

Impressions

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The Cat Food Dilemma

Seldom do people discern
Eloquence under a threadbare cloak.
~Juvenal

The most common cause of fear of old age is
associated with the possibility of poverty.

Napoleon Hill

When I left the Army in 1973, it was to go
to work for the Dupont Walston brokerage
firm. Our training center was in Los Ange-
les about three blocks down Wilshire from
the Ambassador Hotel when Sen. Robert
Kennedy had been assassinated five years
before.

There were 189 in my class all but four mili-
tary veterans and in addition to all the lies
about heroic achievements, there was a
monthly convoy to the VA Hospital in
Westwood for treatment of wounds and dis-
ease.

One of my classmates was a Canadian Scot
who had also been a talented amateur tennis
player so two to three times a week a group
of us would play tennis at some public
courts nearby.

After playing, we would go to a local su-
permarket and purchase cold drinks. One

day as I was standing in line there was an
older woman in front of me.

At first glance, she seemed well dressed al-
though her tweeds seemed a bit heavy for
the LA weather. On closer inspection, the
hem of the skirt had come undone violating
the symmetry of the garment, and the cuffs
of the jacket were threadbare. The collar of
her blouse showed signs of wear and lack of
cleanliness and her hat was outdated and the
worse for wear.

I got interested and noticed her shopping
basket contained a head of lettuce, a tomato
and can of cat food. In one of those flashes
of intuition that can only be called an epiph-
any I realized that she was not going home
to feed her cat and have a salad, this was her
diner! A cat food salad!

Behavioral researchers tell us that there are
four great fears in humans, public speaking,
death, singing before an audience and being
old poor and sick with no solution to the
problem. From personal experience, I will
tell you that public speaking isn't so bad, but
public singing is a true terror. Having faced
it a few times I can say that fear of death is
greatly overrated. I have not experienced the
last one and I hope I never do.

The lady in LA faced one of the great di-
lemmas of our age; she had run out of
money before she ran out of life. When you
are in that situation, the options are bleak if

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not miserable, in short; it is what I call the Cat Food Dilemma.

A great deal is being said about the effects of baby boomer retirement. In the financial services industry, literally, every article in our professional publications concerns the topic and you would think that was the only challenge we face. There is no doubt that this mass movement of 78 million people from full time active work to semi or full retirement is and will continue to reshape the United States.

It is possible that a great number of the boomers particularly those in the early years of the generation will face the Cat Food Dilemma and it is possible that regardless of the best laid plans of mice and men some of the late arriving boomers will also have to decide feed the cat or themselves.

Recently we were doing some planning for a client and we decided to verify what we had heard anecdotally about lifespan. We came across the chart attached to the back of this letter. It shows the number of years of expected remaining life for a white male at various ages and at various times in history.

What is interesting is the dramatic change in remaining life span for a 40 year olds and 80 year olds. In the last 13 years, life expectancy for a 40 year old increased two years or 5.6% and for an 80 year old 12.6%! If that increase could be projected forward in a linear manner (always a dangerous exercise) in the next 13 years, it will add an additional 2.2 years to the average white male's life.

This increase in life expectancy has its roots in improved medical detection of the silent killers of men like testicular, prostate and colon cancer, improved treatment of heart disease, better diets and improved exercise routines. Those same reasons are likely to

make the linear progression of life expectancy a fact rather than conjecture.

Lest you think, I am being chauvinistic by only using white males, females have always enjoyed longer lifespan and those numbers are increasing though at lesser magnitude. The continuation of longer life spans for women complicates the Cat Food Dilemma as it creates a long tail survivor class that needs to be funded. Some wits say that women live longer because men do not, but, whatever.

From a humanistic standpoint, these longer life times should be celebrated as they mean more contributions from each citizen in the form of taxes and cultural output. It means more children will spend more time with their grandparents but from a financial planning and social policy point of view, it will be a headache.

The improved, or extended, lifespan is most apparent in those 40 and older and the number of years increases the likelihood of it being quality life.

Longer life means people will have to stretch their money over more time, increasing the risk (if that is the right word) that they will live past the average mortality making their retirement plans useless. In other words running out of money before they run out of life.

Longer quality life means that people will be active longer than expected which raises issues around the labor force, generational migration, inheritance, estate tax issues, long-term care and medical costs as these longer lives will be expensive.

The answer would seem to be simple; everyone must save more during their working years. Increased savings may be harder to do however, since some of the structural problems with pension plans could necessi-

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tate large tax increases to pay benefits to those already retired. Therefore, the apparent answer is easy again, push back the retirement age. However, older workers staying on the job stifles job opportunities for younger workers. If job opportunities are not created, the result is generational discord and social unrest.

The need to increase savings is not a new concept, having been mooted for years, but apparently, it has not resonated with the boomers. A recent study by Cap Gemini-Merrill Lynch indicated that outside of increases in home equity boomers are only saving 37% of what they will need to provide retirement income at 75% of their current income.

Okay a smart guy would say they would have to access their home equity. That is one possible answer but the issue is if it will be possible. The influx of homes owned by a substantial part of 78 million people to the real estate or reverse mortgage market has to depress prices, and as we all know when prices of real estate fall; it is the equity holder who takes the beating.

Some of this equity liberation may be underway in the successive waves of refinancing. What we do not know is if that equity is going to pay down debt, to purchase other real estate or if it going into investments or into consumer consumption.

Even for those who have worked at big firms all their life, retirement is dicey. There are two basic forms of retirement plans, defined benefit (DB) and defined contribution (dc). Many of the old industrial giants, almost all state and local governments and unions maintain db plans.

GM and UAL are the two poster children for what can happen to db plans. At the current

time medical and pension obligations add \$5,000 to the price of each GM car and GM's obligations are so large that in truth it is a pension fund running a car company.

UAL realized that the only hope of curing its chronic financial problems (other than good management and not being in a crappy business) as well as its best chance to cut costs was to default on its db plans and allow the government to take over. IBM has frozen increases in benefits for its db plans. State and local governments are finding that funding their plans is difficult and as we go to press, Delta is discussing terminating its pension for pilots.

People covered by these plans may not be able to count on their projected future benefits. In the case of UAL, by law, the maximum pension that the Pension Guarantee Benefit Corporation can pay is \$45,000 annually, not bad maybe but a long way from the \$100,000 plus the pilots were getting before the default.

The other type of plan is the defined contribution plan (dc) which includes IRAs, the 401k, 403b and some other variations. The idea here is that rather than a company guarantee of future benefit amount, the company agrees to match employee contributions and the employee directs his or her investments.

These plans are likely to be the primary source of retirement income for the majority of the boomers. It is hard to get data on the saving rate in these plans, and it is impossible to get any figures on the performance of the accounts so their potential adequacy is unknown. What we do know is that the amount that can be contributed is fixed by statute.

The problem of providing for retirement is a balancing act between the factors of life ex-

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pectancy, post retirement tax rates, investment returns pre and post retirement, inflation, time, pre retirement savings, post retirement living expenses, and demographics. The devilish side of the computation is that all the factors move constantly, the best that can be said is that some move in a predictable manner.

As an example, consider changes in the demographics of the nation. We know that the average number of live children born to white females in the United States is 1.8, less than the 2.1 needed to replace the population. If death rates and longevity remain constant and there is no in bound migration, population counts must decline. Therefore, each generation will be smaller providing less people to pay taxes and to work. In that scenario, the pension equation becomes insoluble.

However, life spans are increasing; people are having fewer children and those later in life so population should be constant right? Wrong, the rate of fall in the death rates is steeper than the number of children so population increases. This increases the pressure on pension calculations as fewer pay in and benefits are required for longer periods. Counter to all of this there is in bound migration adding population every day at least equal to the death rate.

When you deal with a number field of 300 million the numbers are so large that small changes have dramatic effects. If the fecundity rate increases to 1.9 the Social Security system will be in surplus in the last quarter of the century. It is unlikely this will happen in the progeny of the largely white boomers, they are just too selfish.

Increased fecundity does however occur in that demographic collection called the minorities, African American, Native American, Hispanic and among religious groups

such as Moslems, Mormons and evangelical Christians. In these groups, large family size is rewarded by cultural mores.

This being true it gives some hope that the demographic side of the equation may not be as stacked against success as it currently appears. Of course, one side effect of this is that the current minorities will not be minorities long, reminding one of that line from Gilbert and Sullivan “when everyone is someone then no one is anybody.”

Then of course, there is the question of what happens if this lump of boomers does not retire at 60, 62, 65 or 67? I have a hunch that many will not retire at those magical ages since the increased life expectancy will also mean increased active life years. This hunch seems to be supported by a recent study indicating that 75% of boomers intend to work at least part time in the years after 65. Boomers get restless easily and they will not take well to enforced idleness.

Since a good deal of today’s work is less physical than in past generations there is no reason for people to be forced into retirement. Another side to this is that boomers have workplace skills not easily replaced and they may be recruited to work longer just to maintain productivity.

While through a glass and darkly a path can be seen by which Social Security’s failure can be mitigated (increased migration, increased fecundity, longer work life) the danger to other pensions is real and one of those secrets not discussed by decent people, which is no barrier for us.

There are few places more idyllic than San Diego. Few places have been the home to more financial stupidity and the areas are currently in the midst of one of those very stupid times. If they were businesses, they would be bankrupt. It is hard to believe that

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a place where 1200 square foot homes, which can see the water only by reflection, sell for millions can be bankrupt but it is true.

They are bankrupt because of the fecklessness of leaders in handling the pension investments for city and country workers. Somewhere along the line, the genius consultants to the plans and the unions came up with the idea that any yearly gain above the projected minimum growth rate necessary to pay benefits should be shared in the form of higher benefits.

Let us examine this paragon of investment reasoning. Fact, a portfolio's value will vary. Fact, trend line growth is determined by averaging out a series of yearly results to determine the mean. Fact, any gains above the trend line are transitory. Fact, increased pension benefits are not transitory. Conclusion, sharing a transitory benefit to create a permanent liability is stupid, and eventually leads to bankruptcy.

It would be nice if it ended there but it does not, most municipal and teacher plans have similar features. With the markets unlikely to produce the golden goose returns of the past 18 years, most of these plans are underfunded. Ergo, the pensions of state and municipal workers are unstable. Solutions, cut benefits, raise taxes or default; which do you think will happen first? Any choice municipalities and big business make to shore up their plans will lead to higher taxes and more strain on the dc plans of individuals.

If the above sounds scary and difficult it is not due to my soaring literary talents, it is because fact is scarier than fiction. The decisions we making (and I include myself in this we) are going to be the most important long-term decisions of our lives. Woody Allen once made the following comment:

“we are at a fork in the road, down one path lies nuclear war and the physical destruction that follows, down the other is social disintegration and anomie. Let us hope we have the wisdom to choose correctly.”

The cross roads we face is not so clear-cut. We all have the option of taking charge of our futures. They really do not make the big decisions about your life in Washington DC or Sacramento or Olympia they are made between your ears.

So what do we do? First, get over your fear of death, it is going to happen. Being afraid of dying means that you did not live your life correctly.

Second, if you are younger than 50 stop thinking that Social Security will be part of your retirement. It might be but that is in the hands of politicians and therefore unstable and not subject to good thinking.

Third, plan for longer life. Survey your blood family and determine the ages of death and the conditions of your predecessors it will give you a clue to your expected life, but whatever the result, add years to your life.

Fourth, make some decisions about how you want to grow old. Do you want to be independent until you die, do you have family that can care for you in your declining years, what level of medical intervention is acceptable to sustain life. Determine what your definition of living with dignity is and communicate that to your children, their spouses, and to the executors and powers of attorney.

Understand that even though you may retire at 62 you may have as much as 40 years of life left. A century ago, that was an entire

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lifetime. What are you going to do with those years?

Fifth, demand that your financial advisor turn his or her brain on. The industry has gotten very soft in the easy times of the last 20 years; the going will not be so easy in the next few years. Your financial advisor needs to be thinking ahead for you and using the benefits of their experience and knowledge to create pathways to success in the new environment. If they are not turning their brain on or are incapable of that sort of action, fire them.

Sixth, save more money.

Seventh, explore your options spend at least as much time on that exploration as you do exploring options for vacation.

Eighth, if you feel you might not be prepared and you are afraid don't whine; do something about it you all have time left to make change.

STOP THE BOOMER TRAIT OF PROCRASTINATION, THERE WILL BE NO MAGIC BEANS OR MUSHROOMS TO TAKE YOU AWAY FROM THE SITUATION, THE GREATEST GENERATION IS NOT GOING TO RESCUE YOU. DO SOMETHING AND DO IT NOW!

Remember finally, this paraphrase of that great Australian philosopher Crocodile Dundee "cat food, you can live on it sure, but it tastes like S - - t."

"Insatiate Cormorant"

In looking back at the recent bull market, it is universally agreed that during those 18 years the market were in a perfect scenario. Low inflation, rise of an investor class, a world at peace, social stability in the US,

increase in productivity driven by technology spending, the commercialization of a new technology (the internet) and interest rates at historic lows both in real and nominal terms.

It is not universally accepted but it is coming to be more accepted that the perfect scenario has given way to less than perfect one or in some minds a perfect storm.

The words insatiate cormorant are taken from John of Gaunt's great speech in Shakespeare's Richard II as John on his death bed condemns Richard for being so greedy that he mortgages the entire kingdom.

I am not one of those Cassandras who goes about wringing my hands about the debt carried by others although I know that it is a problem for some people. In the line following the cormorant John of Gaunt talks about how the ever-hungry bird having consumed its means of living starts to prey upon itself and its peers. Market cycles are like that also.

Bull markets sow the seeds of their own destruction as they advance, through the creation of imbalances. Bull markets and an advancing economy forgive many mistakes and people grow lazy and inattentive. Bull markets, like fire suck in the oxygen (money) needed to support them and they will not be extinguished unless fuel is denied.

The bull market that recently ended was an insatiable cormorant as it sucked in money to ventures that appeared made sense in those halcyon times when annual returns of nearly 20% seemed to be fated to continue forever. Many of these ventures now appear less wise in the face of 8-9% expected returns.

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It took a considerable period for the imbalances to be created and it will take longer to unwind them due to investors being unwilling to accept losses. This insures that the markets we currently see will be the norm.

To make a meaningful change in the market direction there first must be a destruction of unsound ideas and practices and in fact they must not be merely destroyed they need to go the other way to the point where people will not look at even good ideas out of fear.

We are not there yet. In the meantime, people continue to search for something that will give them that one big hit or that one edge that others are denied. They will find it for a while, and then the insatiable cormorant will devour the means and turn upon itself.

The markets will continue to be dominated by the actions of the increasing number of hedge and private equity funds, most of which are run by people who just before the bull market were asking critical questions like "you want fries with that? Or what kind of car were you driving?"

There are changes occurring that allow investors as opposed to speculators, to make money. Bear markets and dynamic times foster creative destruction.

The choice for many is going to be binary, try to out trade the hedge funds, or to find a good investment course based on long-term trends, preservation of capital and be opportunistic. Hint, you will not out trade the hedge funds the level of stupidity, greed and fearlessness is just too high.

Web Site

For years we have wanted to have a web site to help us disseminate information about the firm and help hold down costs.

Our delay in launching a site was that the expense outweighed the results and that it imposed another time demand to maintain the content.

Through the offices of good friend of ours, we have finally launched a web site. Like every airport in the United States, it is still under construction. We have some content to add and we are developing a customer section so clients can access their reports.

We are client driven and would welcome your comments on the site and what we need to do to improve it. I will warn you do not access the web site after eating, my picture is posted and that sort of thing can be very upsetting. The web address is :www.sweetwaterinv.com

Good Luck,
Dennis Gibb

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Life Expectancy by Age, 1850–2003

Calendar period	Age								
	0	10	20	30	40	50	60	70	80
White males									
1850 ¹	38.3	48.0	40.1	34.0	27.9	21.6	15.6	10.2	5.9
1890 ¹	42.50	48.45	40.66	34.05	27.37	20.72	14.73	9.35	5.40
1900–1902 ²	48.23	50.59	42.19	34.88	27.74	20.76	14.35	9.03	5.10
1909–1911 ²	50.23	51.32	42.71	34.87	27.43	20.39	13.98	8.83	5.09
1919–1921 ³	56.34	54.15	45.60	37.65	29.86	22.22	15.25	9.51	5.47
1929–1931	59.12	54.96	46.02	37.54	29.22	21.51	14.72	9.20	5.26
1939–1941	62.81	57.03	47.76	38.80	30.03	21.96	15.05	9.42	5.38
1949–1951	66.31	58.98	49.52	40.29	31.17	22.83	15.76	10.07	5.88
1959–1961 ⁵	67.55	59.78	50.25	40.98	31.73	23.22	16.01	10.29	5.89
1969–1971 ⁶	67.94	59.69	50.22	41.07	31.87	23.34	16.07	10.38	6.18
1979–1981	70.82	61.98	52.45	43.31	34.04	25.26	17.56	11.35	6.76
1990	72.7	63.5	54.0	44.7	35.6	26.7	18.7	12.1	7.1
1992	73.2	64.0	54.3	45.1	36.0	27.1	19.1	12.4	7.2
1993	73.1	63.8	54.2	44.9	35.9	27.0	18.9	12.3	7.1
1995	73.4	64.1	54.5	45.2	36.1	27.3	19.3	12.5	7.2
1997	74.3	65.0	55.3	45.9	36.7	27.7	19.6	12.7	7.4
1998	74.5	65.2	55.5	46.1	36.8	27.9	19.7	12.8	7.5
1999	74.6	65.3	55.6	46.2	36.9	28.0	19.8	12.9	7.5
2000	74.8	65.4	55.7	46.4	37.1	28.2	20.0	13.0	7.6
2001	75.0	65.6	56.0	46.6	37.3	28.4	20.2	13.2	7.7
2002	75.1	65.7	56.1	46.7	37.4	28.5	20.3	13.3	7.7
2003	75.4	66.0	56.3	47.0	37.6	28.8	20.6	13.5	8.0

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