My Investment Plan: Easy to Understand and Easy to Implement

I couldn't help but laugh to myself recently when I read an article in a major business publication about banks selling structured notes linked to FAANG stocks. The only thing more complicated than an explanation of the business case for some of these tech stocks is a structured note based on their performance. It's the opposite of [my small-town Vermont axiom] "Simple is Sophisticated."

Any investment plan you make should work hard to eschew the use of such exotic investment products (they're called products because they are *sold* to consumers). Instead you should focus on an investment plan that is easy to understand and easy to implement.

I explained just such a plan in July 2003. This plan worked for me then, and now—fifteen years later—I am more committed to it than ever. I wrote then:

> ***Steady Cash Flow***
>
> *I do not invest in securities that do not throw off cash. I value compounding above all else. When I have cash to compound, I am content, and I wish the same contentment for you. I don't take big loses because I don't do stupid things. Perhaps I'm not the best investor or even one of the best. I know that by taking more risk, I might be able to improve my returns. No thanks! I sleep well and make plenty with my keep-it-simple flow of cash, low-turnover strategy. And I have succeeded with this strategy for four decades without one meaningful loss. I'd like you to come along with me on the*

> *slow, steady cash-cow track. I can help you achieve the comfort and investment success you have been looking for all of your life. But I can do this for you only if you adhere rigidly to the format I lay out for you. If instead you spend each month second-guessing me or totally disregarding my advice, we will not have much in common, will we?*
>
> ***Know Enough***
>
> *I hope you will not think of my approach as know it all. It certainly is not. Rather my approach is know enough. My plan is straightforward—easy to understand and easy to implement. Transactions are few, requiring little of your time in executing orders. It is not rare for me to go the entire year without a sale in my portfolio. I do not follow the markets daily or weekly. And I could not tell you the price of anything I own.*
>
> *Successful investing is counterintuitive. For example, don't you think most investors choose mutual funds based on their good track records of recent years? I hear it all the time, as must you. Well, it's jive. All funds, even the best managed (of which there are few) can have lengthy periods of wretched performance.*

Don't doubt the value of simplicity. It hasn't failed me yet, and it won't fail you.

Trump's Pro-Business American

Revolution: Part II

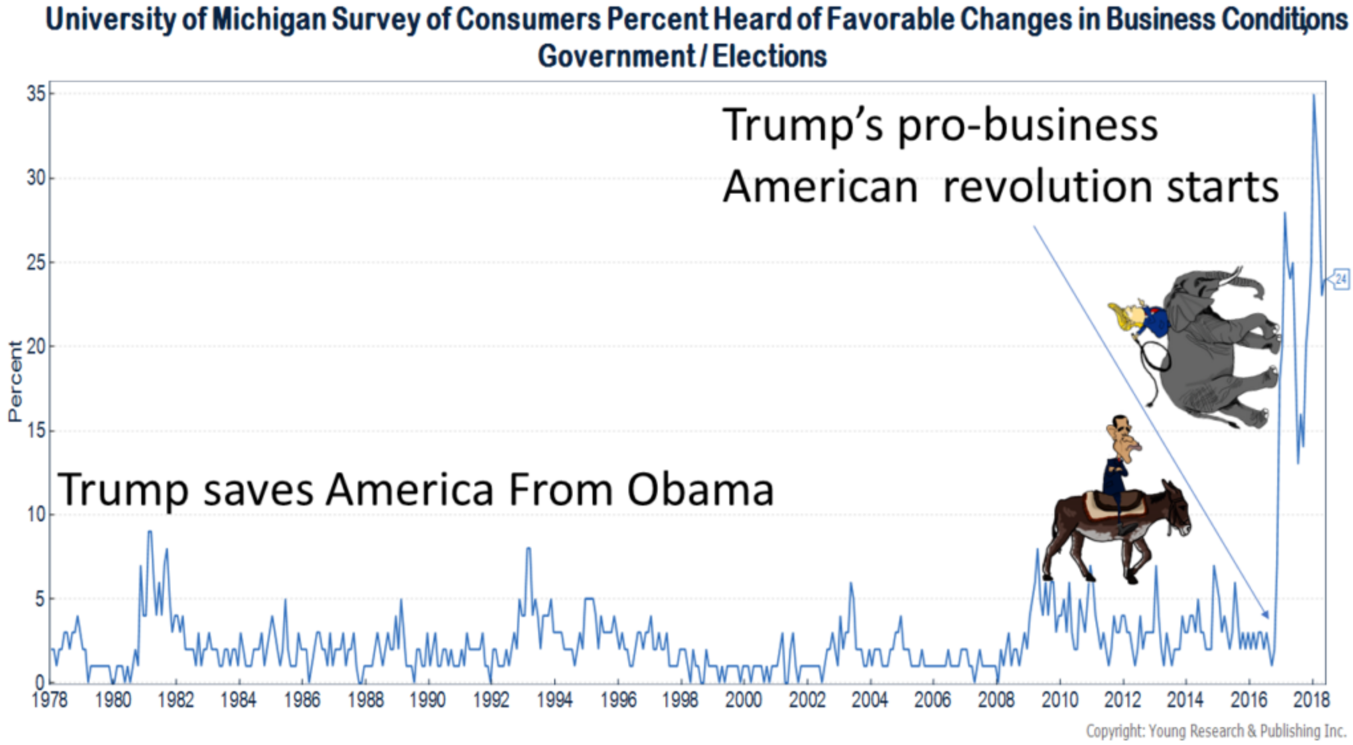
One has to search far and wide to find a single positive headline from the mainstream press about the Trump administration. Trade-wars and foreign policy gaffes dominate the papers, but the story that isn't being covered well is Trump's pro-business American revolution.

After eight years of anti-business regulation and rhetoric, U.S. business finally has a spring back in its step. Small business confidence is at some of the highest levels on record, and CEO confidence, even in the face of some disruptive trade rhetoric, remains strong.

The University of Michigan Survey of Consumers shows that the percentage of respondents reporting positive changes in business conditions with respect to government and elections is off the charts. There hasn't been anything like this on record—ever.

And it isn't just sentiment that is booming. The manufacturing sector is on fire. Industrial production is humming, the ISM manufacturing survey is strong, and capital goods orders (a signal of business confidence) is also strong. The labor market has almost never looked better and wage growth is on the rise.

The President may not have the polish that some Americans have become accustomed to, but since when has polish ever been a reliable indicator of positive results?


University of Michigan Survey of Consumers Percent Heard of Favorable Changes in Business Conditions
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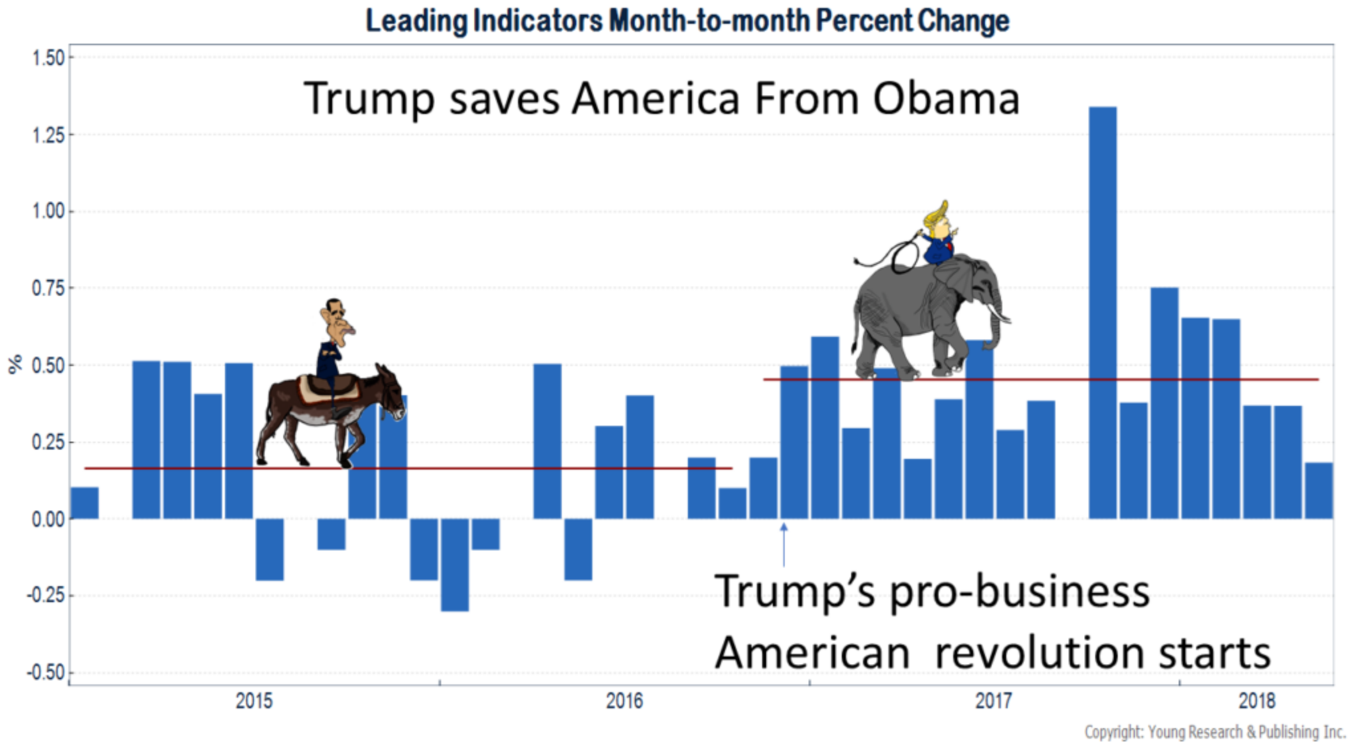
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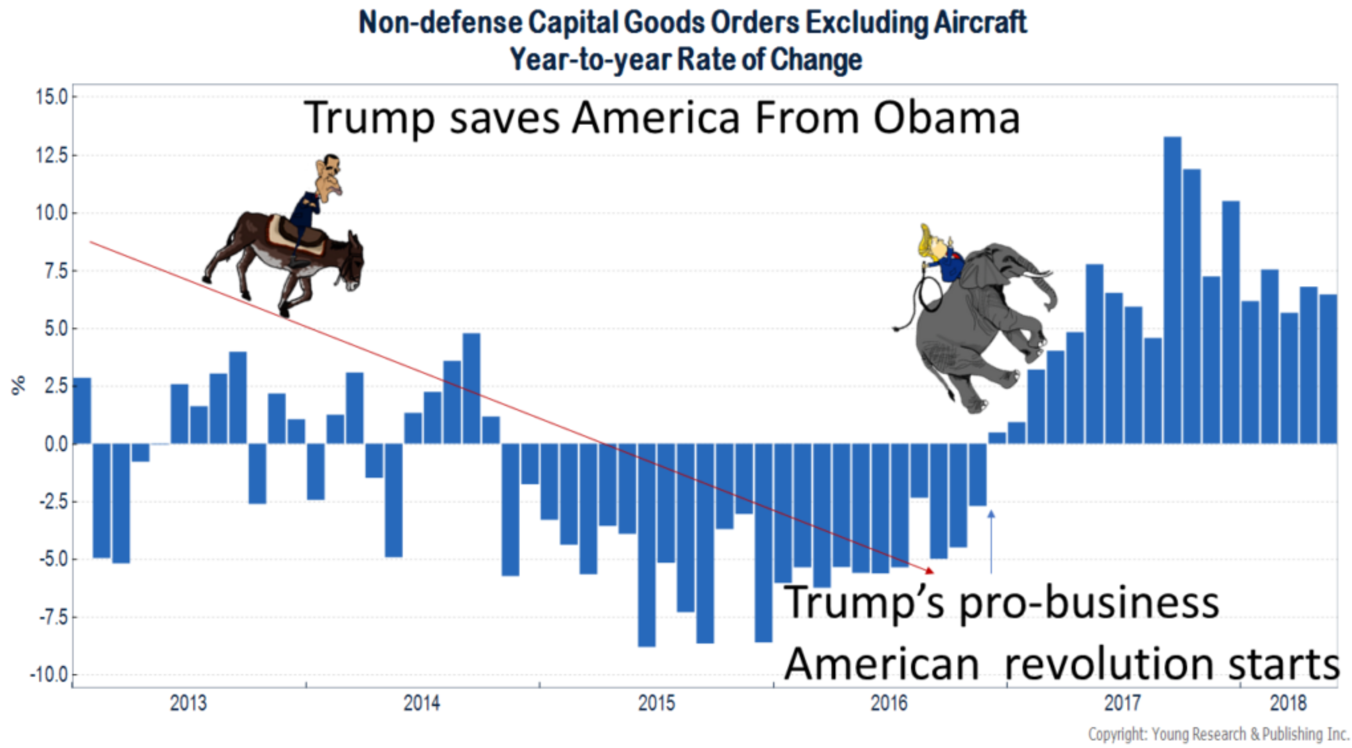
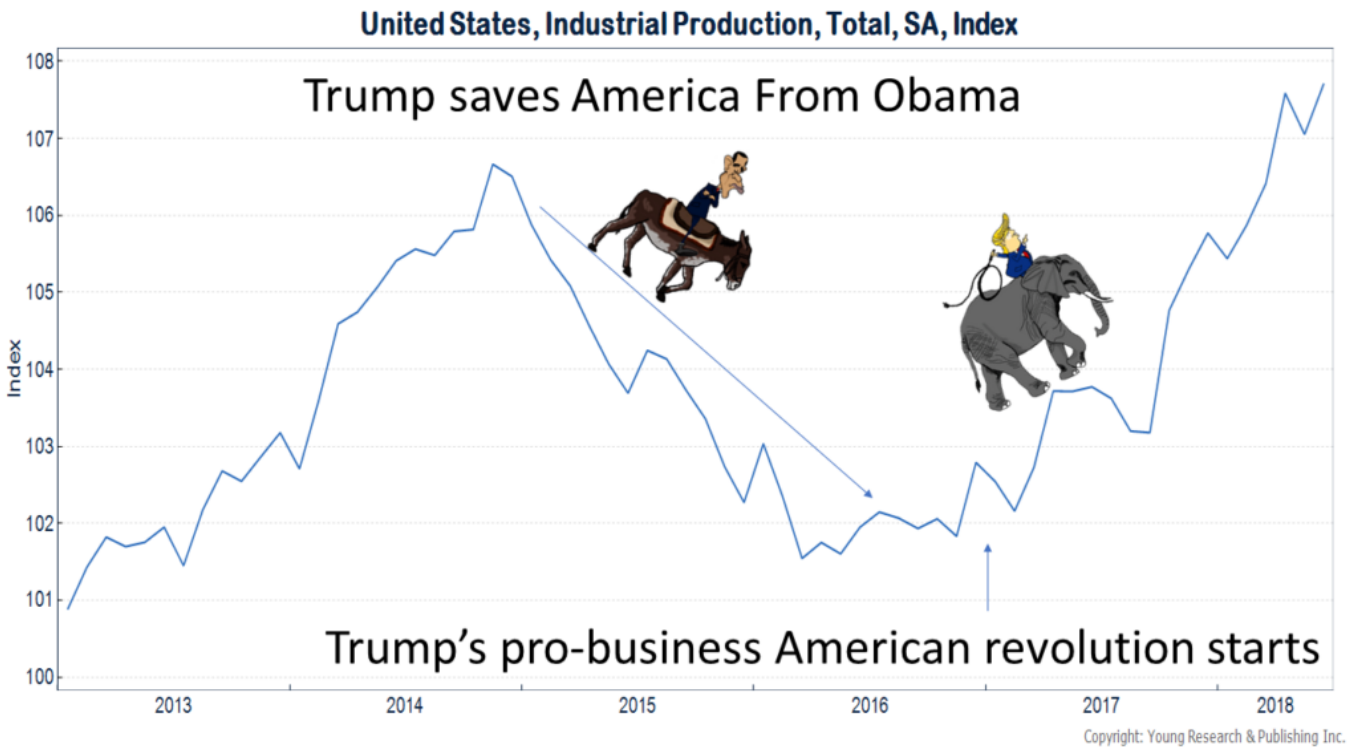




Read [Part I here](#).

Do Old Investing Rules No Longer Apply?

Do the old rules no longer apply? Can you live on corporate earnings alone? Is ignoring your margin of safety advisable?

It turns out, unsurprisingly that the answer to all these questions is no. Back in November of 1997 I wrote the following (my emphasis added in bold):

> ### *Ben Graham's Margin of Safety*
>
> *Graham died in 1976, yet his wisdom is as fresh as if he were standing before us today. Ben Graham & Co.'s advice to investors is to evaluate a stock as if you were considering buying the entire company. Graham's secret of sound investing can be distilled into three words—margin of safety.*
>
> *Why am I focusing on Graham's margin of safety? Because we are all happy as sin with the stock market advances of recent years, but I don't want you to lose perspective. When I was in the institutional brokerage business with Model Roland & Co. in the early 1970s, the Dow fell by 44% in just two years. As bad a year as 1973 was—the Dow fell over 16%—it was only a warm-up for 1974. In 1974, the floor caved in. The Dow plummeted over 27%.*
>
> ### *Sixteen Years of Falling Stock Prices*
>
> *Investors tend to be a little myopic. Many investors are terrific at extrapolating the past into the future. These misguided souls are not investors at all. Rather, they are speculators. Do you know that the Dow was actually down 10%*

over a 16-year period from its starting point in 1965 to year-end 1981? Do you realize that the yield on the Dow today is less than 40% of its historical average? Stocks are paying an average of only 1.7%, versus the historical average of 4-1/4%. ***But it's a new era, you're thinking. Things are different today. With the Dow at 8100, the old rules no longer apply.***

Well, I can tell you for sure, when you're not getting paid to invest, you're not getting paid. Pure and simple. Today's common-stock investor is plunking down his hard-earned money and, in effect, saying, "I will take my gains on the come. Don't worry about paying me anything today." It's the greater fool theory, not investing. I can give you lots of reasons why yield is low today. In the end, you can still say to me, reasons schmeasons, I'm not getting paid! And you would be right.

OK, it is clear that investors are not being paid, but what about corporate earning power? Don't earnings control stock prices? ***As far as I know, you still can't pay your telephone bill or mortgage payment with earnings. Dividends yes—earnings no.***

…

I invest my own money for the long term, and I do not trade or speculate. My portfolio turnover is lower than an index fund's. The awesome power of compound interest, along with low turnover, taxes and commissions, and a lot of time do wonders for any portfolio. It's exactly the strategy I write about and advise for you. But even if you are faithfully committed to the long-term power of compound interest, you need to tinker and prune. ***You want to invest newly available money with an eye toward current market conditions and Ben Graham's concept of a margin of safety.***

All of what I wrote then applies today. Over the last few days investors have been shocked to see some of their favorite stocks getting hammered by events unrelated to earnings. Facebook is facing legal troubles. Amazon is looking down the barrel of federal regulation. Tesla has been rocked by the crash of one of its self-driving cars.

Prices of shares have dropped and could fall further in reaction to their troubles. What will investors be left with? Certainly not a steady stream of dividends.

In 1997, when I wrote the piece above on Ben Graham’s margin of safety, the P/E ratio of the Dow Industrials was 21.2, and its historical range had been from 6 to 24. It would eventually peak in 1999 at 44.2, before crashing back to earth in the dotcom bust. Today’s P/E of 24.75 is higher than the historic average for the Dow, but nothing like the dotcom era.

Higher valuations demand justification. If you can’t rely on your money ever being returned to you in the form of dividends, and instead you plan on selling shares to a greater fool in the future, that’s no justification at all. You need a margin of safety. A steady stream of dividends used to generate compound interest is that margin of safety. Invest accordingly.

Originally posted on March 30, 2018.

Can You Outguess the Market?

Many investment gurus, panelists, and wunderkinds attempt to prove, day in and day out, that they are smarter than the market. Often they suggest that if you simply buy when they buy, and sell when they sell, you will have investment success.

But reality is that most of the time, such market timing behavior leads investors into playing a losing game of catch up. They often end up chasing the market and buying near the high, then selling near the low for the same reason. In 1992 I warned readers about the dangers of trying to outguess the market. I wrote:

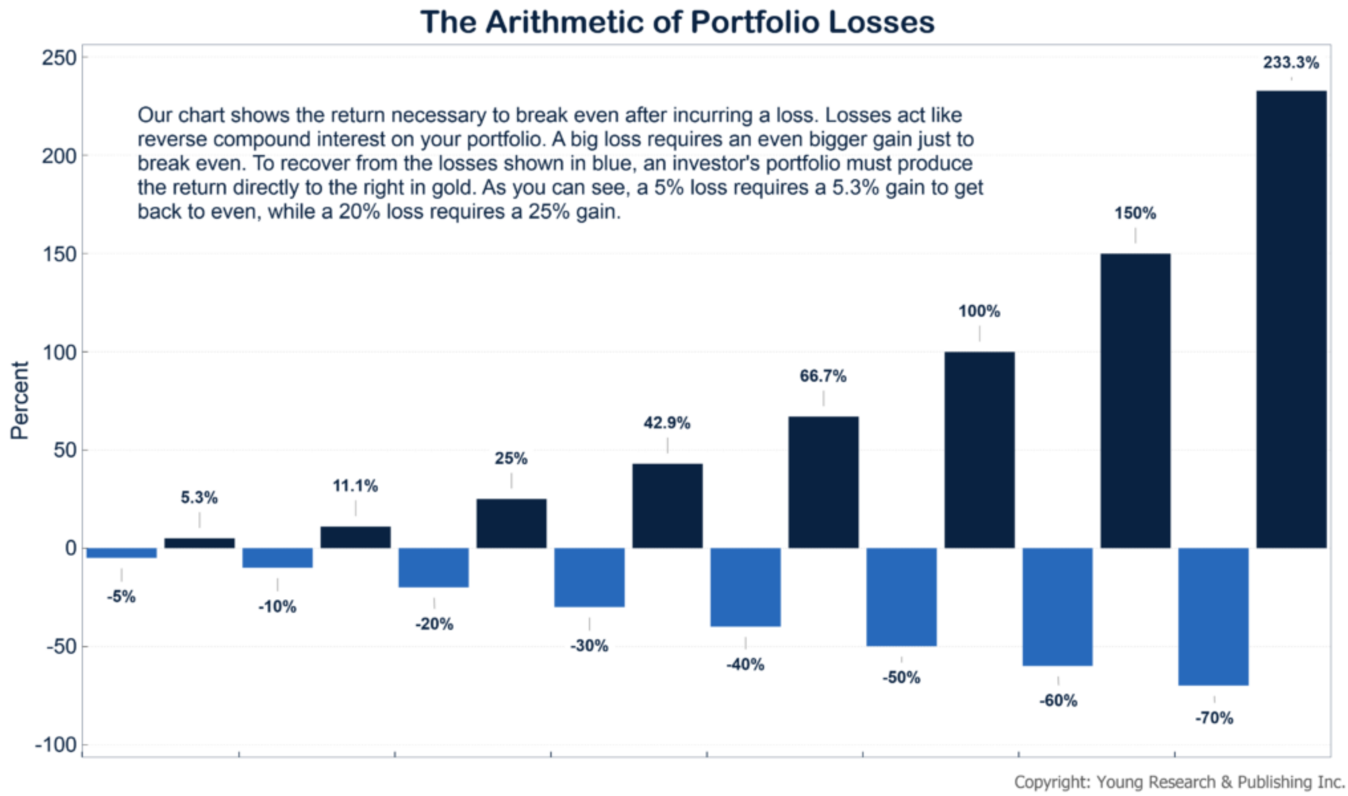
> *How many investors are lucky enough to trade correctly to catch just 30 months out of 600 months? Come on, the odds are real poor. If you stay fully invested, however, you cannot fail to capture all of the good months. Sure, you'll ride out some tough times. The stock market is high today based on value—no doubt about it. That was also true in 1987, when stocks got clobbered in the autumn of 1987. But the rebound from the 1987 lows was swift, and precious few investors sold pre-crash and got back into the market in a timely fashion.*

Your defense against the volatility of the market is not to attempt some casino-like strategy of moving in and out. Instead, craft a diversified investment portfolio of stocks and bonds that provide comfort and confidence in bull markets as well as bear markets. Suffering massive losses in your portfolio due to a bad market timing call can be devastating.

Take a look at my chart on the Arithmetic of Portfolio losses below. You can see that after a 30% loss in your portfolio, you'd need a 42.9% gain to break even. And after a 50% loss you would need a 100% gain. Those are not easy returns to produce, and to be sure it would be best not to lose so much in the first place.

Don't try to outguess the market. Instead, seek to craft a portfolio that will support you and your family in and out of bull markets, corrections, or even collapses.

If you need help crafting such a portfolio, please sign up for the Richard C. Young & Co., Ltd. client letter (free even for non-clients) written by my son Matt. The letter will give you an idea of the measures our family investment counsel firm puts into place for our clients' portfolios. Hopefully those strategies will allow you to become a more successful investor.



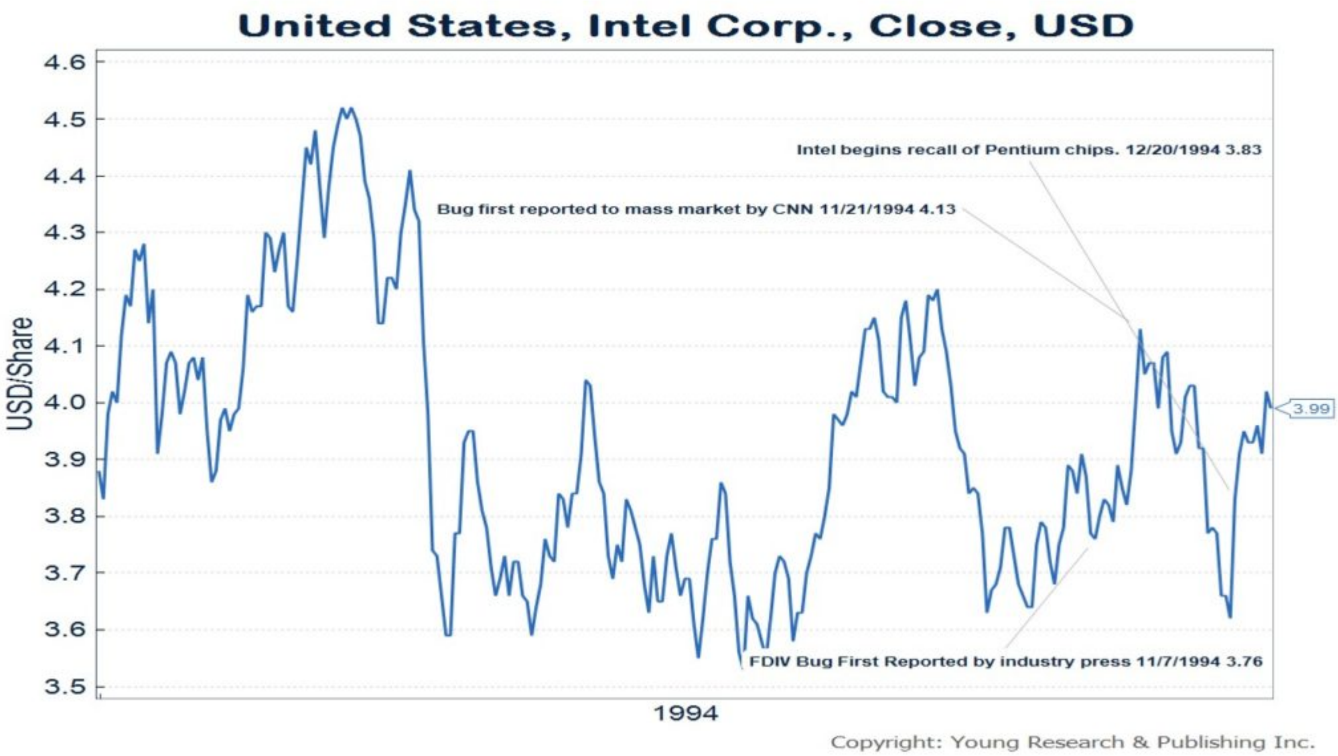
Is Your Investment Game Plan Ready for Action?

History has a way of repeating itself. In early 1995 I wrote about a math professor named Tom Nicely, who worked at Lynchburg College. Nicely was examining prime numbers using a group of five personal computers. While four of the computers gave Nicely the correct answer to a problem, 1.2126596294086, the fifth turned up a slightly different answer, 1.2126596248915 7804.

The cause of the fifth computer's error was the Intel Pentium processor installed on it. Nicely called Intel to explain, but was given the cold shoulder. Next, he did something which at that point was still novel, he asked for help on the Internet. Others checked Nicely's work and came back with the same results, confirming his conclusions.

Intel had already known about the problem since May when one of their own researchers had discovered it, but only after they had been backed into a corner by independent confirmation did Intel acknowledge Nicely's research. The company even offered him a consulting job.

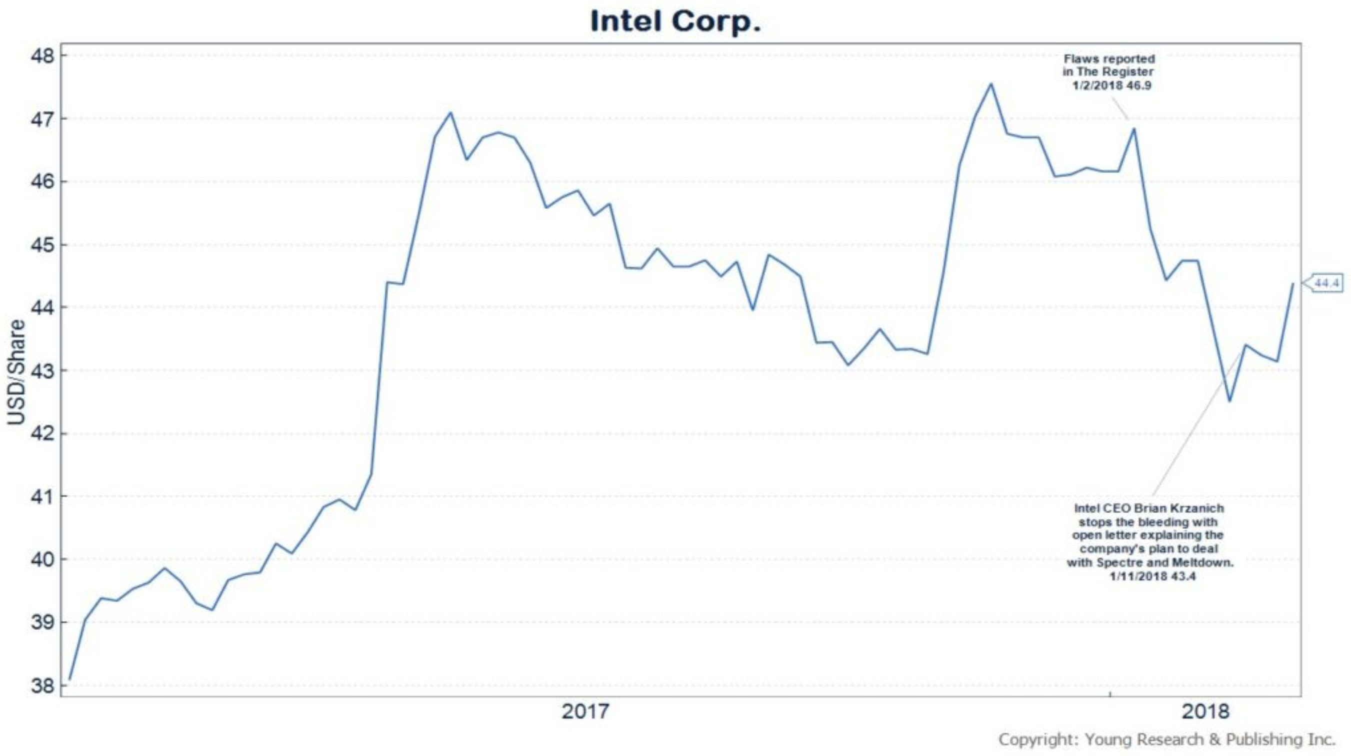
The bug was first reported in an industry journal known as *Electronic Engineering Times*, but when it was reported by the mass media on CNN on November 21, 1994, the stock dropped over 12.3% in a little less than a month. The stock only began gaining again after Intel offered a recall on December 20th.



Here We Go Again

Today Intel is in a somewhat similar, though not exact, position. A group of researchers connected by the Internet, have exposed a much larger flaw in Intel's processors, and now the company needs to deal with the fallout.

The issues, known as Spectre and Meltdown, could potentially be used by hackers to attack computers using Intel processors. The news was again first reported in an industry journal, the *Register*, out of the U.K. But in today's rapid information world, it didn't take much time to disseminate to the market. Intel's share price dropped over 9.2% in eight days.



Only after CEO Brian Krzanich wrote an [open letter](#) to the tech industry explaining Intel's next steps were investors willing to climb aboard Intel once more.

Do You Have a Game Plan?

I do not relay this story to you to shame Intel. What I want you to see here, is that companies often undergo rough periods. The tech industry in particular is prone to volatility thanks to complex products and low barriers to entry. The unexpected happens, and without a game plan you may see a lot of your own money wiped off the board quickly.

My game plan for decades has been one laid out first by Ben Graham in the *Intelligent Investor*. Graham wrote, "One of the most persuasive tests of high quality is an uninterrupted record of dividend payments for the last 20 years or more. Indeed, the defensive investor might be justified in limiting his purchases to those meeting this test." I would add to Graham's astute analysis that focusing on companies dedicated to increasing dividends helps as well.

What are Your Goals?

Another factor in investing is understanding the business you are investing in. Not many investors today can honestly say they understand what the Spectre and Meltdown flaws in Intel's chips really are. Are you prepared to invest in a company that builds a product you don't understand and can't explain? These shares are no doubt appropriate for some portfolios, but if risk avoidance is one of your goals, understanding the company from top to bottom is a good place to start.

I practice risk avoidance in all aspects of life, and especially in investing. If you are in or nearing retirement and are looking to relieve the burden of the work that must be done to minimize risk in your investment portfolio, I urge you to visit the website of my family run investment advisory, Richard C. Young & Co., Ltd. You can sign up for our client letter, free even for non-clients, to get a better idea of the principles used to make investment decisions.

Originally posted on January 19, 2018.

How Pennies Can Win the War

Back in January of 1987, Ronald Reagan gave a State of the Union address in which he lamented the brutal war being waged by the Soviet Union on the people of Afghanistan. Behind the scenes though, Reagan was operating what has become popularly known as “Charlie Wilson’s War.”

Reagan and his supporters in Congress, including Charlie Wilson, were sending Stinger missiles to the Afghans fighting against the Soviets. Those missiles cost pennies on the dollar compared to the Soviet MI-24 Hind gunships they were used to target with a lethal 79% successful kill rate.

The mere pennies the U.S. was spending on the war against the Soviets really added up. The massive cost of the war was a major contributing factor to the eventual breakup of the USSR.

The same month Reagan gave his address, I was writing to subscribers to encourage them to realize the value of their hard-earned pennies.

That month I wrote:

> *I’ve told you about the vital importance of dividends and compound interest. At a 10% return, money doubles in only seven years. One member of the highly successful Rothschild family referred to compound interest as the eighth wonder of the world.*

> *I’ll always remember Bob Rose’s historic note in The Wall Street Journal a while back. Bob wrote, “Early in the last century, an English astronomer, Francis Baily, figured that a British penny invested at an annual compound interest of 5% at the birth of Christ would have yielded enough gold by 1810 to fill 357 million earths.”*

When put into terms of earths worth of gold, it is easy to see the value of compounding. All the mined gold in the world today would fit into a 68-foot cube. The idea of 357 million earths volume of gold is incomprehensible, but it makes the point Baily was getting at. A small investment can generate a powerful return.

At the end of his speech, Reagan told the American people “my fellow citizens, America isn’t finished. Her best days have just begun.” It was true. American went on to win the Cold War, becoming the undisputed most powerful nation on earth. It all started with an investment of what seemed like pennies in Afghanistan.

If you harvest the power of compound interest, your best investing days have just begun as well.

The Most Important Thing in Investing

Back in 2006 I was celebrating 20 years of writing *Intelligence Report*. Debbie and I were in Vermont, and had just visited Vermont’s Authentic Designs to purchase lighting fixtures. The shop uses 150 year-old machines to manufacture colonial and early American lighting fixtures. There, on one of the machines for all the craftsmen to see was taped a sign that read “Simple is Sophisticated.”

After reading that taped up sign in Vermont all those years ago, I adopted “Simple is Sophisticated,” as a personal mantra to keep me focused on the essential elements of my investment strategy. The most fundamental of these, and the one I have employed to the greatest benefit to myself, and hopefully to you if you have been a subscriber or client, is compound interest. Below you will read the story of how I have employed compound interest to the benefit of my grandchildren, and how you can do the same. I wrote back in May of 2006:

> ***Rich as Croesus***
>
> *I want you to begin on your quest for sophistication through simplicity by focusing laser-like on compound interest. Here is an amazing story. I call it my grandchildren’s “rich as Croesus” strategy. (Croesus was the last king of Lydia from 560–547 B.C.)*
>
> *When each of my four grandchildren was born, I opened accounts for them at Vanguard’s TaxManaged Growth & Income fund. Each year, I deposit $10,000 (and yes, I know you can now give away $11,000/year tax-free). The money is invested with little in the way of long-term tax implications. Let me show you how compound interest works its magic.*
>
> ***Gettin’ Rich Slowly***
>
> *If you invest for a compounded rate of return of 10%, it’s easy to think that your long-term return would be twice the return gained by investing at 5%. That is not the case—not by a long shot. Let’s take a long-term look here, for that is my intention with my grandchildren. Investing $10,000 at 5% for 50 years gives them $115,000—a staggering sum, to be sure. But*

at 10%, $10,000 grows to a mind-boggling $1,174,000 (that's million). Double the growth rate to 20% (admittedly unrealistic, but useful in this example), your $10,000 would become a stratospheric $91 million (over 77 times the return). And you thought you understood compound interest?

You and Counterbalancing

As noted, a 20% annual return year after year is unrealistic. But you can achieve really terrific success, most conservatively, by counterbalancing your portfolio with fixed-income and common stocks. …

In 1989, the editors of Fortune published an article headed, "A Low Risk Path to Profits" profiling Loews Corp. money manager Joseph Rosenberg. Fortune noted that J.R. believed so fervently in the awesome power of compound interest that he carried a compound interest table in his pocket at all times. Sayeth J.R., "It is the most important thing in investing." As the article noted, it's foolish to undermine the power of compounding by taking big risks that kick you out of the game.

As Rosenberg noted then, compound interest "is the most important thing in investing." If you want to succeed as an investor for your family, your grandchildren, or yourself, stay focused on the simple, yet sophisticated strategies that really make a difference.

My 1% Miracle: How to Avoid

Outliving Your Money

Back in 1991 I addressed the most terrifying aspect of saving for retirement that any investor can face, the prospect of outliving your money. I cannot impress upon you enough the importance of saving more than you think you'll need.

Those of you who have been diligently saving and intelligently diversifying your portfolio through the last nine years of historically low interest rates are surely wondering if your savings will hold up after you retire. Ultra-low interest rates from the Fed have been a direct assault on retirees and savers. But now rates are rising, and you have the opportunity to participate in my 1% miracle.

I wrote the following back in 1991. The numbers for inflation and return don't coincide with today's reality, but the principles remain the same. Capturing higher rates of return as interest rates rise can have a big effect on your spendable income. I wrote then:

> *Do you believe in miracles?*
>
> *Try this one for size. I call it DICK YOUNG'S 1% MIRACLE, and I think you'll be stunned.*
>
> *I want to show you how just a 1% increase in your average annual investment income can increase the annual earnings from your investment portfolio by 40%. "Right Young," you say, "a 1% increase in income can translate into a 40% increase in earnings? Give me a break." But hold on, here's the miracle—along with instruction on how to apply my miracle to your own investment program today. See if you can beat this!*
>
> *SPENDABLE INCOME ON $1 MILLION IS ONLY $20,000*
>
> *Let's assume, for illustration, that you have a $1 million*

pool of retirement cash. Let's also assume 5% inflation, an annual 9% return on your capital, and a fair tax bite. Okay, 9% translates into $90,000 gross income on $1 million. With a 5% inflation rate, you must plow back $50,000 to capital to maintain future buying power. Most investors forget all about the inflation cancer that eats away at portfolio buying power. If you do not add back to your capital annually at the inflation rate, you are badly kidding yourself. Now, let's assume $20,000 in taxes—I'm being kind—on a $90,000 gross income. Don't worry about the preciseness of this tax figure; it doesn't matter, as you'll soon see.

After tucking away $50,000 to maintain purchasing power and paying $20,000 in taxes, your spendable income is only $20,000. That's it! And yes, that is the maximum I would personally plan to spend today out of $1 million in retirement capital. I know it's not a lot of money, but if you spend more, you are eating into your capital. Now you see why the financial problems of retirement are much more difficult than explained to you by most fuzzy-thinking financial planners. You cannot consume the host!

Increase Earnings 1%, Increase Spendable Income 40%

Now assume you increase your portfolio income by just 1%, to 10% from 9%. Gross portfolio income now becomes $100,000, up from $90,000. Tuck away the same $50,000 to maintain portfolio purchasing power, and pay taxes of $22,000 instead of $20,000, and what do you get? Instead of $20,000 spendable income, your spendable income becomes $28,000. How does $28,000 relate to $20,000? It's an increase of 40% in spendable income, just as I promised would be the case. To get this unbelievable 40% increase in income, all that was needed was to improve your portfolio income by an annual 1%.

You, of course, are looking for flaws in my 1% miracle. But there are no flaws. And you are astounded at how little

> *spendable income is available on $1 million at a 5% rate of inflation. You're not accepting what I'm telling you warmly and happily because the level of spendable income I'm suggesting is so unappealingly low.*
>
> *Don't Destroy Your Capital Base*
>
> *Don't fall for the tempting argument that $1 million is such a large sum, you can afford to accept a 5% per year decrease in earning power due to inflation—or even to dip into principal. To help you stay on the straight and narrow, ask yourself: "Do I expect to be alive 15 years from now?" Most people will answer yes—and with today's longer life spans, that's being realistic. If you retire at age 65, you stand a good chance of reaching 80. And if you retire early at age 55, as so many are doing, you certainly expect to be alive and kicking at 70. You definitely don't want to find yourself broke at either age 70 or 80.*

How can you boost your return by 1% without magnifying risk? Craft a diversified portfolio and eliminate emotionalism from your investment process. That's easier said than done. If you need help, consider that Vanguard estimates that the potential gain from using an advisor to help manage your portfolio can add as much as 3% per year to your return. Working with an advisor on strategies such as rebalancing your portfolio, appropriate asset allocation, building a spending strategy, and most importantly guidance on what investments to make and which not to make can have a significant positive effect on your returns.

For a glimpse at how my family run investment counsel service helps clients implement those strategies, signup for the monthly client letter (free even for non-clients) from Richard C. Young & Co., Ltd.

Put the Odds on Your Side

Near the end of 1993, Debbie and I were hunkered down at The Dorset Inn in Vermont. Its wide pine board floors, restored tap room, gourmet dining room and antique-outfitted guest rooms make the small inn a special place to get away from the constant din of markets and politics. The events of that fall were oddly connected to this very moment in American history.

In November of that year President Bill Clinton told the world that North Korea must never be allowed to develop a nuclear weapon. And in December, Clinton signed NAFTA into law. Projections made in 1993 on how the Korean situation and NAFTA would turn out look poor in hindsight. Attempting to divine the future is a fool's game, and as I wrote back then, in investing you must "invest in what you know to be true today, not in what you think will be true tomorrow."

I wanted you to focus then on the value of putting the odds on your side, and I still do. I wrote:

> *OK, given that there is a lot of similarity among long-term results and that different styles of investing, as well as managers, come in and out of style, what's the best strategy for successful mutual fund investing? How can you be a consistent winner with confidence?*
>
> *At the top, invest in what you know to be true today, not in what you think will be true tomorrow. Insist on putting the odds on your side. Take full advantage of the tools of the mathematician. For example, here's a little mathematical shortcut you can use to determine compound interest. How long does it take for money to double at a predetermined rate of interest? Use the Rule of 72. Simply divide the rate in*

> *question into 72. If your interest rate is 9%, money will double in eight years (72 ÷ 9 = 8). That's all there is to it. Compound interest should be your most trusted investor ally (aside from Dick Young, of course), and the Rule of 72 can help you understand the value of compound interest.*
>
> *Putting the odds on your side—such as understanding the power of compound interest—will make you a winner. That is most certainly your first rule for successful long-term investing.*

Don't let unsure expectations of what will happen in the future cloud your investing judgement. You must instead seek to minimize risk, investing in dependable streams of income, and harden your portfolio against uncertainty.

When Investing, It's Better to be a Leper than a Lemming

During my five decades of investing, I have more often than not been arguing against the going wisdom of the markets. To call me a contrarian would be accurate. Leper investor also fits.

In December of 2001, I explained what I called "Leper Investing," to my readers.

> ***Leper Investing***
>
> *In order to invest successfully over your lifetime, you need to act counterintuitively; that is, against the prevailing Wall Street wisdom. You want to buy contrary-opinion names—those stocks loathed, despised, and shunned by the institutional magnets. Your caches of lepers will generate*

> *above-average returns for you when you exercise patience. You must be ahead of the curve to invest this way. You must have vision and patience and be able to look over the horizon. Most often, you will want dividend-payers.*

Later I went on:

> *I've suggested that conservative investors buy only dividend-paying stocks. I can't emphasize this rule strongly enough for you. My Retirement Compounders program is built 100% on dividend-paying equities. Ben Graham, the father of value investing, said, "One of the most persuasive tests of high quality is an uninterrupted record of dividend payments." Burton Malkiel, Vanguard trustee, Princeton economics professor, and author of A Random Walk Down Wall Street, one of the best books ever written on investing, wrote in his book, "Historically, high-dividend yields have meant better returns…looking for above-average yield is itself a contrarian strategy. Investing in high-dividend stocks therefore is likely to lead you to attractive issues."*

I continue to encourage investors to seek out unloved, forlorn and out-of-favor stocks with a focus on those paying dividends, and with a history of increasing those dividends each year.