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The Case for Optimism

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Anyone following the news of the last several months has noticed there is no shortage of economic problems plaguing the world. The global imbalances exposed over the last several years seem to still remain. Much of the policy responses by central banks of the world have treated the problems as cyclical in nature, even though it is becoming very clear that most are actually structural issues that need to be addressed more comprehensively. Plus, the market whipsaws of strong advances followed by steep declines appear to be more correlated to central bank policy decisions than actual economics. In fact, I've come up with a new term for the condition we all seem to be experiencing—volatility fatigue. The relentless large up and down movements of the market seem to be weighing on us all. In addition, global growth continues to vacillate in an unstable manner with traction appearing to take hold at times followed by disappointment as the economic recovery just feels too slow.

These issues have led to some of the highest levels of worry and anxiety by many that I've seen in my 18 year career. The impulse is to replace "investing for the long-run" with "protecting for the short-run." Many today would argue that the problems are unprecedented. And, who could argue with that point, except to say that all large problems have always been unprecedented.

As I pondered all of these points, it occurred to me that in some ways we all can fall victim to fear of the future. Several years back I penned a newsletter to clients entitled, "Optimism is the Only Realism." In that piece, I laid out how historically it was the pessimists who were always wrong. The pessimists always project the problem as something that could/will spiral out of control and become insolvable. While in reality, the track record of mankind is one of inge-

nuity and exponential problem solving. There is no doubt that our global society sometimes gets blown off track as certain economic excesses lead to painful readjustments in order to heal the system. Sometimes these readjustments can take much longer than any of us want to tolerate. But, the larger and more important point is that there is a constant trend line of society advancing throughout the ages, albeit punctuated by periodic and sometimes long-lasting painful readjustments. With that type of backdrop, it is no wonder that Warren Buffett recently stated that he is confident the United States' best days are still ahead and that our children will live in a more prosperous society and be better off than we are today.

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All of this reflection on our current problems in a historical context got me thinking about the case for optimism today. What are the potential key developments that could move us beyond today's problems and into a more prosperous future? I thought of three areas that the U.S. could pursue today that would have very large economic benefits and lasting results. I should also probably preface that given the large political divide in the country today that most anything can be construed to be a political statement. Please know I am certainly not trying to make a political statement, but rather wanted to speak to the economics of the points below.

Energy Independence

For nearly 40 years, every president has paid lip service to the U.S. becoming more energy

Society continues to advance through the ages.

United States' best days are ahead.

Our country has always been at its best in crisis.



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policy. Yet, none of them has had one. Energy resources have been moving against our country for the past 60 years. Over my lifetime, I've watched as our country has spent more and more on imported oil. In a typical year, and depending on the price of oil, we export between \$400 billion - \$600 billion to purchase oil. Much of those dollars go to parts of the world with governments we don't particularly like, and those governments don't particularly like us. As any economic student can attest, there is a multiplier effect on dollars spent and retained in our own economy (versus being spent in other countries). Simple math will tell you that keeping \$400 billion - \$600 billion at home would create jobs, and those people would spend and reinvest that money here domestically. A reasonable multiplier of 2-3 times would add \$800 billion - \$1.2 trillion to our economy, not a small chunk of change in a \$14 trillion economy.

Recent advances in hydraulic fracking and horizontal drilling have unlocked vast amounts of natural gas and, to a lesser extent, sizable amounts of oil. As with many new technologies, the environmental implications and regulations need to be worked out, but the economic potential is huge. Whether we like it or not, our modern world is dependent on energy to propel our society forward. The additional reserves added to our domestic energy supply are breathtaking. Prior to the introduction of fracking about seven years ago, our natural gas reserves were estimated to last 20-30 years at current usage. Today it is estimated that our domestic natural gas reserves exceed 125 years and are likely much larger than that. T. Boone Pickens has estimated that if we convert the 18-wheelers on the major Interstates and supply routes along with converting our public sector utility vehicles (buses, garbage trucks, construction vehicles, etc.), our country would be able to reduce our importation of oil by 50%. Imagine how much further we could reduce our importation of oil if we were to convert a reasonable portion of our personal automobiles to natural gas or electricity (battery), and couple that with policies that encourage efficiency. Likewise, our domestic oil reserves have been increasing at a fast clip as fracking and horizontal drilling have allowed us to access "tight" oil in areas we previously thought were unrecoverable.

Military Spending

Our country will spend upwards of \$900 billion on our military this year. To put this amount in perspective, we spend approximately 80% of what the rest of the world combined spends on defense. We have over 150 military bases around the world. We spend billions on defense items that were designed to fight the Cold War. In addition, much of this spending in part is related to "defending" the developed world from significant energy supply disruptions. Large oil price changes have considerable impacts on economic growth, discretionary spending, and productivity. Given the importance of stable energy on our economy, it is very surprising that energy independence is not considered a domestic

"security" issue. As described above, the implications of energy independence could help facilitate a reduction in our military budget. Without the fear of energy supply disruptions, our country could reduce its defense spending and redirect those resources to other pressing needs.

Health Care

Our country directs 17% of domestic GDP to health care spending. The next closest country, Switzerland, spends 11%. In a \$14 trillion economy, like ours, that gap between 17% and 11% represents over \$800 billion.

Much has been said and proposed to address the health care "issue." It will clearly be a hotbed topic in the coming presidential election. However, from our perspective, when you boil down all the noise surrounding the proposed solutions, they appear to rest in two camps. One camp feels a single payer system is the best solution to control costs, deliver health care with better outcomes, and cover all people. They argue that the current system of complex pricing and multiple payers (insurance companies, Medicare, Medicaid, and individuals) causes huge inefficiencies in the delivery of health care. The other camp feels high health care costs and poor outcomes are a failure of economic policy. This camp believes there is a disconnect between the payer of health care (insurance and Medicare) and the recipient of health care (you and me). Simply put, they argue there is a lack of true competition, since the consumer of health care is not directly paying the costs and in many cases is limited on what provider he/she can use.

Clearly there is a lot of energy on both sides of this issue, and I am not going to debate the merits of adopting one solution over the other. That debate is truly for another day. What I do know is that "hanging" out in the middle between the two camps where there is both little competition and little cost control is clearly not working. Bridging the 6% gap and freeing up \$800 billion spent on health care and redirecting it to other areas of our economy would have hugely productive results.

Seeds of Change?

Our economy today is faced with budget deficits of \$1.2 trillion for as far as the eye can see. In addition, entitlements (largely related to health care) are projected to add multiples to this number if left unaddressed. Likewise, our country is searching for ways to boost long-term economic growth and get this country "back on track" again. Perhaps I am over simplifying things here, but adding \$800 billion - \$1.2 trillion to GDP through energy independence, reducing our defense spending by \$300 - \$400 billion or more, and reducing health care spending by \$800 billion would go a long way in solving our "unsolvable" problems. I recognize the gridlock in Washington is very high and that cooperation between the parties seems nearly impossible. I remain hopeful that our political leaders will start better representing the people

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that elected them. It may not happen today or even this year, but frustration by our populous has many times lead to significant change. Our country has always been at its best in a crisis.

Sometimes that crisis is pronounced, like Pearl Harbor or 9/11. Sometimes the crisis percolates beneath the surface for years (slavery, women's suffrage, civil rights). In either case, there always seems to be an inflection point that shifts the bulk of our populous to action. In much larger measure, we are seeing great change take place in Egypt and Libya today where the people reached a turning point. While I am in no way predicting anything like the dramatic uprising and regime changes these other countries are experiencing, perhaps today's discontent at home will lead to the change we seek.

In closing, I find it helpful to remember not to remain too negative for too long. Even when

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things seem the bleakest, the healing process continues. The misallocation of capital is redirected to more productive uses. Companies strengthen their balance sheets and sharpen their processes. Individuals pay down their debt, save more, and improve their personal balance sheets. Governments are forced to address the overpromises, excess spending, and misguided tax policies of the past. All of these things are extremely painful in the short-run as economic activity adjusts to these new realities. However, it is also helpful to remember, that in the long-run, all of these things also set the stage for healthy long-term growth in the future. Our country alone has over 320 million people that are

trying to improve their lot in life. Likewise, the countries of China, India, and Brazil have nearly 4 billion people striving to improve their standard of living. I find it unimaginable to believe that mankind has hit a brick wall and will stop trying to improve prosperity for their children. The global problems facing us today are large and real. They will likely take a few years to address. However, things will look better over time.

At a recent staff meeting, we had a discussion about how enormously blessed we are to have such wonderful clients. These times are challenging, but we're in it with you. At least in part, we prosper as you prosper and we suffer as you suffer. We don't know how today's problems will end, we just know using history as our guide, that they will end.

During this holiday season, we wish you and your family peace, health, love, and future prosperity.

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