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Trusted Advisor

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WHO WE ARE
Certified Financial Planner™ with 35 years direct experience advising investors

WHAT WE OFFER
Complete review of your budget, your tax situation, and your ability to build wealth. We can also review your safety net: Sufficient emergency fund? Properly insured?

WHY YOU CAN TRUST US
We are retained as direct consultants to you. Since we act as fiduciaries, we do not offer any products, insurance, or investments for sale. We are your trusted advisor.

HOW WE ARE COMPENSATED
We are paid by you for rendering advice for your benefit. We may make a one time review or provide ongoing financial and investment advice. Our fees are very competitive and fully disclosed.

U.S. Government
Default?

Our five year composite track record, net of all fees shows that we produced an average annual return of 6.07% for our discretionary clients during a tumultuous time in the financial markets. By contrast, the Standard & Poors 500 stock index averaged only 2.94% per year. This is by far the best relative five year performance we have generated for clients. Most importantly, this was achieved with a very low rate of volatility as measured by "standard deviation", a commonly used measure from statistical analysis. Full disclosure requires me to note, however that even this very decent return fell short of that you could have earned on an index of bonds, at 6.52% per year. So, why not move all your funds into bonds? Well, right now, interest rates are most unattractive, the largest bond issuer in the world, the US government may default, and historically, bonds have outperformed stocks only during the Great Depression of the 1930's (hmmm. what does that say about the current era?). I continue to believe that a balanced approach, using various financial instruments of high quality will achieve superior returns for our clients, whatever the future brings, when the client commits to an investment time frame of three to five years.

A number of clients and acquaintances have asked my opinion of the meaning of a possible U.S. government default for investor portfolios. First, I agree with those who do not believe such a default will occur. Even the most inadequate politicians are usually nudged by history to make bold decisions. This is one of those moments and, as I write, we are hours away from yet another self-imposed deadline in which it appears likely that the midgets in Washington will kick the can down the road. Problem is, the end of the road is close at hand and the can will likely bounce back into the laps of elected officials very soon. While I do not see any reason for immediate optimism, I absolutely believe there continue to be opportunities to make money and do not see a need to retreat into cash at this moment. Let's consider briefly how we got here:

If I recall correctly, Ronald Reagan's first Director of the Office of Management and Budget, a young David Stockman, pinpointed the 2008-2012 date range as the

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point at which Americans would come face to face with the simple fact that the promises of generations of politicians was simply unaffordable, unless major reforms were made to Medicare and Social Security. Initially, Stockman sold Congress on Supply Side economics and was successful in negotiating significant cuts for income tax rates with then House Speaker Tip O'Neill. But Stockman was soon dismayed to realize that the success of lower tax rates, i.e. rising Federal Revenues, was still being exceeded by the rate of Federal spending. In a recent interview, he blames Republicans for failing to resist spending in the '80's and beyond. Politically, the failure of the Republican party to hew to its fiscally conservative heritage is understandable: they were competing with a party that successfully promised everything to every body, thus achieving majorities in Congress for decades. Once in power, the Republican party borrowed from the Democrat's playbook in order to retain their hold on government. Since the days of Lyndon Johnson, Presidents of both parties have foisted irresponsible policies on the country: wasteful military spending, ineffective welfare spending, massive foreign aid and worst of all, promising retirement security to the nation while failing to properly tax and fund to meet this promise. Johnson's mendacious contribution was the creation of a so-called "Unified Federal Budget". Here, the operating expenses of the government, which were in serious deficit during Johnson's term, were mingled with Social Security taxes to make the deficits disappear. The perfidy continued as recently as 2004, when former President George W. Bush convinced reluctant Republicans to support a Medicare Drug benefit just prior to his re-election bid, adding about $700,000,000,000 in unfunded promises to the Federal deficit.

My conservative friends frequently blame "Obama" for most of the current deficit woes, due to stimulus measures that were put in place after his election. Massive government intervention, however, began under George W. Bush, and I believed it was a necessary evil at the time, as investor confidence had collapsed and we were staring at a complete breakdown of the banking system. President Obama can be tagged for his failure to provide honest leadership on this issue, due to his failure to support his own Deficit Commission[1] which produced a bold bi-partisan plan calling for the end of many real estate tax deductions, a delay in eligibility for Social Security benefits and requiring wealthy seniors to pay more for Medicare. There is something in it to offend both left and right, and this is exactly what must happen if an effective plan is to be put in place. Had the President decisively backed this Commission with its politically difficult solutions, we might not be staring at an 11th hour political circus which will likely lead to a loss in confidence among our international lenders, upon whom we are desperately dependent for financing.

Beginning with Stockman and continuing since, various economists and even a few brave politicians have predicted the crisis now faced by our nation. I've watched with dismay the approach of the current crisis for many years, having been a member of the Concord Coalition (a non profit that advocates for a balanced budget) for over 15 years. The Concord Coalition, founded by a Republican and a Democrat who had retired from the Senate, has been a voice in the wilderness, warning of this day.[2] While long aware of the impending Federal train wreck, I failed to notice the equally abusive promises made to state and local employees, something that has become particularly damaging to the quality of life for California taxpayers, among others.

When one looks at predicted Federal outlays vs predicted revenues over the coming few years, the figures are astounding and tragic. With social welfare costs growing vertically (especially for medical care), tax revenues are expected to be flat. As depressing as all this sounds, I'm reminded that the private sector is pretty resilient. Consider that major German corporations like Daimler, Krupp, Thyssen and Bayer, to name a few, were in business prior to the second world war, saw much their infrastructure destroyed, yet emerged as profitable companies in the post war era. Today, the USA is under assault by foreign businesses that enjoy government protection and financial assistance, and by foreign labor forces that are educated, efficient and who work for less money than most US workers.

The current crop of today's elected officials are running short of options to finance promised spending. At the state level, where the option of borrowing to delay a day of reckoning is closed, pitched battles are seen between public employee unions and the officials who must balance their budgets. Illinois, Wisconsin, New Jersey and Minnesota have been forced to deal with this issue. Parks and hospitals are closing, classrooms are bursting with students, and layoffs abound. Those states that insist on supporting overly generous promises and bloated bureaucracies by raising taxes will likely see businesses flee. Entrepreneurs who might have created new businesses and jobs choose other states for their ventures. Capital will move to wherever it can earn the best after tax income.

Wrangling at the state level anticipates the Battle Royale now underway at the Federal level. We appear to be wallowing in a long term period of restructuring of the excesses that have built up over the past half century. Quite simply, this means that Americans, in general, must learn to live with less government support. Figuring out which groups will be most harmed, and how this will play out in terms of business winners and losers will be one of the most important tasks of financial analysis.

As stated in our newsletters over the years, I believe there is always an opportunity to make money. This we demonstrated by wading into fixed income investments and some stocks during the dark days of late 2008. Today, I still have faith in the ability of creative, hard working capitalists to profit their backers over time. One must separate day-to-day market opinion from the longer term viability of certain businesses. I have tried to keep this distinction in mind when choosing investments for client portfolios.

We own high quality bonds and preferred stocks, businesses with dominant, monopoly characteristics, and companies that enjoy growing market share in the Developing economies. We try to find businesses that are run by managements that employ shareholder capital in a rational manner, or return it to shareholders in the form of high dividends and share buybacks. Also our clients have had a meaningful commitment to investments that can profit from a weakening US dollar, for many years.

On my desk sits a copy of "*How You Can Profit from a Monetary Crisis*", Harry Browne's prophetic economic treatise predicting a collapse of the US dollar and many of the financial crises we are facing today. I first read it when it was written in 1974. At the time, Mr. Browne advised his readers to get out of real estate, convert most of their assets to gold and silver and to buy a remote retreat far from the expected urban violence that would sweep America's cities as thousands of desperate, poor people roamed the streets seeking to plunder the wealthy. Those who took this advice to heart saw the value of their precious metals soar over the next six years, but missed out on multiple real estate booms during the 20 years from 1921 to 2001. During this same 20 years, precious metals, which do not pay dividends or interest, collapsed in value and were "dead money". Perhaps those who followed Mr. Browne's advice did get to enjoy a remote mountain cabin with neighbors like Ted Kazinski (AKA "Unibomber") living nearby!

Today, we hear virtually identical recommendations from those who seem to see the glass as half empty throughout their lives. An important part of my job is to prevent my clients from becoming irrationally frightened when times are threatening, or irrationally exuberant when it seems there is no way to lose by throwing money into the current hot investment arena. To repeat, in my opinion, the current turmoil still presents opportunities to prosper.

footnotes:

[1] Important to note that originally the National Commission on Fiscal Responsibility and Reform was promoted by both parties in Congress, but at the last minute a number of Republican supporters voted against the Commission in an effort to force the President to take all the responsibility for its recommendations.

[2] If you wish to consider joining this worthwhile group, their web address is www.concordcoalition.org

Sincerely,

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