

# A COMPENDIUM ON ACHIEVING FINANCIAL INDEPENDENCE



**EnRich** Financial  
PARTNERS  
ALIGNING YOUR MONEY WITH YOUR LIFE

Christopher D. Rich, CFP®  
Elaine B. Rich, CFP®

2nd Quarter 2010  
Volume 10, Issue 2

## Finding Financial Peace During Times Of Extreme Economic Forecasts

by Christopher D. Rich, CFP®

**"Most of what is said about the U.S. economy these days could be true or false, depending on your angle."** -Rich Karlgaard, Forbes Magazine March 25, 2010

As most of you know, we place a strong emphasis on trying to provide as much financial peace of mind with respect to your ability to achieve and maintain your goals and dreams as we can. Anxiety resulting from the Great Recession and market whiplash of the past year can leave anyone harried. While both the economy and market appear to be mending, great potential headwinds still remain. Seeking financial peace in an uncertain world is never easy but may be especially unsettling right now. How does one balance the desire for low risk investments against the need for the inflation protection that equities have historically offered and achieve a reasonable level of financial peace in light of the different possible outcomes we face today?

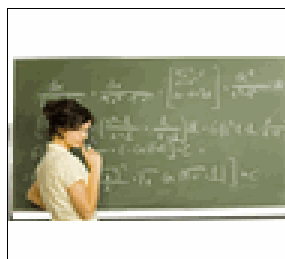
Over the past year or so, we have had many conversations about how the level of uncertainty regarding the possible outcomes for the U.S. economy and market has never been more broad and divergent. Rich Karlgaard's quote above encapsulated our thinking in one short statement. Mr. Karlgaard in his March 25th essay goes on to provide us with a very useful framework with which to evaluate the array of possibilities that are presented to us today as investors. He defines a seven-band spectrum of bears to bulls.

### The categories are:

\* **Apocalyptically bearish.** Believes in the crash-chaos-anarchy scenario described by Paul Farrell. Book author Harry Dent and bloggers too numerous to mention fit here.

- \* **Strongly bearish.** Believes that a long, Japan-like stagnation is inevitable for the U.S. This category includes Shilling, Roubini, Ferguson and Koo, as well as Charles Munger, famous investing partner of Warren Buffett.
- \* **Moderately bearish.** Believes that the bull rally since March 2009 is on thin ice but that the U.S., despite its problems, still has a good future. Here you might place GMO's Jeremy Grantham, Fusion IQ's Barry Ritholtz, Seabreeze Partners' Douglas Kass and Millennium Wave Advisors' John Mauldin.
- \* **Neutral.** Thinks the market is fairly valued and awaits further data. Two well-known market timers, InvesTech's James Stack and Hulbert Financial Digest's Mark Hulbert, would fit here.
- \* **Moderately bullish.** Believes the market is fairly valued and will rise another 10% to 20% on momentum before it gets stuck in a several-year trading range, barring pro-growth changes in taxes and regulation. Rich Karlgaard fits here.

**"Most of what is said about the U.S. economy these days could be true or false, depending on your angle."** Rich Karlgaard



- \* **Strongly bullish.** Believes the November elections will create enough balance-or gridlock-to get America's narrative away from Washington politicians and back to entrepreneurs and investors, where it belongs. This is where you'll find Fisher Investments' Ken Fisher, First Trust Advisors' Brian Wesbury and CNBC's Larry Kudlow.
- \* **Extremely bullish.** Believes that we have only begun to touch the technological miracles that will enrich our minds, bodies and pocketbooks. Nobody I know fits this category.

- Seeking reasonable levels of financial peace
- Balance between risk reduction and adequate returns
- Individualized planning

6425 Odana Road  
Madison, WI 53719

Phone: 608.275.3442  
Toll-Free: 888.204.1557  
Fax: 608.275.3445

www.enrichpartners.com  
info@enrichpartners.com

Investment Advisory  
Services offered through  
EnRich Financial Partners  
LLC, A Registered  
Investment Advisor

## Financial Planning and Market Commentary

No one knows what the future holds, and neither do we. However, corporate profit expectations for 2010 and 2011 seem aggressive and appear to be dependent on a new peak in profitability. While economists' forecasts suggest conservatism, corporate profits growth expectations are robust. Since the beginning of the year, expectations for 2010 S&P 500 earnings have risen from around \$74 to more than \$78 (according to Thomson Financial), while 2011 forecasts have increased from around \$84 to more than \$91. This implies that a year after the bottom in the economic cycle corporate profit margins will return to all-time high levels. Much of the improvement in earnings in recent quarters is related to increased efficiencies and improved labor productivity achieved by reducing workforces and capital spending. While in the short-run it is possible that companies can meet the higher demand implicit in earnings forecasts with their existing operations, eventually they will need to retool and add employees. Other factors that may influence profitability in the coming months are potentially more negative than positive (e.g. rising tax rates and higher raw material costs). A counterargument to this (that will only be validated over time) is that S&P 500 companies gained significant market share in the downturn and will operate at higher levels of profitability going forward.

Given all this conflicting data, we personally find ourselves falling in the **neutral** category. There is a great deal of effort and commentary devoted to the near and long-term prospects for the U.S. and global markets and economies. As many of you know, our long-term position has always been agnostic, with the exception of the late 2008-early 2009 financial crisis, regarding economic forecasts and problems. We have always believed the "apocalypse du jour" commentary of the moment ultimately always proves to be false over time. Economies ultimately recover and so do markets. The financial crisis of late 2008-early 2009 may be an exception. The freezing/contraction of credit and the extreme debt load carried by many U.S. consumers may have caused, in our opinion, a permanent (or at least a very extended) change in consumer behavior and a reset of the U.S. economy. Given the evidence that a contraction of consumer credit and deleveraging (debt reduction) of households has a nearly perfect track record around the world in similar situations (i.e. the U.S. in the 1930's and Japan in the 1990's) of causing economic recoveries to take 3x-4x as long to recover from than a normal post WWII recession, we feel it is prudent to be more conservative in our portfolio positions than we normally would recommend due to the strong array of potential outcomes.

We are also mindful that some very prominent investors, such as Charlie Munger (Warren Buffett's business partner), and Jeremy Grantham of GMO fall into the bearish category. Even Warren Buffett, who has always bought when others are desperately selling, admits in his December 14, 2009 Wall Street Journal interview that "[he] didn't maximize the opportunities offered by the chaos." Counter balancing this macroeconomic sentiment are many of our fund managers who are finding pockets of significant opportunities, even at very conservative future growth estimates. Thus, how is an investor to position oneself with such a broad array of extreme potential outcomes? In addition, the risk of being on the wrong side of the outcome could be rather high. On the one hand, being highly exposed to equities (stocks) in an economy experiencing significant headwinds to profits could be risky should the market decline to reflect a poorer economic condition. Likewise, the risk of strong inflation remains high due to the extreme monetary and fiscal actions taken by our government to revive our economy. The former risk implies one should reduce exposure to equities (due to potentially lower corporate profits and growth), and the latter implies one should have a higher exposure to equities (due to the long-term inflation protection equities have offered).

Complicating this matter further is what we term the "two data set dilemma." The father of securities analysis, Benjamin Graham, proposed in his book, *The Intelligent Investor*, that investors take a 10-year averaging of earnings and adjust them for inflation to arrive at a "normalized" earnings number to use when valuing a stock. The premise is that corporate earnings go through periods of prosperity and setbacks and that by averaging out the earnings over ten years, all the bumps are smoothed out. However, the last 10 years pose a dilemma for investors, since corporate earnings on the S&P 500 averaged about 50% above their long-term trend line through the market peak in 2007. If we assume corporate profits are to return to their above trend profit levels over the next couple of years, then stocks appear to be very reasonably priced. However, if we assume that economic headwinds and the lack of excess consumer spending that had been driven by borrowing will result in a return of corporate profits to a level more in line with their long-term trend, then stocks appear to be richly valued on average. We've attempted to somewhat side step this issue by utilizing managers that value each company individually using conservative assumptions about future profitability. Unfortunately, we cannot do so completely, since each company's future prospects are in some portion tied to

## Financial Planning and Market Commentary

how the overall economy does going forward. Thus, to say a rising tide will help raise all ships and a receding tide will lower all ships is at least partially (if not largely) true.

We wish we had the ability to foresee what the future holds and then optimize portfolios to reflect these economic and market conditions. Unfortunately, we operate in a world of uncertainty and incomplete information. Thus, we seek to position portfolios that help reduce risks and produce adequate returns in light of each client's current and long-term objectives. We know this time of uncertainty has caused many of us to question the wisdom of everyone from our elected leaders, to the heads of corporate industry, to our financial

advisors. Our commitment to you, our client, is unwavering. We work to place your long-term interests first. We seek to be as committed to your long-term success as we are to our own plan. We believe the determining factors in your long-term success will be a combination of having a plan, following that plan, adjusting the plan when conditions warrant, responding appropriately to market conditions, and having faith that the path of mankind will be better in the future, albeit with obstacles along the way, rather than worse.

Thank you for your continued trust. We know these times are trying for many. Please know the phone still rings on our desks. We are here to listen and help work through any concerns or questions you have.

The S&P 500 Index consists of 500 stocks chosen for market size, liquidity, and industry group representation. It is a market value-weighted index. The Russell 2000 Index measures the total return of small capitalization U.S. stocks and is a market value-weighted index of the 2,000 smallest stocks in the broad-market Russell Index. The MSCI EAFE is a Morgan Stanley Capital International Index designed to measure the total return of the developed stock markets in Europe, Australasia, and the Far East. The S&P 500, Russell 2000, and EAFE are unmanaged indexes. One cannot invest directly in an index. Past performance does not guarantee future results.

This material may contain forward or backward-looking statements regarding intent, beliefs regarding current or past expectations. Such forward-looking statements are not a guarantee of future performance, involve risks and uncertainties, and actual results may differ materially from those statements as a result of various factors. The views expressed are also subject to change based on market and other conditions. Furthermore, the opinions expressed do not constitute specific investment advice or recommendations by EnRich Financial Partners.