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the BENEDICT *REPORT*

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What if your bank started 'charging' you to hold your savings?

Negative interest rates, Deficits, Deflation/Inflation, Middle East, Money printing, Energy companies going bust, Presidential election, Immigration crisis, China's economic slowdown…

And the good news is…….?????

"Oh, it's going to be terrible for the next generation…"
"When will these tough times end…"
"So many young people cannot afford to buy a home…"

And the good news is…….?????

The last two Reports that we sent out were titled, "It's so Ugly Out There," and I planned that this one would be nothing but upbeat. That was my plan, but plans change. Maybe our Lunch with Benedict the last Friday in April will be the upbeat message you want to hear.

It seems to me that most people totally ignore the day-to-day big picture news. Oh, they get involved with local events and even follow murders that happened way far away, if there is a lot of intrigue and maybe a famous person involved. And, if they have money invested they may follow the stock market, especially when it is falling rapidly. However, most people seem to isolate themselves from the big picture economic news and from the world-wide conflicts that seem so ever present. I hear far more about Facebook postings than I do the problems with the Middle East…and thank you all for that.

And rightly so, as what can any of us do to have an impact on the world's global economy or the world's seemingly continual conflicts. Any of the individuals running for political office that try to have a dialogue about any big problem, will quickly find themselves not invited to the next debate party.

But, it seems to be changing, at least a little. We are starting to get questions about some major economic events. The biggest one currently is the subject of "negative interest rates."

Let's take a glance at history and see how "negative interest rates" evolved…

(NOTE: This is a greatly simplified account based more on my life's experience than in-depth research. If you have a PhD in Economics, please do NOT read this piece.)

I guess I come from the old school that says an individual, a household, a business, a government must *live within its means,* meaning not spending more than it takes in. Then about forty-five years ago the U.S. Dollar was taken off the gold standard and an economic theory that had appealed to a lot of followers, Keynesianism, became more doable in this country…it pretty much said that the federal government should spend more during tough economic times to help stimulate the economy and spend less during the good economic times to stock pile funds for the eventual economic down times.

That theory quickly became the mantra…at least the first part of it…of many economists and certainly a LOT of political leaders. What person in power doesn't want to have a lot of other people's money to spend on whatever he/she thinks is important?

So now the government had a new tool to use whenever it felt the tool was needed…deficit spending, even during non-war times. This should end all financial/economic problems.

Then came the stock market crash of October 1987. Most stock market indices dropped over thirty percent in a matter of days. Panic was in the air. Our economic leaders feared an economic recession would follow. But, the leader of the Federal Reserve came to the rescue. In a speech using a lot of fancy sounding words in long, rather complex, sentences he explained to the country that the Federal Reserve would "flood the financial system with money," (definitely not his exact words) thereby providing massive amounts of liquidity that would prevent an economic slowdown.

It seemed to work. The stock market started recovering almost immediately and was back to the previous high mark in a matter of months. And, the economy avoided a big recession. And, it pretty much 'proved' that the Federal Reserve could manipulate our economy so that we would no longer suffer through bad times.

So now the government…the Federal Reserve…had a new tool to use whenever it felt the tool was needed, money printing. This should end all financial/ economic problems.

Then came the mortgage crash of 2007-08, and the stock market crash, and the fear that many banks would fail. Panic was in the air. Our economic leaders feared an economic *depression*. But, the leader of the Federal Reserve come to the rescue with a program called *Quantitative Easing*, or QE for short. The Treasury Department would issue bonds (debt) and the Federal Reserve would buy the bonds, with money they made up and deposit them in the accounts of the banks that were members of the Federal Reserve. Then the banks would have plenty of "reserves" money in their accounts (if you have followed this far, you may wonder if this doesn't already sound a little goofy, but…) and the banks would be anxious to lend to borrowers, thereby stimulating the economy.

So now the government…the Federal Reserve…had a new tool to use whenever it felt the tool was needed, *Quantitative Easing*. This should end all financial/ economic problems.

To many observers this hasn't seemed to work overly well even though the banks had plenty of "reserves." Possibly because many of the anxious borrowers were not the people the banks wanted to loan money to and the people the banks wanted to loan money to, weren't asking to borrow.

So here we are in 2016. Many of the world's major economies are in some sort of recession or tittering on the edge of one. And there are many pundits that say the U.S. economy is only months away from an official recession.

So what have many of the world's Central Banks done? Create *negative interest rate*s of course. You deposit $100,000 in a bank and it comes due worth $98,000. The thinking is this will stimulate the economy and they seem to believe this is very rational. (??) If someone knows they will *lose* money by putting it in the bank, then they will spend the money instead, thereby stimulating the economy. Really? Why not just stick it under the mattress?

Ops, you're right, we didn't think of that. But, a former Secretary of Treasury wrote a piece, probably to lay the ground-work for action, offering how we need to eliminate the $100 bill. Of course, the argument is because it is used in crimes. Maybe the real crime is creating *negative interest rates.*

(In case you are not catching on, maybe this will help. If you have $100,000 and you convert it into $100 bills, you have 1,000 bills. I have not experimented with this, but I imagine if they were spread out they could fit under your mattress without creating much sleep annoyance. However, if they eliminate the big bill, then you would have 5,000 of those pesky $20 bills to put somewhere. They would make for a lumpy sleep, thus discouraging this action…I guess. I also imagine large quantities of either denomination of bills kept in the house may also increase the number of household burglaries, but that is just speculation.)

So now the government…the Department of Treasury… has a new tool to use…no large bills. This should end all financial/economic problems.

To anyone who grew up believing in the forces of supply and demand, the evils of debt and the benefits of a strong currency, this all seems like some sort of hocus-pocus. Are the Central Banks of the world doing the right things or are they embarking in totally unchartered waters? Will their magical actions keep us from economic harm's way or are they just adding fuel to the next great economic blow-up?

I don't know…maybe both, depending on your time horizon.

(NOTE: From my youth I was a rather avid reader of history, but I have now found that living history is much more interesting, as I don't know how it will end.)

More on Negative Interest Rates

"Almost a quarter of the world's gross domestic product (GDP) now comes from countries with negative interest rates." (*The Economist*, March 8, 2016)

Here is a sampling of two-year government bond yields from the March 11, 2016 edition of *The Wall Street Journal*:

Belgium	-0.37%
France	-0.40%
Germany	-0.46%
Japan	-0.16%
Netherlands	-0.45%
Sweden	-0.60%
United States	+0.96%

Now when you first look at this you may say to yourself, "this doesn't look so bad. The two-year bond yield in Belgium is *only* minus 0.37%. That is not a big negative."

And, to some extent I would agree. If the negative yield doesn't get a lot larger and doesn't last a long time, then maybe it isn't so bad. Maybe. But, so far the negative yields do not seem to have provided the economic *stimulus* the Central Bankers were hoping for. So what do they do next? Do they make the rates *more* negative? It seems obvious to me they…the Central Bankers…**will not do nothing.** What do they do?

The world's Central Bankers (The Federal Reserve in this country) have seemingly created all these economic distortions to more-or-less bail out the debtors and try to stimulate economic demand. I'll let you decide whether it is working or not.

But, I know what it has done to the average income retiree who was supplementing his retirement with earnings on his savings. He has had to greatly reduce his standard of living OR he is spending his principal. (If our retiree had $100,000 in two year government bonds in the year 2000, he was earning about $500 per month. Today he is earning about $80 monthly on his savings. That is lost spending power of over five thousand dollars per year. Multiply this by all the retirees in the country that did put some dollars away and maybe you can see why the economy needs stimulating to replace the purchasing power that the retirees lost.)

What is the answer?

Obviously, to the people in power…and maybe the voters…the answer is NOT to quit fiddling with the situation and let normal economic forces work.

Isn't there a Good Way to Take Advantage of "Negative Interest Rates"?

We had the question above asked to us just recently; "Isn't there a good way to take advantage of "negative interest rates"?"

The concept of "negative interest rates" seems so foreign to us that we have to stop and think about it and how to benefit from the concept.

Taking on debt to own a potentially appreciating asset or an income producing asset would be a way to benefit from less than zero interest rates. The problem with this is that, so far, most negative interest rates are on relatively short-term bonds and most asset acquisition requires a much longer-term mortgage. But, rates on the longer-term mortgages are also near an all-time low. But, I also imagine that the rental income is also at an all-time low, as a percentage of the purchase cost of the asset.

I'm not sure as a *retirement income strategy* that taking on debt makes a lot of sense, but maybe if your goal is long-term accumulation of wealth, and you have plenty of liquidity, then maybe it makes sense.

A Financial Catastrophe is about to Happen…

Catastrophizing**…the human tendency to view an event or situation as worse than it actually is.**

Hardly an hour goes by when we don't receive an email, a headline, a mailing, a whatever that is predicting that a financial catastrophe is right around the corner. "It's the biggest bubble ever, so it's going to be the biggest crash ever." "Watch this video presentation of how the crisis will play out…" "You'll never believe how bad the economy is going to get."

Most people in the financial news arena will tell you that 'scare' sells. And most of us, if we are honest with ourselves, will tend to pay close attention the 'scare' predictions and disregard the 'rosy' predictions. This is basic human nature.

How do we combat this sensationalism here at the office? Maybe we see so many of the 'scare' headlines that we tend to become numb to them. Also, we try very hard to anticipate bad things happening and positioning ourselves to handle the unpleasant times with as little pain as possible.

For example: we are quite certain that the stock market will go through one of the minus twenty percent cycles in the future. We don't know if the future is days away or years away, but we do know that market volatility (nice term for market crashes) is real and has not disappeared.

Generally our defense against the down market is not to try and avoid it, but to be prepared for it. We want to own assets that will still be around when the cycle changes and the market starts back up. We want to own assets that we feel will still be able to pay us a good dividend even during down market cycles.

In some ways our actions during down market cycles are rather subtle. We may buy into a sector that has been very volatile to try and take advantage of the situation. We may get the funds to do this by selling an asset that didn't drop much or maybe we have some "dry bullets" (what we call money in an account that is there to be used to buy during down market cycles) that we can use to take advantage of the situation.

But, these actions will seem minor to anyone who has watched their investment account value drop by a large amount. And, during those times of great financial turmoil, it is almost impossible to believe that the system will right itself and the market values will start rising again.

We continually look at hedges (something that goes up when the market goes down) and other alternatives that may soften the emotional and financial blow of a major down market cycle, but all come with costs, many times high costs, and there is no guarantee they will work. And, any assets we use to acquire the hedges are assets that are not producing a potentially growing dividend income within the account.

> Let's take a little *time-out* and go back a few years.
>
> It was the late 1970's and early 1980's. Inflation was rampant, interest rates were higher, the economy was bad, our leaders seemed clueless and life did not feel good. Part of this is from my memory, but I did find a copy of "The Duck Book." I can't remember where the name came from but the author, Robert White offered a lifetime subscription to his newsletter for a modest cost…his life not mine…he was suffering from a fatal disease. The front of the book says the purpose is "to try and wake up the American people to the dilemma now facing our economy and our country." The first chapter offered to, "Help you to survive what's ahead of us." "Duck Clubs" opened in many cities across the country so members could collectively moan about our economic future.
>
> Beside "The Duck Book" on a shelf in my closet was, "Crisis Investing for the Rest of the '90's," by Douglas Casey. Mr. Casey, who was at Georgetown University with Bill Clinton, wrote how Clinton's economic vision will fail with disastrous consequences. We were about to encounter the Greater Depression. (Now I don't know if Mr. White succumbed to his illness or lived several more years. And I am not trying to indicate that even if Mr. Casey's predictions did not all come true, that I don't have a lot of respect for his thinking and writings.
>
> Oh, and beside Casey's book was a 1984 *Fortune* mag azine. The lead story was, "What would send the Dow to 2000?"

We still believe the best "solution" is a sort of "no solution." We want our investment accounts to generate a decent income and hopefully that income will grow over time. If you are withdrawing more than the income of your account or plan to over the next two or three years, we strongly urge you to withdraw it now, then a down market cycle should not hurt you, at least not financially.

Get out of The Market?

We hear it all the time, "The way things are, shouldn't we get out of the market?" Of course, the answer to that is yes, if you are going to panic and sell after the market declines and miss out on the recovery. But none of us know how we will react. Our emotions take over.

The problem is that over all the years I have been in this business, I have not been able to accurately guess when the market was going to go up or go down. And, I don't think that skill is going to get better with time. But, I do know big market changes…up and down…can happen very quickly.

I read an article by Steve McDonald, Bond Strategist for The Oxford Club. He analyzed the last forty-five years, which was a total of 11,620 trading days. An investment made in the spring of 1971, and held would have increased 1,910%. However, if you missed the twenty-five best days during that time, then your return would have been 341%.

Missing just 25 days out of 11,620 days made a huge difference in the return. Of course, I'm quite certain that if you could miss the 25 worst days, it would also benefit your return greatly. Oh, but you may say, "I'll gladly miss the best 25 days if I can miss the worse 25 days." I think that is emotion talking again.

Do You Own this Stock?

29.88 +0.85 (+2.93%) NASDAQ - As of 4:00PM EST
After Hours: 29.88 0.00 (0.00%) 5:43PM EST

Here is the one year price chart of a large company. And, I know you are wondering, but the name of the company is not important.

A year ago the share price was above sixty dollars per share and now it is under thirty dollars. Is the company going out of business? It doesn't appear so. Is the company in the oil industry? No, nothing remotely tied to the energy industry.

You might argue that this is not a fast growing company. In 2010 the company had revenues of $11.1 billion and by 2015 the revenues had grown only to $12.8 billion. Net income followed a similar pattern.

But, let's look at a couple of other numbers that are VERY important to shareholders:

<u>Free Cash Flow</u>
2015 = $2.1 billion 2010 = $646 million

<u>Free Cash Flow per Share</u>
2015 = $6.44 per share 2010 = $1.26 per share
(NOTE: Numbers from *Morningstar,* chart from *Yahoo Finance*)

Basically, a company's Free Cash Flow is the money that is left over after paying everything…operating expenses, high salaries, capital improvements, research and so forth. This is the money that is available for the shareholder and can be used to pay dividends or buyback shares, which directly benefits the shareholder. Or it can be used to make the company better in the future, through expansion or internal growth.

Just looking at these basic numbers it is difficult to understand why the share price dropped from over $60 to under $30. Maybe the share price of $60 was unreasonably high. That is a possibility. Maybe the market thinks the company is suddenly going to experience very difficult economic times. That is also a possibility.

Or, is the share price of this stock a "screaming bargain." After all, at this share price…under thirty dollars…the dividend yield is about 8% and the company apparently has plenty of Free Cash Flow to pay the dividend.

"Investing" is all about the future and if the buyers and sellers of these shares are concerned about the future prospects of this company, then that will be reflected in the share price.

This is the struggle that goes on in the minds of investors, especially shorter-term investors, all the time. Is the market "right" and this company is about to experience very difficult economic times? Or is the market "wrong?"

The momentum of the share price is down; so many traders will assume it will continue declining, no matter what the fundamentals of the company are.

We don't own any shares of this company and the current dividend in the 8% range is generally a red-flag that something not good is happening to the company. This company has a history of a very volatile share price and it is in a very competitive industry, however, most of us use the products this company manufactures on a daily basis but they are hidden deep inside other products, thus unfamiliar to us.

One more statistic:
Over the last three months while the share price dropped in half, the average trading volume was 5.2 million shares. The company has about 300 million shares outstanding, thus this entire price change in the shares of this company's stock was the actions of less than 2.0% of all the shareholders. Can you see why this short-term trading is frequently called "speculation" and not "investing?" (NOTE: Information from Yahoo Finance)

Are we getting ready to jump in and start adding shares of this company to many of our accounts? No. We haven't even discussed this as a group. It has a history of more share price and earnings volatility than we usually want, however, there is obviously a lot less market "risk" now than a few months ago, so we can't say that it isn't on our radar. But, shares that drop from $60 to $30 can also drop from $30 to $15. Or, they can go back up to $60. This is called "investing."

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WHAT IF YOUR BANK...?

WHAT WE DO...

We prepare retirement income plans, which are essentially blueprints to help our clients pursue their long-term retirement goals.

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. Fredda B Schwartz and Jackie McAdoo handle the layout and editing of the newsletter.