Trump’s Pro-Business American Revolution: Part II

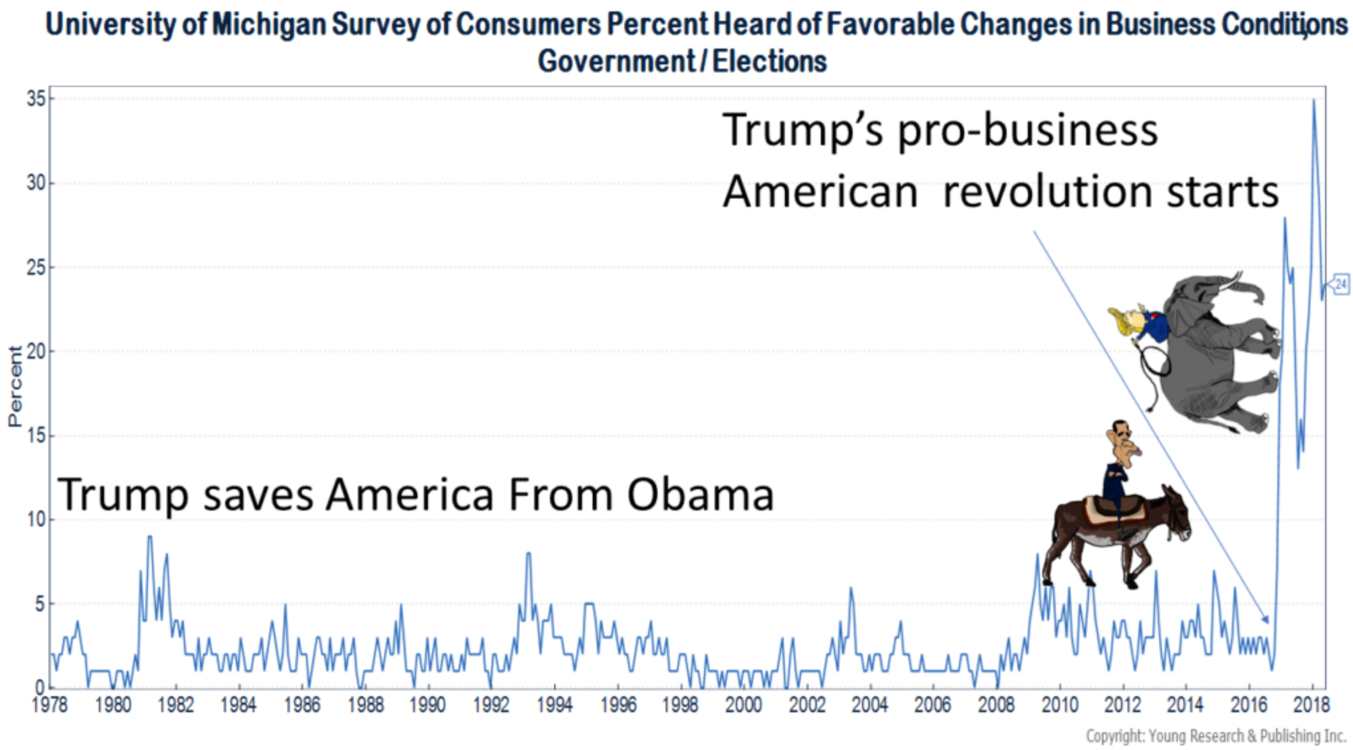
One has to search far and wide to find a single positive headline from the mainstream press about the Trump administration. Trade-wars and foreign policy gaffes dominate the papers, but the story that isn’t being covered well is Trump’s pro-business American revolution.

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
Government / Elections
Trump's pro-business
American revolution starts
Trump saves America From Obama
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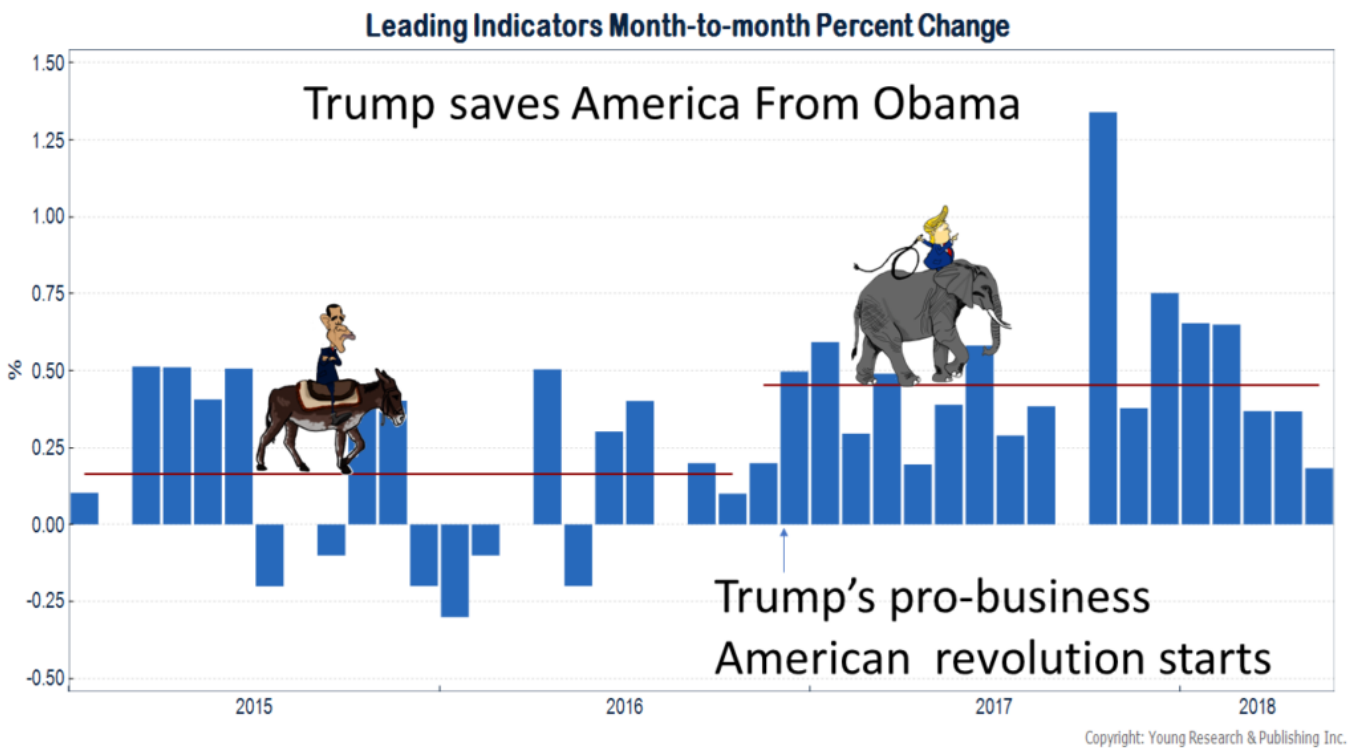

Leading Indicators Month-to-month Percent Change
Trump saves America From Obama
Trump's pro-business
American revolution starts
%
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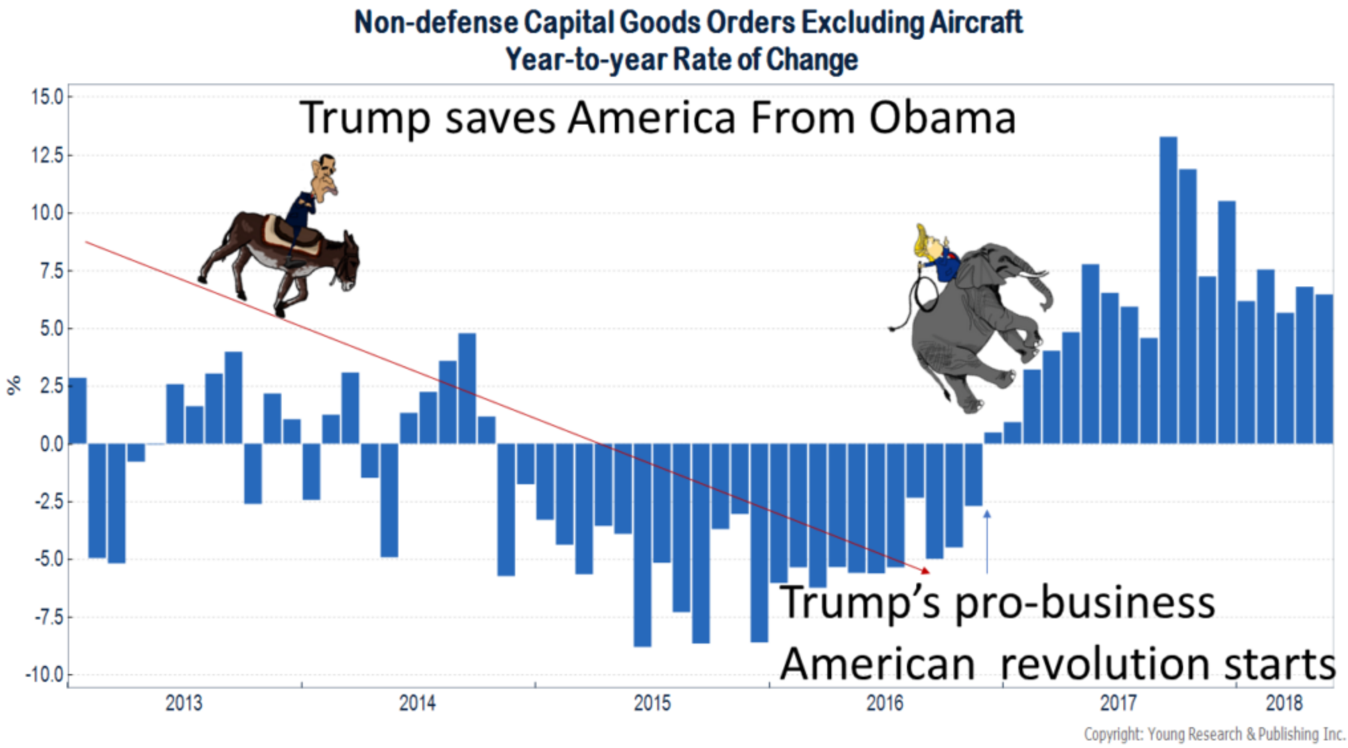
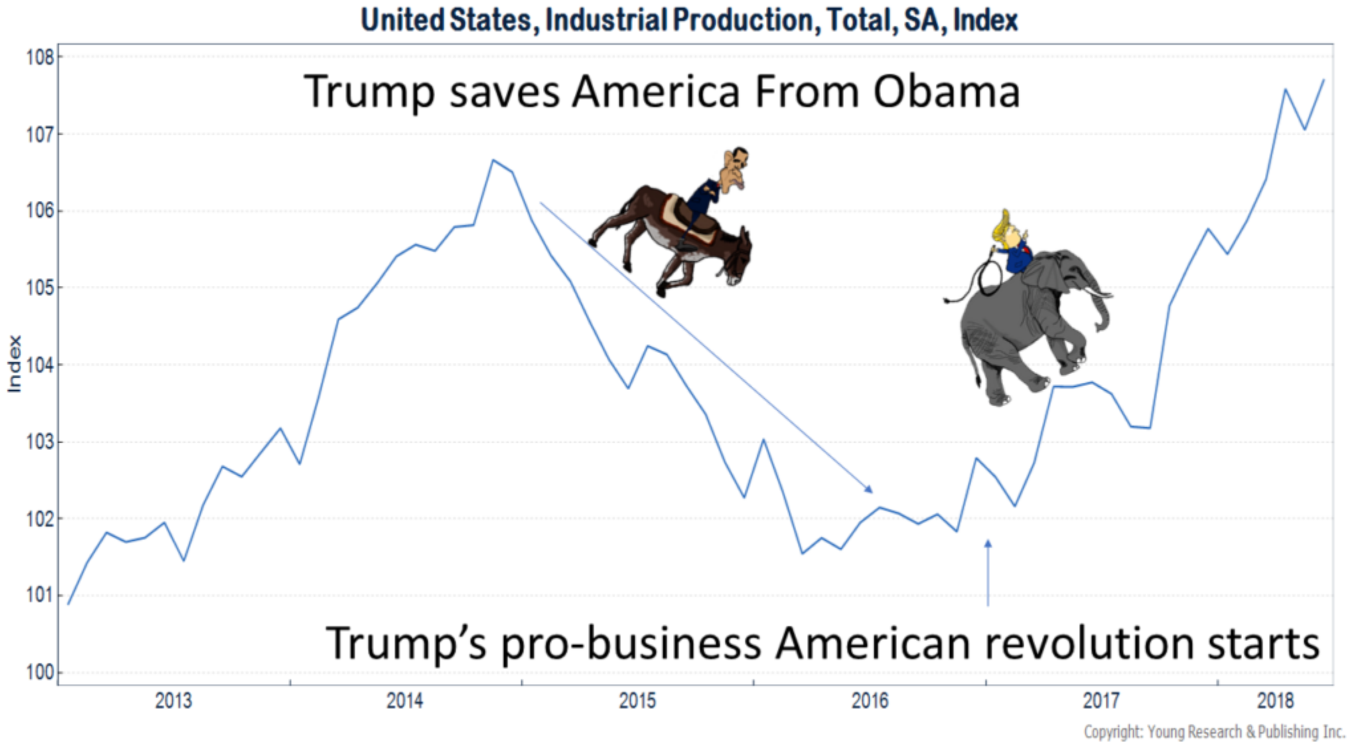




Read [Part I here](#).

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:

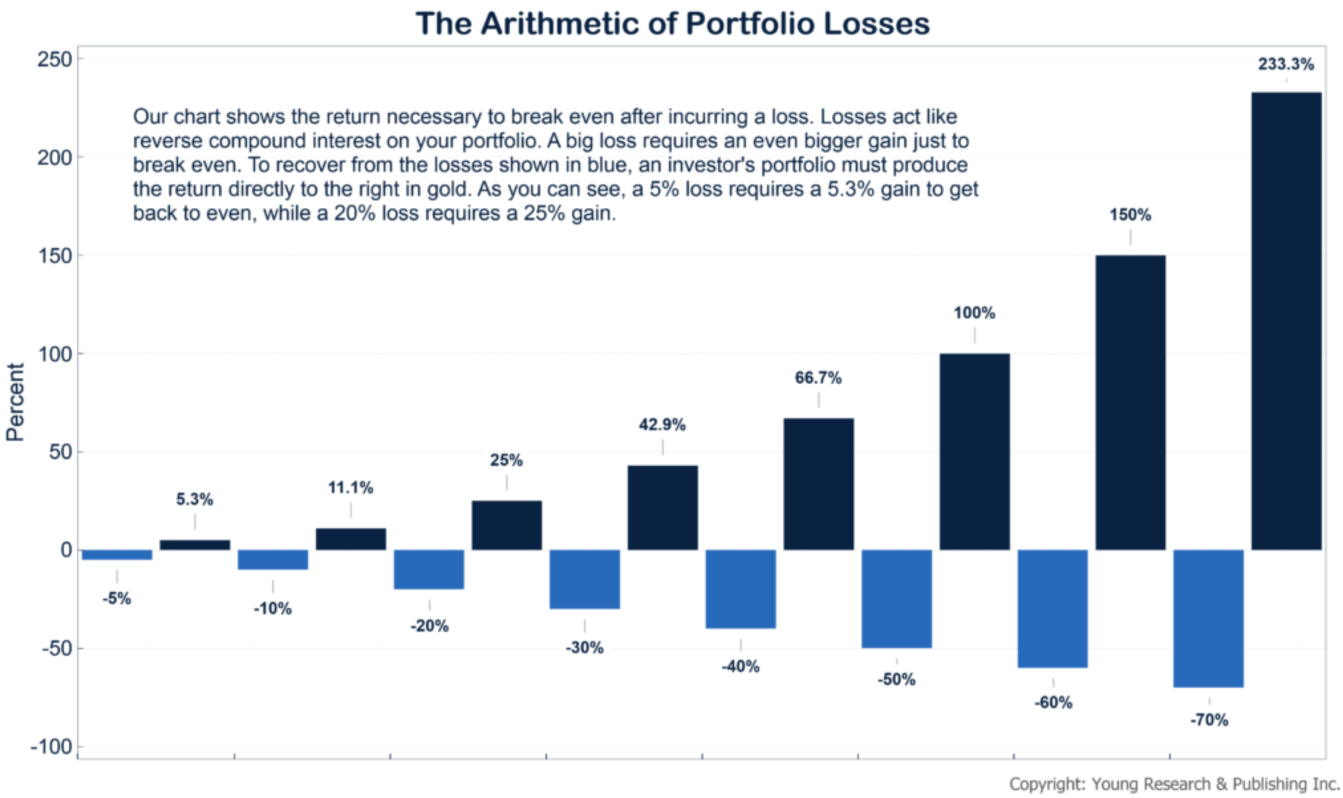
> *How many investors are lucky enough to trade correctly to catch just 30 months out of 600 months? Come on, the odds are real poor. If you stay fully invested, however, you cannot fail to capture all of the good months. Sure, you'll ride out some tough times. The stock market is high today based on 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.



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.

Does Your Portfolio Pass My Three Step Test for Balance?

Back in 1993 I explained my three-step test for balancing your investment portfolio between bonds and stocks. At the time I was recommending Treasuries, but you can use this advice no matter what kind of bonds you’re buying. Use your age and my three-step test as a starting point for how you plan to allocate your portfolio. I wrote:

> *I want you to keep your investment portfolio well balanced. But just how much of your portfolio should be invested in equities and how much should be in Treasuries? Here’s a basic strategy that is based on your age. The percentage of your portfolio that is in Treasuries should not exceed your age. For example, if you are 60, you will want a maximum 60% Treasuries component. That’s your starting point. Now take these tests to see if you need to reduce that percentage. If any of these statements fits you, knock 10 percentage points off your age number. But you will only knock off a maximum of 20 percentage points in total.*
>
> *Test #1: You do not require current income from your portfolio to live on. If that sounds like you, knock off 10 points. Test #2: You consider yourself to be a sophisticated, patient, seasoned investor. Answer yes to all three descriptions without a wince or snicker, and knock off 10 points from your age percentage number. Test #3: You are financially secure, if not wealthy. If you have what you believe is a solid store of financial wealth, knock off 10 points from your age percentage figure. If you qualify with two or three tests, you can knock off the maximum allowed, 20 percentage points, but no more.*

A fixed income component to balance out your equity portfolio is a vital necessity for any serious investor focused on income generation and capital preservation.

Young Research's Three Part Screen for Common Stocks

In the late 1990s, I offered my readers a simple three-part screen to make the job of core common stock selection easy and comfortable. It reduced the field of play to what one might call investment-grade common stock issues.

What was the screen? I advised investors to stick with NYSE listed dividend paying stocks trading at less than 3X revenue. When I introduced the screen in 1998, it winnowed the common stock investment universe down to a few hundred issues from an unwildy 7,500+ at the time.

There was still much work to be done to craft a final investment portfolio, but the screen did a nice job of helping investors fish in the lakes stocked with trout and bass and avoid the ones where carp was the dominant species.

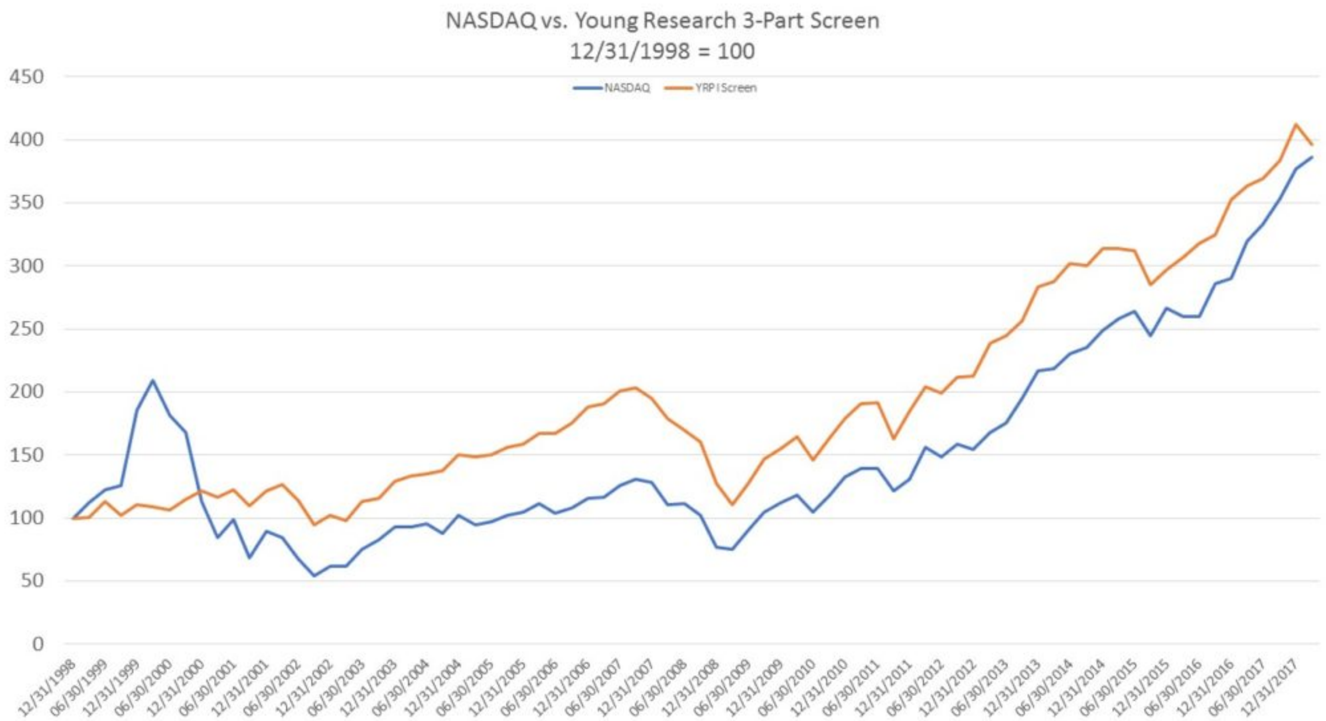
I explained the screen to readers as follows:

> ***Rule #1: Stay on the NYSE.*** *You have probably noticed that NASDAQ sotcks can be especially volatile. Most NASDAQ stocks are smaller and less seasoned than their NYSE brethren. Just the other day, computer component supplier Adaptec reported quarterly earnings below Street predictions, and traders hammered the rather thinly traded shares down 40% in a single session. A 40% haircut in one day is volatility beyond what I'm sure you find comfortable.*
>
> *One way to reduce this volatility is to buy only NYSE stocks for your CORE portfolio. Don't venture over to the NASDAQ. Yes, I know many fine companies trade on the NASDAQ, but a set of hard-and-fast rules is the tonic you need to stay out of trouble, and hard and fast means some compromising.*

Rule #2: Invest only in dividend-paying stocks. *By simply eliminating the non-diviend payers, you dump a huge hunk of the speculative stock universe and greatly reduce your field of eligible NYSE candidates for your CORE list.*

Rule #3: Pay no more than three times annual revenues. *Here, you are relating a given stock's market cap (price X number of shares outstanding) to annual revenues.*

How has the investment-grade common stock universe I described in 1998 performed since? The chart below compares the performance of this exact screen run every quarter from year-end 1998 through March of this year, to the performance of the NASDAQ Composite.



Both the screen and the NASDAQ are capitalization weighted. As you can see, the screen performed slightly better than the NASDAQ, but most importantly, it did so with only about 60% of the risk of the NASDAQ.

The structure of the stock market has changed a lot over the last 20 years and an NYSE listing is much less meaningful today than it was in 1998, but the concept of sticking with quality dividend payers at reasonable prices remains my advised approach for eliminating a huge chunk of the speculative stock universe.

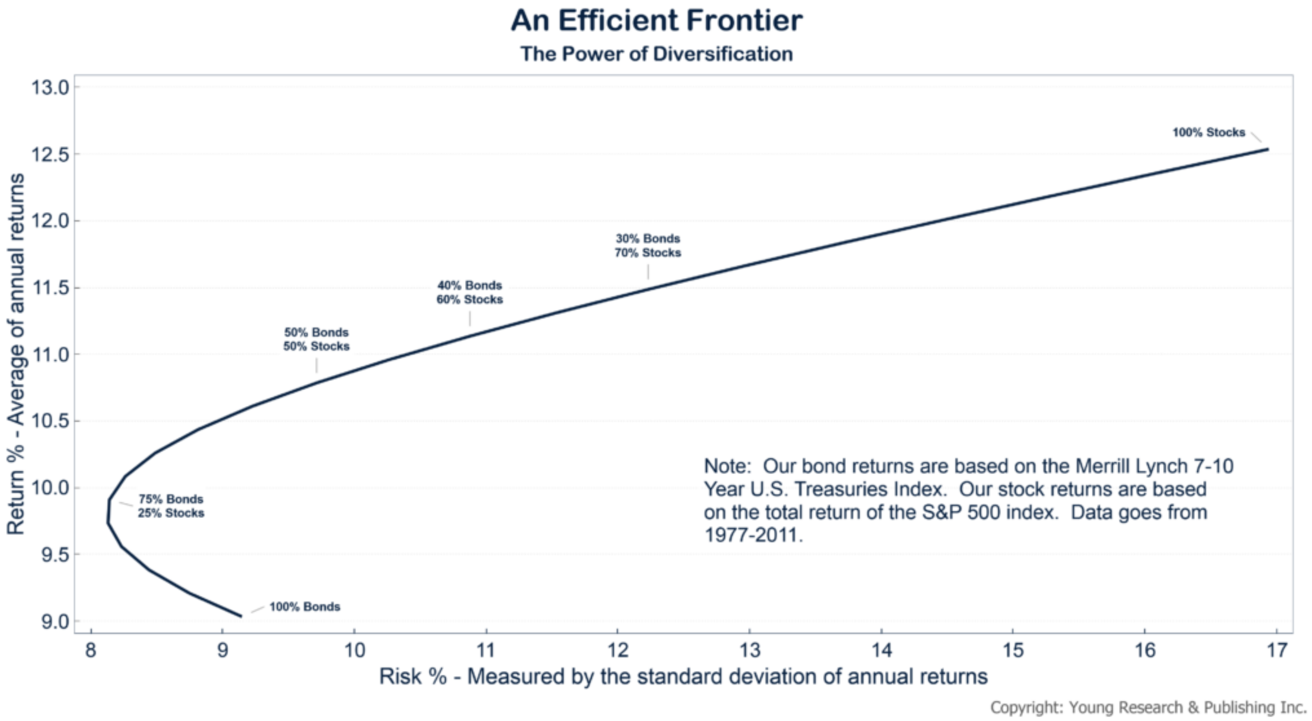
Issues included in that speculative universe that are widely held among mutual funds and ETFs you may own include Facebook, Amazon, Netflix, and Google (here I eliminate the NYSE listing criteria). Not one pays a dividend, and all four trade at more than 3X revenues. You may argue all four are good companies that dominante their space. That may be true, but it was also true of Microsoft, Intel, and Cisco in 1998 (none passed my screen at the time). Ten years later, all three were down and down more than the S&P 500.

Two decades and a couple of ghastly bear markets later, the same focus on quality, dividends, and value remains essential to your long-term investment success no matter how dominant you may believe today’s social media giants have become.

The Must-Know Investment Concept

The concept of an efficient frontier is central to proper portfolio management, but far too few investors are familiar with its use and application. Brokers and advisors, more interested in pushing product than offering investment counsel, may be to blame. An Efficient Frontier can help you calibrate risk and find the portfolio you are likely to be most comfortable with. Here’s what I wrote about the Efficient Frontier back in 2002:

The concept of an Efficient Frontier is central to everything we do at our companies. First, we lay out our basic investor tenet of diversification and patience built on a framework of value and compound interest. Next, we overlay any investment plan under review with an eye on an Efficient Frontier. I write about this pivotal concept for you in every letter. You will read little or nothing about an Efficient Frontier in other strategy letters. I have no idea why because the concept is so absolutely central to proper portfolio construction. An investor not up to speed on both the mathematics of compound interest and the power of an Efficient Frontier is operating far beyond the fringes of investment reality. In fact, I would go as far as to say that an investor devoid of a thorough working knowledge of these two powerful investment concepts has little chance of achieving a comfortable, rewarding retirement. Hence my inclination to hammer away monthly at both concepts.



As I have written often, an Efficient Frontier is nothing more than the line that connects one optimal portfolio across all levels of risk. An optimal portfolio is the mix of assets that *maximizes portfolio returns at a given risk level. My chart illustrates an Efficient Frontier for a combination of two asset classes—long-term corporate bonds and stocks. We have used data from a representative long-term corporate bond fund and a suitable Index 500 fund.*

Clearly an Efficient Frontier is about diversification. And investors saving in retirement portfolios or who are already retired want the appropriate mix of bonds and stocks. Here I'm writing to investors 50 years and older, but I'm tempted to mandate that investors in their 40s maintain a solid fixed-income component. I'll suggest it, if not mandate it.

Exactly what are we looking at? It's what I refer to as the boomerang. The vertical axis measures return; the horizontal axis measures risk. I always advise you to first gauge risk and much later worry about return. You'll note, as you travel along an Efficient Frontier from left to right, risk gets greater. How much do you value a good night's sleep? As I have reminded you often, between 1965 and 1981, a period of 16 years, the Dow fell 10%. Will such an extended period of stock market decline occur in coming years? I don't know about 16 years, but I can count three. And the stock market is now down for the third consecutive year for the first time since 1950, so you tell me.

Personally, I invest with no view on where the stock market will be next year or the following, for that matter. I invest with the absolute knowledge that, long-term our population increases and that the stock market tends to generate a compound rate of growth that matches the compound rate of growth of GDP. We're talking about 7% plus, of course, dividends. That's my basis for investing in stocks—nothing more, nothing less. It's not prudent to count on making one cent more long-term than the annual compound average GDP growth, plus dividends. If you are banking on more for *yourself, you're barking up the wrong tree.*

If you are having trouble managing your portfolio's risk, look for help at a seasoned, well regarded investment advisory like my family run firm, Richard C. Young & Co., Ltd. Talking with a professional can help you develop a retirement plan that will allow you to avoid crippling losses and achieve your goals. Read more about the concept of an Efficient Frontier by visiting Youngresearch.com here:

- Risk and Reward: An Efficient Frontier
- The Fright of Squandered Capital

Where do you Begin Investing?

To the uninitiated, investing can seem daunting. There are thousands of stocks, bonds, and mutual funds to choose from, and probably just as many opinions on which you should buy and which you should avoid. Even the most diligent novice can become overwhelmed by the number of decisions that must be made.

To get started, I have long advised a risk-first approach. That means a focus on fixed income.

> *For most investors, it's a little hard to know where to even begin. So where do you begin? Tops on my list is your fixed income component. Most investors fail to maintain an adequate mix of fixed income. Ignore my warning at your peril. In today's environment, it's not how much you are going to make, but how much of your capital you will keep. Returns ahead are going to be meager. If you are retired, draw no more than 4% out of your portfolio annually. And my tendency is to reduce this already low number. Times are tougher than you may*

believe. The more than-two-decade decline in interest rates is fading into history. Could rates fall further? Sure rates could give a little more ground, but there just is not much running room left on the downside.

I advised investors of the above over a decade ago and it remains true today. In today's environment, it's not how much you are going to make, but how much capital you will keep. Returns ahead are likely to be meager. Think mid-single digits on the high-side.

The Ten Worst Bets

Almost thirty years ago in 1989, I advised my readers on the ten worst bets for the year. Topping the list was overpriced real estate in New England, New York, and California followed by Japanese stocks and real estate.

My long-time followers may recall how real estate prices fared after that projection. Housing prices cracked in all three regions and entered a severe downturn. Anybody levered and long in residential real estate took it in the neck.

According to the Case-Shiller real estate indices for Boston, New York, and L.A., the peak to trough decline in prices ranged from 15% to 27%. A 20% down payment on a house was wiped out in the crash. In L.A., it took more than a decade to get back to even after accounting for inflation.

How did Japanese stocks fare in 1989?

The Nikkei 225 index was up almost 30% for the year (in local currency terms).

That was a bad call…

Indeed it was, but only for the first 12 months.

The Nikkei peaked on December 29th of 1989. Over the ensuing 14 years the Japanese shares lost 80% of their value. To this day, the index remains 45% below its all-time high.

My timing was off, but the direction was not.

I don’t mention these past projections to boast. I call them to your attention because both projections were based on a careful consideration of risk. For the prudent investor, risk must always come before return.

Things could have turned out differently for U.S. house prices and Japanese stocks, and that would have been fine. The point is that the risk one had to take to participate in those markets far outweighed the potential reward.

I see many pockets of unfavorable risk/reward relationships in today’s financial markets. Some of these assets may not fare as poorly as house prices and Japanese stocks did 30 years ago, but the prudent approach is to avoid them.

Caution, balance, and diligence remain the mandate for your serious money today.