Summer 2011

BATES Briefings

from George's Desk

As I meet with clients one subject is often mentioned: "George, I do not want to see a repeat of what I have just gone through." I understand, nor do I. A fact that I am very pleased about, is that only one client took most of their money out of the stock mutual funds at the bottom of the market.

I had some people who thought I should have done more to stop the losses; had I known how to do that, I certainly would have. However, the fact is that by encouraging clients one by one to not take their money out of their mutual funds, virtually everyone has recovered most if not all of their former account value. It is probably noteworthy that the popular indices (e.g., the Dow Jones Industrial and the S&P 500) are still 10 to 15% below their peaks, as of this writing.

Believe me when I say I do not consider myself a hero for what I have just stated above, I see it as doing my job. I help people make rational decisions, not emotional ones. I believe my experience with sharp market declines such as the mid-sixties, 1973-74, 1987, 1994, 2000-02 and the subsequent recoveries, gave me confidence that we would recover this time as well. "Ok," you say we appreciate what you have done, but what is your point? Rewind to my first comment about experiencing another big decline; it will happen, I just do not know when. Hopefully, it will not happen for several more years.

What I am leading up to is this…there are predictions from many sources that would scare the majority of people. However, I want to comment about my view of the future, the current environment, and what my associates and I are doing to stay at the "top of our game."

First, the current situation: Oil prices are high but adjusted for inflation, they have been higher. I believe the turmoil in the middle-east has allowed the oil speculators to run-up the price but sooner or later consumer demand will adjust the price. I agree with Warren Buffet that gold and silver look too expensive, and in the long-term does not look very positive (to say nothing that the metals themselves do not produce any income so you are speculating on future appreciation alone). Cash or cash equivalents (e.g., treasury bills, money markets, savings accounts and short-term certificate of deposits) are paying 0 to 1%; so that does not look very appealing for money that you do not plan to spend in the next year or two. Bonds also look very vulnerable to price declines as interest rates will likely increase over the next two to five years. Commodities have had a pretty sharp run-up in price until the last few weeks, but there are not very many ways for the average investor to invest in commodities, except exchange traded funds (ETFs) and they have only been around less than five years. Real estate is in the doldrums, except for farm land, without much to suggest significant recovery for some years. Lastly, the stock market, I can give you opinions that are all over the place, from the very optimistic to the very pessimistic, especially in the short-term (one to two years).

So what do we do? My answer is relatively brief – stay the course. Keep a year's income in cash (if you are not working) keep two to five years income in high quality dividend paying stock mutual funds, and keep longer term money in a diversified selection of growth-oriented stock mutual funds with an overweighting in International.

Let me give you some reasons.
1.) Most of the long-term experienced investment managers that I talk to, or read opinions from, do not believe stocks in general are high-priced. 2.) The economic recovery is continuing and is being helped by the growing demand in high-growth developing countries.
3.) Broadly diversified stock funds give us the potential exposure to all of the asset categories that I have mentioned above.

Finally, what are my associates and I doing to keep on top of what is going on and help you achieve your financial goals? 1.) We are reading more than ever before; due to the wealth of information available. 2.) We are attending conferences, teleconferencing with investment managers, subscribing to more investment services and spending unprecedented amounts of capital on technology. 3.) We are constantly monitoring and researching new investment tools in an attempt to bring the best service to you. 4.) We are avoiding what we believe are unproven strategies. Namely, illiquid or high-risk appearing investments, because I want desperately to avoid investments that when they do go down (notice I said when, not if) there is a high probability they will not recover. Most of these efforts are not new, just more extensive, mainly because there is an ever-increasing list of choices. I am not oblivious to, nor unconcerned about, the mounting debt in our local, state and federal governments, which is one of the primary reasons that I continue to overweight international investments. However, at heart, I am an optimist.

Hopefully these comments will reassure those who are apprehensive. I want very much to thank all of you for the trust you have placed in us, and the frequent words of appreciation that so many of you express regularly. As always, we are here to assist you in as many ways as possible and we consider it a privilege to do so.

REMINDER

People may benefit greatly by doing Charitable Contributions from their IRA's, as part of their required minimum distribution.

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The Government's Obligation of Debt

There was a startling article in USA Today, on June 7, 2011 about the size of the U.S. Government's debt. Some of the highlights of the article reveal that though the budget deficit was $1.5 trillion dollars, the government added $5.3 trillion in new financial obligations last year alone.

Those obligations were in the form of retirement programs for government employees, Medicare and Social Security benefits promised to us for the future. According to that article, that brings the total of debt (money owed to investors) and future obligations to U.S. citizens to $61.6 trillion dollars. That amounts to a liability of $534,000 per household in the United States. Considering that a recent study indicated that the lowest 50% of U.S. households had an average net worth of $8,500 that means the upper 50% are responsible for over $1 million per household.

A breakdown of this incomprehensible amount of debt and unfunded liabilities indicates that Medicare's share is $24.8 trillion of this, Social Security $21.4 trillion, federal debt $9.4 trillion, military retirement benefits $3.6 trillion, federal employee retirements $2.0 trillion, and a category listed as "other" $400 billion.

The newspaper reported that they used standard accounting rules since 2004, plus annual reports from Social Security and Medicare and "the little known audited financial report of the federal government" in writing this report. What is not reported in this article, but I think implied, is if something is not done, that $5 trillion dollar unfunded liability for future entitlements will be added to the problem each year until Congress does something.

As I have stated before, but I believe bears repeating, this humongous problem is not because of the Republicans or the Democrats, it is both parties who have overpromised to the American people. The Republicans and the Democrats are going to have to work together to solve it and quit blaming the other party for the problem.

For those who believe we can solve the problem by raising taxes, I would point out that in a recent study two of the four largest state economies in the United States namely Florida and Texas have both seen substantial growth in their economies the last 10 years, and neither state has a state income tax. To be fair, the other two largest state economies, also with large financial growth, are New York and California, and both have among the highest state income tax rates; however, both of the states have dire financial deficits.

In my view, this deficit and debt problem is a national problem for which we all share responsibility and we are all going to have to share in the solution, by simply accepting the fact that the government "credit card" is our "credit card", and we have maxed it out. We need to start now reducing the balance owed and for "heavens sake" quit adding to the balance.

Fortunately, our country is great enough and successful enough that if we, the people, just agree to expect less from the government and do more for ourselves, then we can grow ourselves out of this dilemma.