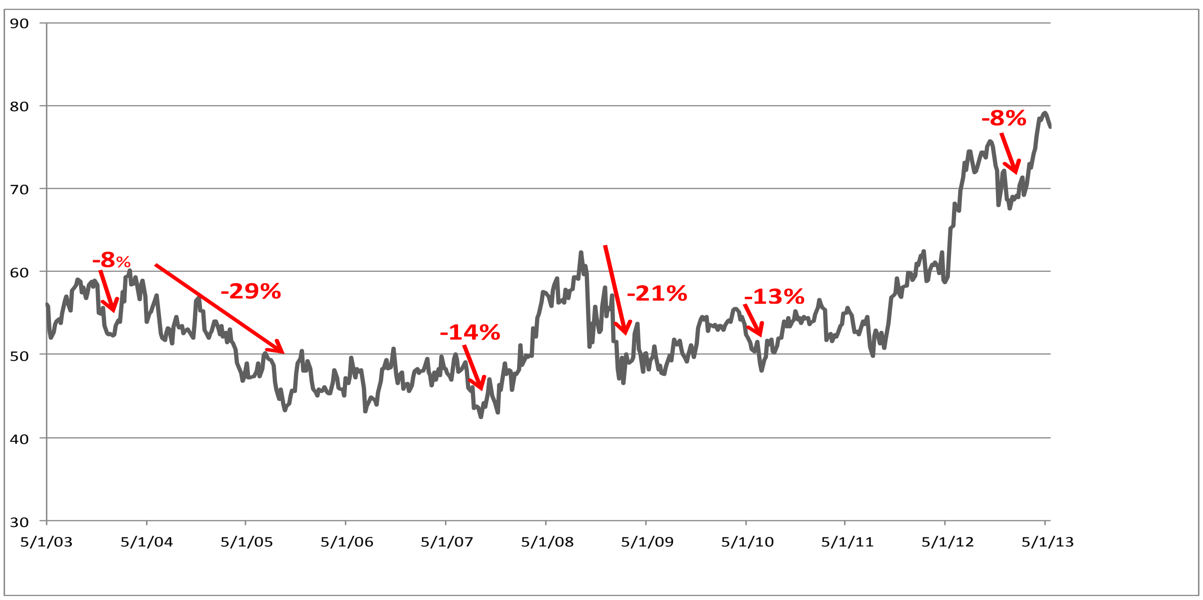
We have government leaders all over the world making money as fast as they can. While this is likely to have a positive impact, at least for a while, on asset prices it also is very concerning to business owners and managers and probably will continue to make them very reluctant to expand. If you are not a business owner you probably cannot understand this, but they fear poor government policy much more than any competition. You can't out-compete the government with higher-quality, lower prices or whatever.

Most of us have a strong fear of losing money, thus we are very open to any "strategy" that promises us that we will not lose any money, or at least, lose only small amounts of money during the tough times.

Get that out of your mind! Or at least change your thinking. Owning investments (assets) is not the same as money. All assets that are traded go up and down in market value. You need to accept that and take advantage of it when you can. When something scary happens in the world, all of a sudden, people want to sell their assets to avoid losing. And the would-be buyers are listening to the same news and they are  suddenly reluctant to buy. Thus, the asset value drops almost immediately. This is a law of nature. We have to accept this.

Our strategy to this "risk" is to have a large portion of each account in quality companies . We want assets that can survive the bumps of life. We expect market turbulence, we don't fight it. We continue with a strategy whose goal it to focus on growing the income of our accounts.

Let's end with a review of one giant, global company. We won't indicate the name of the company or the  industry but neither is important to what we are trying to show. Here is a chart of the share price of this company over the last ten years. The percentages shown are the declines in the share price during times of market turmoil.




Over this period of time you can see how the share price has been up and down and up and down. But let's look a little further at our investment.

Over the last decade:

- Revenues in 2003 were $250 billion, now $470 billion
- Earnings per share in 2003 were $2.00, now $5.00
- Dividends per share in 2003 were $0.35, now $1.60

(SOURCE:  Morningstar…figures rounded)

This company has all the appearances of a strong global company like the type we like to own. We don't spend much time focused on its share price.

## 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®, a 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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*WHAT IS YOUR STRATEGY?*