the BENEDICT REPORT

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Are You an Owner or a Renter?

Most times when you hear this question, it pertains to your primary residence. Do you own your home, or do you rent? While we could offer opinions on the subject and debate the pros and cons of each, the question I'm posing is not about your current living situation…it's about your investments.

So, when thinking about your investments, are you an owner or a renter?

You may be asking, what is the difference? We believe the difference is in your mindset and in your actions…let me explain.

Typically, when we rent something, say a car or an apartment, we may act more off impulse and not do much research…why would we? We're not fully committed and it's only for the short-term…we're just renting.

But what if we decide to buy that house or car? Does our mindset change? You bet. For many of us, the amount of research and due diligence involved goes up dramatically. We want to be certain it's what we want because we are committing to it for the long-term. We are owners.

Now let's consider today's typical 'investor'. How do they invest?

Many typical investors today don't really invest, they trade. It's daily, fast-paced and full of adrenaline. It's whatever is popular and being discussed on social media message boards. It's spontaneous and unpredictable. It's short-term…it's just renting.

Now consider an investor with an owner mentality. The owner has done the research and understands the businesses they invest in. The owner is happy to own those businesses for many years because of their high-quality operating models. The owner can sleep well at night knowing that their portfolio contains world-dominating businesses that have the ability to survive and thrive through different economic environments. The owner has a long-term view and is fully committed to the strategy.

The short-term renter type of behavior may work OK when we're in a bull market…everything is going up! But what happens when we encounter difficult markets?

Which mindset will help you and your portfolio get through the next inevitable down market?

As you can probably guess, we here at BFA have an owner mentality when building and managing our clients' portfolios. We perform due diligence on our investments and have a methodical investment strategy that involves investing for a growing income. We also prefer to predominately invest in individual common stocks but will use certain mutual funds and exchange-traded funds (ETF'S) for additional diversification or to focus on a specific market sector.

Can investing in individual stocks make you a better investor?

We believe owning individual companies can influence your mindset and potentially make you a better investor. How? Because you know what you own. If we own a world-dominating consumer healthcare company in your account, you are probably very familiar with their name and may even buy their products regularly for your household. Or maybe we own a computer software company in your account that you recognize because you utilize their products on your computer.

When we know and understand what we own, it can give us more confidence during difficult market conditions. We pay less attention to the daily media noise and the short-term normal market volatility. We tune out what we cannot control. As an owner, we pay attention to the company, not the stock. That means we focus less on the day-to-day price fluctuations and more on company fundamentals…revenues, profits, cash flow and debt levels. This allows us to stay disciplined and fully committed to the strategy.

With an owner mentality, we are connoisseurs of world-class businesses that can compound our capital over the long-term. With a renter mentality, the thrill is always chasing the next big thing and speculating on the popular investment fads of the masses.

Develop the owner mindset and commit to your investments for the long haul…it can serve you well when we encounter difficult market cycles.

Is the Stock Market in a Bubble?

It seems almost daily that we read or hear about the 'bubble'…

"The market is a giant bubble that is destined to crash"

"The markets are overvalued and in bubble territory"

"This stock market bubble has to burst soon"

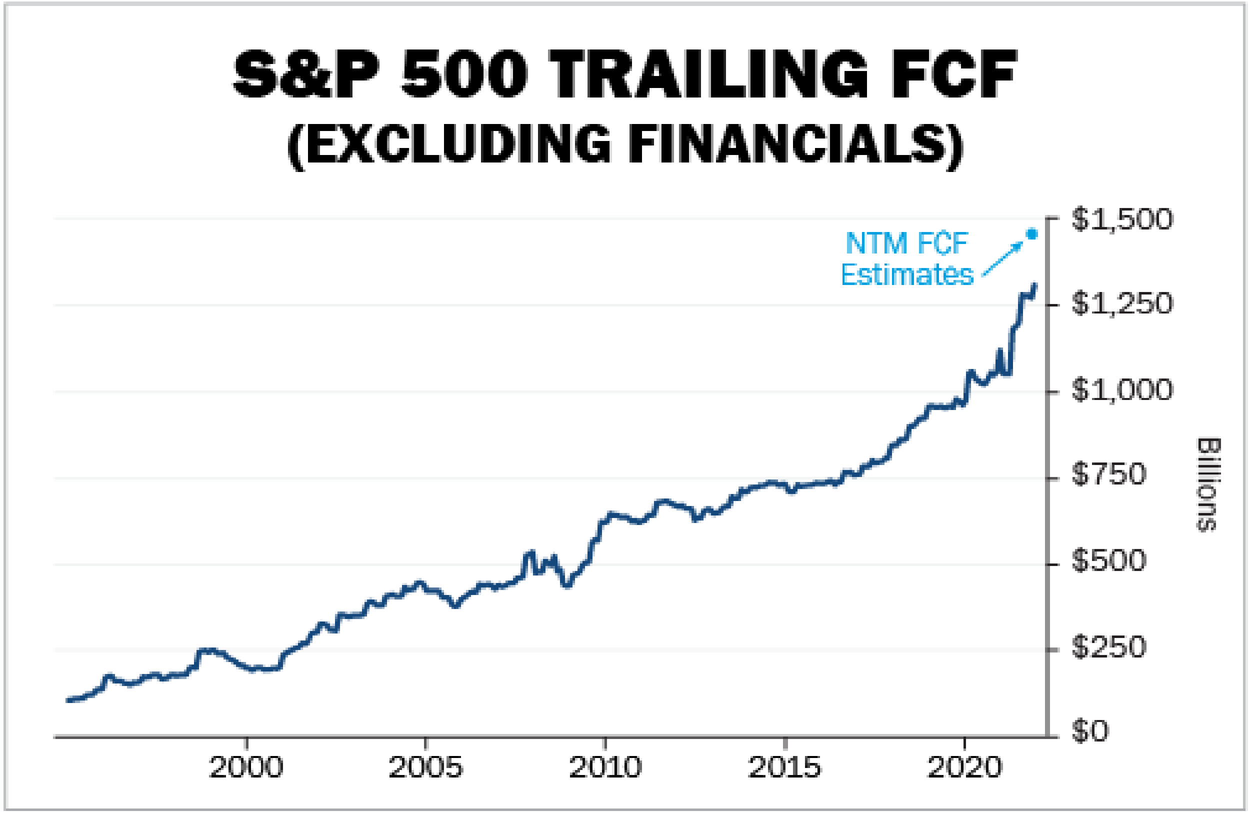
You've probably seen the scary charts or heard the frightening statistics. The traditional valuation models, Price-to-Earnings, Cyclically Adjusted Price-to-Earnings (CAPE), Price-to-Sales and Market Cap to GDP seemingly all point to the market being overvalued.

But what if we use another metric that may be more fitting for valuing individual companies in today's market? What if we look at companies' cash flow…specially, companies' Free-Cash Flow (FCF)?

Free-Cash Flow is defined as the cash that is left over after operating expenses and business investment. It's basically the excess cash a company generates that management can return to shareholders via dividends or share buybacks.

You can argue that free-cash flow is a more important metric than net income or earnings when it comes to valuing companies. That's because the intrinsic value of a company is the present value of future free-cash flows.

Over the past couple of decades, the growth in free-cash cash across the S&P 500 (excluding financials like banks) has been tremendous.



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In fact, since 1995, aggregate trailing FCF is up more than 12-fold…from approx. $100 billion to a recent $1.3 trillion (Sept 2021).

This growth in free-cash flow has been driving the market higher through the years.

And this free-cash flow growth is accelerating due to the changing characteristics of many of the leading companies in the Index. The reality is many of the tech-oriented businesses are fundamentally different, and economically superior, than the companies that dominated the Index in the past. These companies tend to have wide profit margins with low capital expenditures (cap-ex), which means their business models are easily scalable which can convert their growing revenues into increasing free-cash flow.

Compare that to some of the industrial or energy companies that dominated the Index in the past. These businesses tended to have narrow profit margins and required substantial capital expenditures each year.

Consider an amazing fact: A large computer software company generated 20% more free-cash flow (FCF) over the last 12 months than a major oil company generated in the entire decade of the 1990's. (Source: "The Bubble Narrative is Wrong" Stansberry Portfolio Solutions, November 2021)

One more point on the above chart that is worth mentioning…the sharp increase in this year's FCF estimates (NTM = next twelve months). This shows many companies are not only surviving through the pandemic, but they are also actually thriving and increasing their cash flow projections due to certain continued consumer patterns.

This massive growth in free-cash flow has an impact on the market's valuation. By focusing on free-cash flow yields of the Index, we see current valuations are closer to the long-term average than at other times of market extremes…notably the tech bubble of the early 2000's.

What does this mean? We don't know for sure…we can't predict if the markets will continue to march higher or experience a correction due to some other factors. But history shows us free-cash flow growth has driven the market higher through the years…and it seems to be continuing.

Q&A

Here are a few common questions we have received over the last couple of months, so we thought we would address them here:

Prices have gone up for almost everything…do you think it will continue?

Inflation has certainly reared its ugly head over the last few quarters…current year over year inflation rates just hit 7%! But that doesn't tell the whole story. Certain items are up much more over the past year…prices at the pump are up almost 50%, used car prices are up over 35%, meat/poultry/fish prices are up 12%, eggs up 11%, etc. The list is long and extensive. Some of this can be attributed to the pandemic, such as supply chain disruptions and labor market shortages. But some of this inflation comes from government actions like providing multiple stimulus packages and keeping interest rates near zero. How long will it last? It may depend on how the Fed reacts over the next few months.

Is the Federal Reserve going to reduce quantitative easing (printing money) and start raising rates? If so, what affect will it have?

Over the last couple FOMC meetings, the chairman has indicated that they will reduce their monthly bond buying program (QE) gradually over the coming months. They have also hinted that, depending on the data, they may start raising rates in the spring. If the Fed tightens monetary policy while gradually raising rates, it has the potential to bring inflation back under control. But, on the other hand, these same policy actions could cause an economic slowdown and trigger a market decline. The Fed is in a precarious position to say the least.

Has the Gov't passed any new tax law changes that will impact my taxes?

The short answer is no, not at this time. Last year, the new administration discussed passing a huge social spending bill, financed in large part by numerous tax increases. In the beginning, there were some rather extreme proposals being offered to help pay for the bill. As discussions continued, it seems more moderate party members took a stance and said they would not vote for the bill unless significant changes were made, and compromises were agreed upon. Stay tuned…Congress will resume discussions this month.

OFFICE NEWS!

We wanted to share some exciting office news and updates:

Last year, we had three new additions to your BFA team.

In March, we officially welcomed James (Jim) Senkbeil and Jeannette Lewis to Benedict Financial. Jim had his own Registered Investment Advisor (RIA) firm here in the Atlanta area for a number of years. Jim, along with his long-time assistant, Jeannette, began looking to partner with a larger team that could offer increased service to his clients. After initialing meeting a couple of years ago, we finalized our partnership last year and they moved into our office in December.

In July, we welcomed Robert Hamill as the newest advisor to the BFA team. Robert has been in the financial industry about 5 years and previously worked as a financial planning specialist at Ameriprise Financial. Robert is eager to put his experience to work and start meeting with clients.

Please visit our website, www.benedictfinancial.com to see pictures and read more about Jim, Jeannette and Robert.

Benedict Financial Advisors, Inc.

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Ashley A Thompson, CFP®
Robert J. Hamill, CFP®, ChFC®, APMA®
Jeannette Lewis
Jackie Thompson
Fredda B Schwartz

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 this issue of The Benedict Report is Mark A Beaver, CFP®. Philip C Benedict, CFP®, Travis M James, CFP®, Jim Senkbeil, CIMA®, Ashley A Thompson, CFP® and Robert J. Hamill, CFP®, ChFC® provide technical assistance. Fredda B Schwartz, Jackie Thompson and Jeannette Lewis handle the layout and editing of the newsletter.

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