The FINANCIAL SUCCESS Library

# Money Minute

"Smart Ideas for Secure Finances"

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## *Inside This Month's Issue:*



***FEATURE***

# Warren Buffett Wisdom: Quotes from the Past ~40 Years

Warren Buffett, arguably the world's most famous investor, has penned his annual letter for just shy of 40 years in which he shares his thoughts about all things investing. I have selected some of the best quotes and nuggets of wisdom from these letters for this month's feature story, along with some follow-up commentary. Enjoy!

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**1978:** "We make no attempt to predict how security markets will behave; successfully forecasting short term stock price movements is something we think neither we nor anyone else can do."

**1979:** "Both our operating and investment experience cause us to conclude that "turnarounds" seldom turn, and that the same energies and talent are much better employed in a good business purchased at a fair price than in a poor business purchased at a bargain price."

**1982:** "The market, like the Lord, helps those who help themselves. But, unlike the Lord, the market does not forgive those who know not what they do. For the investor, a too-high purchase price for the stock of an excellent company can undo the effects of a subsequent decade of favorable business developments."

**1987:** "The value of market esoterica to the consumer of investment advice is a different story. In my opinion, investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behavior of stocks and markets. Rather an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace."

**1989:** "Because of the way the tax law works, the Rip Van Winkle style of investing that we favor -- if successful -- has an important mathematical edge over a more frenzied approach."

**1991:** "An economic franchise arises from a product or service that: (1) is needed or desired; (2) is thought by its customers to have no close substitute; and (3) is not subject to price regulation."

**1997:** "Only those who will be sellers of equities in the near future should be happy at seeing stocks rise. Prospective purchasers should much prefer sinking prices."

**(Continued on page 4)**

### *QUOTE OF THE MONTH*

*We are what we repeatedly do. Excellence, then, is not an act, but a habit.*

*~ Aristotle*
(Greek philosopher, 384 - 322 BC )

### DID YOU KNOW ?

Of the roughly 6 billion ATM withdrawals that will take place in 2015, roughly 1.5 million will be fraudulent, totaling roughly $300 million.

**Source:** Federal Reserve

# Whole Foods Branching Out, Verizon Buying AOL, Takata Airbag Recall Grows, etc.

**Whole Foods Market**, a premium-priced seller of organic food and other grocery items, is planning to start a sister chain of smaller, lower-priced grocery stores. Current stores average 38,000 square feet in size, and expectations are that the new stores will be roughly 1/3rd that size, putting them more in line with Sprout's Farmers Market and Trader Joe's in size. Same store sales growth at Whole Foods declined to under 6% for the first time since the depths of the "Great Recession" in late 2013 and continued to fall below 3% in late 2014. Prior to that, 7-8% was the norm outside of a few quarters surrounding the recession. The company reported $158 million in profit on $3.65 billion in revenue in its most recent quarter and is based in Austin, TX.

**Toyota** recently posted its third straight year of record profits. The company is the world's largest automaker and posted a profit of just over $18 billion for its fiscal year ending in March. Profit was up by 19% compared to a year ago, largely aided by the weak Japanese yen. The annual profit is the largest ever earned by a Japanese company and exceeds the combined annual profit of its two closest competitors - Volkswagen AG and General Motors.

**Verizon** announced it is buying **AOL** for $4.4 billion. Formerly known as America On-Line, AOL was spun off by Time Warner after what is considered one of the worst deals in business history: when AOL bought Time Warner for $165 billion in 2001. More recently, AOL became a major player in mobile advertising technology, and this capability was the reason Verizon was interested in purchasing AOL. AOL has $1.92 billion in revenue related to its advertising platforms and related services in 2014.

Japanese auto parts supplier **Takata** has filed reports with the National Highway Safety Administration and has, for the first time, acknowledged defects in its airbags. The filings double the number of recalls already announced and bring the total number of recalled vehicles to a staggering 34 million, or roughly 14% of all vehicles on U.S. roads. The airbags are found in a variety of foreign and domestic models. Vehicle owners will hear from automakers by mail, and it is expected to take years to perform airbag replacement on all affected vehicles. High humidity and moisture have been linked to the faulty airbags, whose igniters have ignited with too much force and caused shrapnel to fly into vehicle occupants when airbags deployed. Six deaths and over 100 injuries have now been linked to the problem.

Ice cream maker **Blue Bell Creameries** LP announced it is laying off 37% of its 3,900 employees as it deals with a recall of all of its products roughly 8 weeks ago. A listeria outbreak was traced to Blue Bell products, and the deadly bacteria has been blamed for three deaths and additional illnesses in several states. The company is not currently manufacturing any products, and there is no timeline for when production will resume. It voluntarily recalled all of its products after the CDC linked its ice cream to the listeria outbreak. Blue Bell is number three in ice cream sales behind Nestle's Edy and Unilever's Ben & Jerry's. Blue Bell had $880 million in sales last year and is family-owned.

After Comcast dropped its proposed $45.2 billion purchase of Time Warner, **Charter Communications** announced it is close to a deal to purchase Time Warner for $55 billion. This deal stands a much better chance of winning regulators' approval since Charter has less than 1/4th the number of customers that Comcast currently has. Charter made multiple bids for Time Warner in 2013, but all were rebuffed. If approved, the new entity would have roughly 23 million subscribers, only second to Comcast's 27 million. A long review is still likely, and a deal could take years to be completed.

**FIFA president Sepp Blatter** resigned as president of soccer's global governing body amidst widespread charges of corruption throughout the organization. U.S. authorities have brought criminal charges against several officials, with more arrests likely to follow. Most stem from accusations of bribery related to the voting and selection of the World Cup tournament host country.

## Market and Economic News

- Economic growth (measured by gross domestic product - GDP) for the 1st quarter of 2015 was revised downward from an already weak +0.2% to -0.7%. Net exports and final sales figures were worse than initially reported. The negative reading is the first since the first quarter of 2014.

-This month's Bureau of Labor Statistics employment report showed a very strong 280,000 jobs added in May. The increase will further pressure Federal Reserve officials finally to increase interest rates. The unemployment rate inched up to 5.5%.

- New home sales climbed to a seasonally adjusted annual level of 517,000 homes in April. This figure was just under 300,000 in the fall of 2011 and has risen, with a great deal of volatility, over the past few years.

***At a Glance...***
(as of June 8) **DJIA** – 17,766 **S&P 500** – 2,079 **NASDAQ** – 5,021 **10-yr T-note** – 2.38%

# Readers' Q&A

**Questions? E-mail Brad@R1FinancialGroup.com**

Q. "I have a 'Target Retirement Fund' option in my 401(k) along with a bunch of other investment options. What exactly is a target retirement fund, and should I consider using it?"

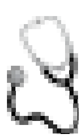
*-Terry – Richardson, TX*

A. Many mutual fund companies market what they call "target date retirement funds." For example, a target 2045 fund would be geared toward a worker who is 35 years old and planning to retire at age 65 (in the year 2045). These target date funds do not invest directly in stocks and bonds like traditional mutual funds. Rather, they invest in other mutual funds to achieve a desired asset mix. For example, given the relatively long investment time horizon (~30+ years) in this situation, a target 2045 fund would be invested largely in stock mutual funds (80-90%) now, with the remainder in bond funds. Over time, the fund will gradually adjust its investment mix to include more bond funds and fewer stock funds. By the year 2045, these funds will have closer to a 40% stock fund / 60% bond fund mix. Each fund company will vary somewhat in their percentages along the way - some will be more conservative, others more aggressive - but this is the basic idea.

The goal of these target retirement date funds is to allow investors to "set it and forget it." Fund companies do charge an additional fee for this convenience, which comes in the form of a slightly higher expense ratio than that of the underlying funds. For those who would rather not spend the time managing their accounts and making adjustments over time, target date funds are great.

One thing to note: it is important to keep tabs on the stock/bond mix in your target date fund at all times. In 2007 - 2009, many target date funds were too heavily invested in stocks and were subject to large declines when global stock markets dropped. Many retirees and those near retirement were surprised to see their account balances drop as much as they did, not realizing these funds are designed to stay invested throughout ones retirement. Because retirement can last 20-25+ years, these funds may still contain a significant percentage of stock funds at all times. I support this strategy, but if you plan to withdraw a large portion or all of your retirement savings when you reach retirement age, beware.

In summary, target date retirement funds are useful for those who'd rather not have to adjust their investment mix manually over time. Investors in these funds just need to check in on the asset allocation periodically to be sure it is in line with their plans. Good luck, and please get in touch for more information.

## YOUR HEALTH


### *Studies Find Diabetes May Pose a Risk for Alzheimer's*

Recent studies show that high blood-sugar levels can have a negative affect on the brain, suggesting that diabetes is a significant risk factor for developing Alzheimer's disease and other forms of dementia. In one study at Washington University in St. Louis, researchers found that raising the blood sugar levels of mice to very high levels corresponded with increased production of amyloid beta in the brain, a protein thought to be linked to Alzheimer's disease. In a separate study of middle-aged humans, those with Type 1 diabetes had significantly more brain lesions (called white matter hyperintensities) and slower cognitive function than a control group. The study was carried out at the University of Pittsburgh and involved 180 test subjects. The average age of the diabetic group was 50 years old, and researchers were surprised to learn that uncontrolled blood sugar has a visibly negative impact on the brain years or even decades before symptoms of dementia start to appear. "These brain abnormalities will impact the speed with which your brain works and how quickly information travels from one part of your brain to another" said Dr. Caterina Rosano, associate professor of epidemiology at the University of Pittsburgh's Graduate School of Public Health. Many researchers believe that those with Type 2 diabetes become cognitively impaired because the brain develops insulin resistance, which causes the brain to become deprived of nutrients from sugar.

Studies involving inhaled insulin and the drug exenatide, which stimulates insulin production, are underway to see if each can improve memory or cognitive function. A 2013 study by Wake Forest University studied the effect of exercise on people with prediabetes and mild memory problems. There were cases of improved memory among test subjects.

*Source(s): Wall Street Journal

**Money Minute**
Trivia Question

Which company is embroiled in controversy after some of its flooring products were found to contain high concentrations of formaldehyde, a known carcinogen?

*A) Lumber Liquidators* *B) Home Depot* *C) Lowe's* *D) Floor and Decor*

*Last Month's Question* – Government-backed studies support the idea of raising the tobacco purchase age from 18 to 21. How many of the roughly 320 million people living in the United States smoke? *A) 22 million* ***B) 42 million*** *C) 72 million* *D) 102 million*

# Warren Buffett Wisdom: Quotes from the Past ~40 Years

(Continued from page 1)

**1998:** "[W]e give each [of our company managers] a simple mission: Just run your business as if: 1) you own 100% of it; 2) it is the only asset in the world that you and your family have or will ever have; and 3) you can't sell or merge it for at least a century. As a corollary, we tell them they should not let any of their decisions be affected even slightly by accounting considerations. We want our managers to think about what counts, not how it will be counted."

**1999:** "Our lack of tech insights, we should add, does not distress us. After all, there are a great many business areas in which Charlie and I have no special capital-allocation expertise. For instance, we bring nothing to the table when it comes to evaluating patents, manufacturing processes or geological prospects. So we simply don't get into judgments in those fields."

**2000:** "But a pin lies in wait for every bubble. And when the two eventually meet, a new wave of investors learns some very old lessons: First, many in Wall Street -- a community in which quality control is not prized -- will sell investors anything they will buy. Second, speculation is most dangerous when it looks easiest."

**2004:** "Over the 35 years [ending in 2004], American business has delivered terrific results. It should therefore have been easy for investors to earn juicy returns... Instead many investors have had experiences ranging from mediocre to disastrous.

There have been three primary causes: first, high costs, usually because investors traded excessively or spent far too much on investment management; second, portfolio decisions based on tips and fads rather than on thoughtful, quantified evaluation of businesses; and third, a start-and-stop approach to the market marked by untimely entries (after an advance has been long under way) and exits (after periods of stagnation or decline). Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy only when others are fearful."

**2008:** (Recall that the financial crisis was raging) "Amid this bad news, however, never forget that our country has faced far worse travails in the past. In the 20th Century alone, we dealt with two great wars (one of which we initially appeared to be losing); a dozen or so panics and recessions; virulent inflation that led to a 21 1⁄2% prime rate in 1980; and the Great Depression of the 1930s, when unemployment ranged between 15% and 25% for many years. America has had no shortage of challenges. Without fail, however, we've overcome them. In the face of those obstacles -- and many others -- the real standard of living for Americans improved nearly seven-fold during the 1900s, while the Dow Jones Industrials rose from 66 to 11,497."

**2009:** "We've put a lot of money to work during the chaos of the last two years. It's been an ideal period for investors: A climate of fear is their best friend. Those who invest only when commentators are upbeat end up paying a heavy price for meaningless reassurance. In the end, what counts in investing is what you pay for a business -- through the purchase of a small piece of it in the stock market -- and what that business earns in the succeeding decade or two."

**2010:** "Money will always flow toward opportunity, and there is an abundance of that in America. Commentators today often talk of 'great uncertainty.' But think back, for example, to December 6, 1941, October 18, 1987 and September 10, 2001. No matter how serene today may be, tomorrow is always uncertain."

**2011:** "The logic is simple: If you are going to be a net buyer of stocks in the future, either directly with your own money or indirectly (through your ownership of a company that is repurchasing shares), you are hurt when stocks rise. You benefit when stocks swoon. Emotions, however, too often complicate the matter: Most people, including those who will be net buyers in the future, take comfort in seeing stock prices advance."

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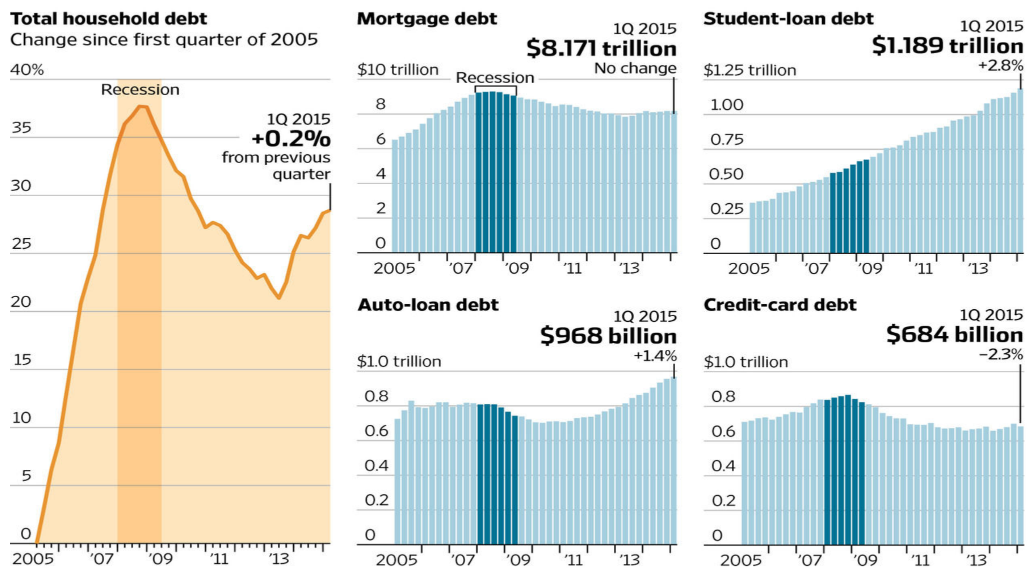
The 84-year old CEO of Berkshire Hathaway's net worth is over $70 billion according to Forbes, and a charity auction for the right to have lunch with Buffett recently fetched $2.3 million. His common-sense approach to investing, his wit, his folksy storytelling ability and his sense of humor are, at this point, the stuff of legend. All of Buffett's annual letters can be found online and have been reproduced in book form, and anyone with even a passing interest in investing should make it a point to read them.

These selected quotes, along with the article by Nick Murray that was reproduced in last month's feature story, offer great insight into the mind of a successful investor. Buffett's investment philosophy has changed only slightly over the past 40 years, and the success of his patient and relatively low turnover investing style is a powerful model for all investors.

# An Interesting Snapshot of U.S. Consumers' Debt

This picture is definitely worth a thousand words. The U.S. economy is six years removed from the official end of the Great Recession, which was caused by a financial meltdown and credit crisis. Residential mortgages and a housing bubble fueled by easily-available credit were at the heart of this financial meltdown, and a look at where mortgage debt as well as other forms of consumer debt stand now presents a very interesting picture. Below is a graphic showing total household debt in the U.S. as well as mortgage, student loan, auto loan, and credit card debt levels from 2005 until today.

**U.S. Household Debt: Total and By Category (Mortgage, Auto Loan, Etc.) - 2005 to Present**




Source(s): Wall St. Journal, Federal Reserve Bank of New York

Total household debt is $11.85 trillion, significantly below its late 2008 peak of 12.68% trillion. Economists believe growth in mortgage debt has been constrained by tighter lending standards and a lack of available inventory for first-time buyers in many markets. Credit card debt remains far below its 2008 peak, the combined result of consumers' deleveraging and paying off balances, write-offs by card companies (particularly in the few years after the recession ended) and restrained consumer spending in general over the past five years.

Many economists predicted that there would be an uptick in consumer spending due to the cheaper gasoline prices Americans have enjoyed for most of the past year. A gallon of regular averages $2.69 right now nationally, $1 less than a year ago. This savings has simply not shown up in the form of increased retail spending yet, and gross domestic product growth - roughly 70% of which is made up of consumer spending - remains tepid.

There were just 112,000 new foreclosure notices delivered to homeowners in first quarter, the lowest number in the past 16 years according to the New York Federal Reserve. Just 3.3% of auto loan accounts have payments 90 days or more overdue; however, 11.1% of student loans are 90 or more days overdue. Outstanding student loan debt continues to rise, and if there is any area of potential concern, this is it.

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## ***Editorial:*** *Assessing Possibilities for Income Tax Reform*

Last month, I shared facts and figures about who pays what with respect to individual income taxes in the U.S. As a follow up, I'd like to explore some tax reform ideas that have been discussed by presidential hopefuls and high ranking congressmen and women, ideas that will undoubtedly become more widely discussed as the 2016 presidential election approaches. Without further adieu, here they are:

One of the major criticisms against the current tax code is its complexity. The Internal Revenue Code is 70,000 pages and four million words long, and Americans spend 3.32 billion hours of their time each year complying with the Code.

**Flat tax** - One idea for simplification is to adopt a flat

## **Editorial:** *Assessing Possibilities for Income Tax Reform*

income tax, where all taxpayers pay a fixed 17% or 19% tax rate on income and retirement plan distributions. Such proposals carry large standard deductions - roughly $30,000 for married couples and $15,000 for individuals - which are much higher than the $6,200 deduction for individuals and $12,200 deduction for married couples currently in place. The most extreme flat tax proposals make all itemized deductions go away completely.

**Likelihood of passage**: Almost non-existent. Our current system is progressive, meaning the more you make, the higher the tax rate paid by the individual. A flat tax system is regressive, and while it would widen the tax base considerably - roughly a third of non-elderly taxpayers did not pay any federal income tax last year - it is probably not wise to seek additional tax revenue from taxpayers in the bottom 30-40% of income earners. There would also be a great deal of lost revenue from higher income earners who are currently taxed at rates as high as 39.6%.

**Simplified brackets, minimal deductions** - another reform idea held by many politicians that is quite a bit less drastic is one in which the current income tax is reduced to just three brackets. Details differ among candidates, but most have an 8-12% bracket, a 15-22% bracket, and a 25-28% bracket. This is down from the current seven-bracket system that goes from 10% on the low end to 39.6% on the high end. Most proposals do away with almost all deductions, but there would be tax credits available for charitable gifts and mortgage interest. The alternative minimum tax (AMT) would be eliminated. Influential congressman Paul Ryan and presidential hopeful Chris Christie, both Republicans, are among those who have supported such plans. Moderate Republicans with an eye on balancing the budget have, in general, coupled their tax overhaul plans with fairly sizeable proposed spending cuts.

**Likelihood of passage**: Low for a number of reasons. First, there is great uncertainty as to how overall tax revenue would be affected with such a plan, and that uncertainty alone is enough for lawmakers to sit on their hands. Annual federal budget deficits are still the norm, and it is hard to imagine a wholesale overhaul of the Code unless it is accompanied by a Republican winning the White House in 2016 and serious spending cuts.

There are a hand full of other proposals to raise additional revenue like a national sales tax and a value-added tax (VAT). I've seen figures in the range of 5% to 6.5% for a national sales tax, which would be above and beyond current state income taxes. Clearly, such a tax would not be very popular with any taxpayer on its own, and such a tax would have to be combined with reductions in taxes or rates elsewhere. President Obama's plans focus on raising tax rates on capital gains and dividends and eliminating the step up in cost basis on inherited investments, both of which would primarily affect wealthier tax payers in a negative way. Also in his plans are a proposed tax on financial institutions and an expansion of the earned income tax credit (EITC) for childless individuals. One idea proposed a couple of years ago centered around having a minimum tax rate for individuals making over $1 million per year, which would negate any deductions or other maneuvering these individuals could undertake to reduce their tax bills.

**Why make a change in the first place?** It depends who you ask. Democrats clearly favor a higher tax, higher spending philosophy with the majority of the tax burden on wealthier individuals. The goal is, in their words, fairness and to reduce the tax burden on middle income earners. Republicans, in general, favor lower tax rates overall, lower spending and a broader tax base. More conservative Republicans are focused on deficit reduction and paying down the nation's $17 trillion debt.

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A grand bargain with respect to individual income taxes does not seem likely anytime soon. Any give and take between the parties (for example, an expanded EITC in exchange for lowering the top income tax brackets) would result in lower federal revenue, something that is not a plus for the budget deficit. It is far more likely that we will see reform with respect to corporate income tax rates first (a reduction from 35% to 25% - 28% while eliminating loopholes) since such a change is thought to be revenue neutral at worst and may even attract corporations (back) to the U.S. and raise additional revenue.



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