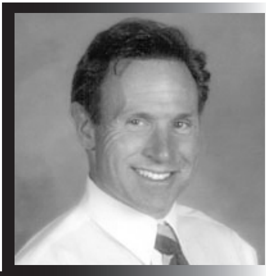

Your Money

By Gary Miller, C.F.P.

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A current joke making the rounds seems to be a sign of the times: "There is good news and there is bad news-the good news is that Saddam Hussein has relented and will allow inspectors into his nation from the West. The bad news-the inspectors must be from Arthur Andersen. At a time when investor confidence has been frazzled by the costly War on Terrorism, and after almost two years of poor stock market performance, investors did not need to have their confidence in the free market system eroded by the shenanigans (if so mild a word is appropriate) at Enron.

Given that most of the "jury" in the hearings going on in Congress were on Enron's gift list, skepticism about who really owns our government is also justified. While the reputation of politicians cannot sink much lower, that of the Certified Public Accountants has suffered a blow. This is tragic because nearly all those we've known over the years are hard working, trustworthy and proud of the integrity they bring to their work, and their work is very important: reliable, audited financial reports are the backbone of the capitalist system. The capitalist system thrives on the willingness of investors to lend money to fund the costly research and development that allows for ongoing expansion, job creation and a better life for a greater number of people. Now the CPA's have been tainted by the same conflicts of interest that have long dogged big Wall Street firms.

These firms have for years pretended that they can both advise businesses how to raise money from investors, while counseling those same investors where to place their hard earned capital. Orange County California fell victim to this incestuous relationship only eight years ago. Now large CPA firms, playing the dual role of consultant and auditor, have proven they are no better at separating these conflicting functions than the brokerage firms. This points to why you as an investor benefit from retaining your own counsel in the investment arena. A fee-only Certified Financial Planner, sells no investment products. Our income is derived solely from investors who want completely objective advice. While we are human and will make mistakes, they will not be mistakes derived from serving two masters.

The structure works for our clients: funds and investments are held by a discount broker dealer, and their job is to execute trades in a timely manner, not sell products. After a good deal of discussion, we design a portfolio customized to each client's needs.

Over time, and with our clients' written permission, we adjust the investment mix as profits are realized and new opportunities appear.. By diversifying the investment portfolios we craft for each client, we believe that when poor investments are occasionally chosen, they will represent but a small portion of the whole pie.

It was with this philosophy in mind that this author, urging clients to beware of over-exposure in technology during the Roaring 1990's, suffered the loss of some customers, who were lured by brokers promising quick, painless profits. Still today, with some technology stocks off 80% from their March 1999 peaks, many speculators are expecting a big Tech rally that will restore their fortunes. Benjamin Graham, father of value investing urged that companies be purchased only if they could be had at well below intrinsic value (i.e. if they can be "stolen"). This approach adds insurance to the already conservative value approach. Insurance is just what investors should be demanding given the challenges facing the markets today.

Clients who attended our annual client appreciation luncheon in early December heard me express concerns about issues weighing on the stock market of the future. Not the least of these is the potential drag on the economy and on corporate earnings of the extraordinary security mea-

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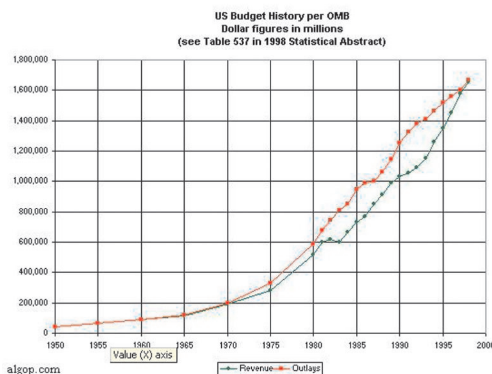
sures that must be taken at all levels of society in light of the organized terror attacks planned on this country. NBC news reported that $300,000,000 dollars was spent on beefed up security at the Winter Olympics. Effectively the United States is engaged in warfare with an enemy who cannot be geographically pinpointed and who may show up on a city street, a bus or an airplane at any moment. Peter Navarro, a business professor at University of California Irvine estimates the annual cost for increased security measures of about $100 billion per year. In a $10 trillion economy this represents an approximate Gross Domestic Product shift of one percent per year to a basically unproductive activity. The U.S. Gross Domestic Product is generally believed to have an underlying growth rate of only 2.5-3% so this is a big price we pay. When precious corporate dollars must be spent installing cameras, hiring bag checkers and e-mail snooping software, funds are diverted from investment in more productive technologies, medicines and machinery.



Another factor that concerns me is way in which the White House proposes to pay the government's portion of these costs, primarily by increased military spending. Based on the preliminary budget proposal that the Bush administration unveiled on January 23rd, we begin with a $100+ BB deficit and continue this way for four years minimum. Rather than ask the American people to take a direct hit for the cost of war on terrorism and by proposing a tax increase in Federal spending, Bush and Congress will no doubt take the politically expedient route of simply running a deficit and forcing the Treasury to borrow the difference.

Lyndon Johnson, Richard Nixon and the Congresses that enabled them got away with ballooning deficits like this for years at a time. Deficits however, create a tax on the American future.

Whether a business or an individual or a government, when an entity continues to spend more than receives in revenue, lenders become skeptical and soon require progressively higher interest rates to entice them to lend to a progressively less creditworthy borrower. This process showed its ultimate destructiveness in the sky high interest rates of the 1970's and early 1980's. When homeowners must pay mortgages of 14 percent as this author did in 1981; we are effectively paying a deferred "tax" for the borrowing of earlier governments. Rising interest rates are not healthy for the bond market or the stock market as we saw in the 1970's.

We agree with those impressive observers, not the least of whom is Warren Buffet, who predict that the baseline growth rate for common stocks will decline from its historical level of 10% to about 7%* . While this will be less growth than in the recent past, it represents an opportunity to build wealth and stay ahead of inflation. To improve on this possibly dampened performance of the future, Investors adopt a few strategic conclusions from this somewhat gloomy outlook:

1. Instead of investing, use some fund to pay off debt that is expensive, especially non tax deductible credit card debt. This is just smart financial planning. We help people analyze their income and expenses and sometimes the best thing to do with you money is reduce debt.

2. Stay well diversified - use investments that are moved by differing economic forces.

This is known as "non-correlation", and we employ it in our client portfolios

3. Reduce the cost of investing: avoiding high commission brokerage accounts, annuity contracts, sales charges on mutual funds etc.

4. Embrace a value philosophy that says in essence "I will not buy a stock unless I can obtain Cartier quality at Pic n Save prices".

We offer help in achieving all of these approaches. We believe returns in excess of the average market return can be achieved over a market cycle through superior financial structuring and money management. ***Please call or e-mail if we can be of service.***

*Warren Buffet on the Stock Market, Fortune Magazine, December 10, 2001

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