VALUE FINANCIAL ADVISERS, INC.

Over-Leveraged & Under-Funded
What's the Future of America ?

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Presented by Bill Connors, President

First things first. I am not a college-trained economist. I was raised in a frugal German family of small businessmen (I never heard the word entrepreneur until college). My grandfather started and ran a manufacturer's rep. business. He retired at age 52. My father bought the business from him and retired at age 51. I started working in the business doing bookkeeping, customer mailings etc at age ten. After working in a variety of different jobs my father officially hired me at age 25 and I worked for him for three years until we had a falling-out.

I bought my first stock around 1977. I was intrigued and kept investing. Eventually I got licensed and entered the business. After 22 years I'm still with the same firm where I started. My early business exposure gave me a practical seat-of-the-pants view of successful businesses. And I was brought up to understand the importance of being frugal as it pertains to being successful.

Over the last two decades I've also had the great fortune to listen to and read the ideas and philosophies of some of the world's most successful investors. All of this background sets the stage for my thoughts about America and it's future. While I wouldn't dare denigrate the training or intelligence of trained economists, perhaps not being one has the advantage of seeing the forest and not just the trees.

Over-Leverage. America has become a consumption-based economy. To make matters worse, Americans increasingly borrow money (leverage) so they can consume even more. There is a positive to this – jobs are created. If lots of us borrow money to buy new cars, the car manufacturers may hire more workers to build cars. Then those autoworkers have money to buy new houses so the homebuilders may hire more workers to build houses. Then the home-construction workers have more money to buy cars and so forth. This creates a 'Virtuous-Cycle', where standards of living increase for all as long as the cycle is being fed. And what feeds it ? Why of course, increased debt and consumption.

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At the personal level, any adult with common sense recognizes that, eventually, you have to pay back your debts or you can never quit working. And neither countries, states, cities, corporations or any other entity can continue to increase their debts forever or they'll go bankrupt. Part of the problem is that as debt is increasing, standards-of-living are improving, so the borrowers get complacent. Wise folks may comment that 'this can't continue', but few listen.

The result is 'always the same'. Something happens that slows the fuel to the cycle. It could be higher interest rates, lower asset prices, spiking oil prices, some external shock, a and b, all of the above etc. This could happen quickly or be a slow atrophy. But it 'always happens'.

Under-Funded. America has become a low-savings economy. Frankly, if people or institutions are borrowing, they are almost never saving simultaneously, so this should come as no surprise. On average, most Americans have almost nothing saved for retirement. Social Security has, essentially, no assets saved to pay future benefits. Both today and tomorrow's retirees are being paid by payroll taxes from current workers.

State and City pensions have far less money invested than their actuaries project will be needed. Colorado's PERA, for example, claims to have just 80 % of the required present value, and this is based on an average investment rate of around 9 % per year. What if they don't make 9 % per year ? Then they have less than the 80 % required. Available information suggests this is the norm across the country.

Corporate Defined Benefit plans are notoriously under-funded. By law, this is permitted within certain boundaries. If a shortfall should occur a federal agency, The Pension Benefit Guarantee Corporation (PBGC) insures that pensioners will receive benefits (not to exceed a monthly limit that could be less than promised by the corporation). Does the PBGC have enough money to cover the shortfalls in the future ? Since no one knows how many Pension Plans will need help it's hard to say, but my educated guess is – not even close. Last but not least, some smart folks who cover this area believe that Medicare's future costs are larger than all other Government programs combined (and there are NO funds set aside for Medicare).

So, how does this play out ? History shows that something 'always' comes along and upsets this type of structure. It's impossible to predict what this 'something' will be, or when it will come along but, in my opinion, it's inevitable. And like a rubber band you are stretching, unfortunately, the longer it takes to break, the harsher the consequences.

So, if I'm right and America 1. has or will have more leverage than it can service and 2. has significantly under-funded benefits, what's the future ? Simple stated: American's average standard-of-living will decline for a generation or more.

Usually, as the general populations' desire or ability to take on new debt wanes, the economy starts to slow. If taking on more debt created a Virtuous Cycle, the reverse is a Vicious Cycle. Remember, one man's debt is another's income. As the economy slows, unemployment starts to increase.

Having studied the 1930's, The Federal Reserve, U.S. Treasury, Congress and the President sense that the economy has so much debt that a sustained slowdown is dangerous. To prevent a debt-liquidation cycle (a precursor to deflation) they lower interest rates, print money, spend money, reduce taxes etc.

The effect on the average American is twofold. If increasing debt improved one's standard-of-living, paying off debt has the reverse effect. Additionally, the above-referenced actions by the government will head off deflation, but will increase inflation (if you print money, it's value declines). So any income American's have will buy less.

Frankly, based on my observations and a study of history, I see no alternative. An individual may be able to get in 'over their head' and recover. But for an entire country, there is no magic wand to wave that can cure an over-leveraged, under-funded situation.

As Investment Advisors we have little sway on the policies of America's governments or corporations. Likewise, we have little sway over the spending and borrowing habits of most Americans. If we have a relatively clear view of the future we can, however, have a large impact on the financial futures of our clients and others we come in contact with. Through our investment practices we may help our clients profit individually even as others do less well. And through our newsletters and workshops (like the one you're attending today) we may educate some to the risks associated with the current habits of average Americans.

If you would like to talk further to me about our outlook for the future, and what investment strategy might help you preserve and grow your portfolio, please call me @ (303) 770-3030. Initial meetings are always no charge and no obligation.

Wishing you good luck,

Bill Connors
President