

The Patient and Disciplined Investor...

Ruminations on long-term wealth building

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"Many an optimist has become rich by buying out a pessimist."

Robert G. Allen, investment advisor and author

2013 and Beyond

There certainly are reasons for optimism in 2013 and beyond for investors – and certainly plenty of things to be concerned about...like there always is and will be. Let's start with a look at 2012 in the rearview mirror. We see a stock market that mostly shrugged off a lot of "bad" news to post strong returns. Consider 2012 for a minute: a polarized election, the "fiscal cliff" with debt ceilings, deadlines and political stalemates, a persistently high and stubborn unemployment rate, continuing European troubles, the LIBOR scandal, a slowdown in the Chinese economy, the Mayan calendar, Superstorm Sandy, slower corporate earnings growth, a new strain of flu virus, and I'm sure about 20 other "crises" that the media cooked up for you in its tired but effective attempt to keep you hooked on bad news...all of this against a backdrop of the "collective car crash" the world went through in 2008. Result? The S&P 500 returned investors about 16%¹. Not bad. Imagine if we get some good news this year.

Why might you be optimistic going forward? You might not be if you get your information from the news outlets. But patient and disciplined investors might continue to be rewarded moving forward in 2013 and, more importantly, beyond. The theme for optimism is what it's been for the last 200 years...technology that improves productivity, reduces costs, and solves problems.

Energy

***"The Stone Age did not end for lack of stone. And the Oil Age will end long before the world runs out of oil."* – James Canton**

The U.S. has completely turned the tables on energy production since 2007 – we've gone from a stubborn

chronic dependence on foreign energy to a net exporter of energy.² The U.S. was running out of natural gas in 2007, and now we're awash in the stuff due to technological progress with fracturing type technologies.³ The environmental and regulatory issues can and must be solved. As the 1980s song goes, "The future is so bright, I gotta wear shades."⁴

Let's briefly explore the evolution of energy.⁵ Muscle power has always been used, but long ago powerful people figured out that they could enslave others for energy. This eventually gave way to animals, depending on where you were in the world. Oxen and horses were used for centuries throughout Europe. Watermills were later used in Europe, and peat gave the Dutch the upper hand in the 1600's. Eventually, Britain, with only a population of 8 million in 1750 (compared with 25 million in France), successfully used carbon fuels to ignite economic progress and set off the industrial revolutions. Along the way, people have burned wood, but that's not always a great idea. Burning wood tends to obliterate nearby forests and cause health problems due to unhealthy, indoor air.

Remember that wood, peat, carbon, hay, etc. are captured sunlight. Carbons are very dense and have captured sunlight for millions of years – that's why they're outstanding sources of energy when burned. But now we are starting to enter into a golden age of energy – and I'm not talking about growing more corn for ethanol while we drive up food prices for the world's more impoverished nations.

² See <http://www.bloomberg.com/news/2012-02-29/u-s-was-net-oil-product-exporter-in-2011.html>, and <http://www.iea.org/newsroomandevents/pressreleases/2012/november/name,33015,en.html>

³ In fact, the U.S. might become the world's largest energy producer in 2013. See <http://money.msn.com/now/post.aspx?post=98ef598c-5c21-47a8-a41e-14574ccd7e5b>

⁴ In case you have to know, the band is Timbuk 3.

⁵ For a very good summary on this topic, see *The Rational Optimist* by Matt Ridley (2010).

¹ <http://www.standardandpoors.com/indices/sp-500/en/us/?indexId=spusa-500-usdof--p-us-l->

It's anticipated that renewable energies (i.e., solar, wind, etc.) will be at "grid-parity" within the next five years or so...essentially, renewables will cost the same or less than coal-driven energy from power plants.⁶ This news has been anticipated – unlike the surge in energy production through fracturing - but it will be a game-changer nonetheless. Imagine solar panels in Africa supplying a large percentage of Europe's energy needs. The future might actually be bright in Africa, too.

Biofuels could also play a huge role. Big Oil has noticed – Exxon invested \$600 million in 2010 to grow biofuel from algae. Nuclear could make a comeback with stage IV technology, which, as I understand it, solves many of the vexing problems associated with operational hazards and waste issues. We might, in the next 20-30 years, get to the "holy grail" of energy: fusion, which uses seawater for fuel.

Stay tuned...this could be one interesting and exciting ride. One day our grandkids might ask, "Grandpa, we're learning about energy crises in history class. What was that like?"

Demographics, Cell Phones, and Collaboration

"No pessimist ever discovered the secrets of the stars or sailed to an uncharted land or opened a new heaven to the human spirit." - Helen Keller

Once again, a little history helps our understanding. Going back 300 years and beyond, most Europeans drank alcoholic beverages in lieu of water simply because it was safer than drinking the water. During the late 1500's to early 1600's, coffee made its way to Europe that led to the rise of coffee houses. Instead of starting their day with alcohol, people began starting their day with coffee, and coffee houses provided the perfect place to discuss and collaborate on ideas about politics, science, philosophy, and business – hence the Enlightenment, or Age of Reason, was born. This eventually led to the industrial revolutions in the late 1700's and 1800's. Telephones, radios, and televisions came along. Eventually, this set the stage for the "do-it-yourself movement" in the 1960s and 70s – a movement deeply suspicious of authority that sparked personal computers. This has moved power away from institutions to individuals.

The western world then connected through the internet in a profoundly new and meaningful way. Today,

⁶ See Abundance, The Future is Better Than You, Think by Peter H. Diamandis and Steven Kotler, p. 160 (2012)

consider that 3 billion people are coming on line around the world – exponentially accelerated by cell phones, smart phone technology, and tablets. These billion people are moving from poverty into the middle classes...that's three billion with a big capital B.⁷ Three billion people that have a chance to change their lives, get educated, contribute to the world dialogue, solve our most vexing problems, create wealth for themselves and others, and – significantly for investors - buy goods and services from U.S. companies.

The media will spin this massive success story as more pollution, outsourcing of jobs, scarcity of commodities, greater greenhouse emissions, inflation, food shortages, famine, viruses, blah, blah, blah. What they're missing – and who can blame them, for they simply wouldn't sell more news if they didn't create another "crisis" – is that people start to care about their environment and political freedom once they don't have to think about simply surviving. Ever since Malthus' prediction 200 years ago of population explosion resulting in world hunger, famine, and disease, productivity enhancements and technology have and will continue to solve our food shortage problems. We've had problems distributing food to poverty-stricken areas, but we certainly do not have problems producing food. Outsourcing of jobs is very political, and I'm sure we all have different opinions on this topic. But for investors, it generally translates into higher returns on investment. But even new technologies and political instability abroad are now bringing jobs back to America.⁸

Medicine

"I have observed that not the man who hopes when others despair, but the man who despairs when others hope, is admired by a large class of persons as a sage." – John Stuart Mill

The word "crisis" is used so often in the media that all of its meaning is beaten out of the word. If there is one issue, however, that constitutes a "crisis", it would be the future, projected spending on Medicare and Medicaid (and possibly Social Security). But I wonder whether "crisis" is the right term to use on our

⁷ See

<http://siteresources.worldbank.org/EXTABCDE/Resources/7455676-1292528456380/7626791-1303141641402/7878676-1306699356046/Parallel-Session-6-Homi-Kharas.pdf>

⁸ See

<http://www.usatoday.com/story/money/columnist/kay/2012/11/24/at-work-manufacturing-jobs-coming-back/1721539/>

anticipated health care expenditures. I'm starting to think it's more of a "problem" than a "crisis".

Imagine if we solve our medical spending problem like we're solving our energy problems. How would that improve the lives of millions of Americans and turbo-charge our economy? How much would companies save in health insurance costs that could be passed along to consumer in the form of lower prices and investors in the form of higher stock prices? This just might happen over the next 10 to 20 years.

Before long, the internet will be in the walls of our homes. Instead of going to the doctor when you feel sick, you might simply go to your wall screen and talk to "Robodoc".⁹ You touch the screen, and a very human-like doctor appears, and he or she will ask you a series of questions. You will speak to the screen. Robodoc will also analyze the data from your bathroom, clothes, and furniture, which have been monitoring your health via DNA chips in your home. Robodoc might also evaluate you with a portable MRI scanner. All of this information will be run through data based on the best medical minds in the world. If a prescription needs to be called in to the pharmacy, then Robodoc forwards the information, and you simply go pick it up (obviously some regulatory issues to be solved here). Or if you need to go see a specialist, then you would schedule an appointment like you do now.

Think what this alone will do for the cost of medicine. It's estimated that the great majority of doctor's visits could be eliminated thereby removing huge burden on our current system. Think of how our energy problems looked to us in 2007. Natural gas and oil were spiking to all-time highs, and the mood was decidedly negative that we were going to solve this problem anytime soon and get off of our dependence on foreign oil. Predicting things is tricky and dangerous business, but I'm slowly getting off the bandwagon that says our medical costs, aging population, and budget deficits are catastrophic. The costs are so huge to the system – however, the potential rewards so big for those creative individuals and entrepreneurs who solve these problems. I wouldn't bet against America just yet, budget deficits notwithstanding.

Bottom Line: Patient, disciplined investors could be well rewarded. I like the longer term trends in several key areas.

Books to Consider for your 2013 Reading List

Here were my favorite books that I read in 2012 related to investing. Getting your information from the media is hazardous to your emotions and therefore your investment portfolio. As much as we'd like to think emotions do not enter into decision-making on investments, time and again the studies show that investors are their own worst enemy. The world's day-to-day success stories rarely make the front pages. Despite what's in the news, accelerating and massive progress is being made, and I encourage you to feed your mind the right information.

Physics of the Future by Michio Kaku. This is an outstanding and very interesting book on where science and physics will take us in the future. Enormous breakthroughs are happening and will propel society into an ever more Star Trek type environment. Mr. Kaku is not a Harry Dent-like demographer, rather he's a professor of theoretical physics at City University of New York and hosts two radio programs. This book might even give your teenager or young adult child ideas on career choices.

Abundance by Peter Diamandis and Steven Kotler. If you read just one book this year, this should be the one. For me, this book represents everything that's going right with the world, and then some. You cannot read this book and come away with a pessimistic sense of the future. If you're a chronic pessimist, you probably won't be able to finish this book...it would destroy your sense of self and the all the reasons you like to complain.

Growth Map by Jim O'Neil. This provides a piece of the story on the emerging three billion people moving from poverty into the middle classes. Mr. O'Neil works for Goldman Sachs, and it was him and his team who predicted the rise of the "BRIC" countries before anyone noticed – Brazil, Russia, India, and China. As it turned out, he was incredibly correct, especially on Brazil, India, and China. This book goes on to identify 14 additional countries that he and his team see as the up and coming economies moving forward. It's a surprisingly easy read.

Grand Pursuit: The Story of Economic Genius by Sylvia Nasar. The literary style of this book is terrific. Ms. Nasar takes you through the history of the how all the major bodies of economic thought developed - all the way from early industrial England to Karl Marx to Schumpeter to Keynes to Milton Friedman. You will come away with an understanding of how the

⁹ See Physics of the Future, Michio Kaku, pp. 78-79 (2011).

entitlement state began with the movement started by Beatrice Webb and how Irving Fisher began to realize that control of the money supply deeply affected price levels. Given how much our economy – and what we might do about it – is in the news, this book will give you a much better understanding on the current debates of today on the economy. You do NOT have to be an economics geek to enjoy this one.

End this Depression Now by Paul Krugman. As a financial professional entrusted by clients with the deeply responsible job of helping them reach their financial goals, I feel that it's my duty to read opinions that differ my own. Paul Krugman is a very, I guess you would say, extreme economist. I actually liked his book, though I think his ideas are a bit much in places. He makes some excellent points and gets the reader to think, but in places his book devolves into what feel like rants and frustration. In essence, he's calling for the government to spend whatever it takes – mainly on infrastructure – to get people back to work and the economy humming again.

Monetary History in the United States: An Intellectual and Institutional History by Richard Timberlake. This book is not for the faint of heart. Strap in if you decide to plow through this one. But if you like history and want an understanding of how we got to today with the Federal Reserve and economic policymaking, then I would highly recommend this one. Mr. Timberlake takes you through the entire history of U.S. monetary policy. You might be fascinated to know how currency worked pre-Civil War, the gold and silver standards, the creation of the Federal Reserve, New York money interests, how the Great Depression was exacerbated badly by the Federal Reserve, and post-World War II policies. This is not a new book – written in 1993. But it's an outstanding treatise on this topic.

Dissolving Dollars: Exposing the Debt-Based Insanity Behind Modern Money by Alex Marchand. This rather short and informative book will give you a very good understanding of how societies can set up currencies, and how our currency, the dollar, is based on debt issued by The Federal Reserve. Be forewarned: this book will tug at your inner conspiracy theorist. The Civil War – which is a key point in monetary history – changed forever how currency was issued into circulation in the U.S. This is a highly recommended read if you want to better understand where money comes from in the U.S.

Greenback Planet: How the Dollar Conquered the World and Threatened Civilization as We Know It by H.W. Brands. This book covers the rise of the American dollar as the dominant world currency. The reader will get a sense of how fiat money – not backed by gold – originally came about during the Civil War. The author then takes the reader through the rest of the 19th century, creation of the Federal Reserve, the dismantling of the gold standard, Bretton Woods, the 1970s inflation, and our recent troubles. This is a good read if you're looking for a fairly short book to get a sense of these very relevant issues.

Conflict of Visions by Thomas Sowell. I read this book while traveling in Europe this last fall – the perfect backdrop for this read. It's not a book on investing or money, per se, but this surprisingly insightful book will decode for you why our two political parties – and other centers of ideas – pretty much talk right past each other. In part, it's because their assumptions are so radically different. This, too, is not a new book – written in the 1980s, but Mr. Sowell could have written it yesterday, and it would feel very relevant. You will come away with a much better understanding of the political stalemates we're seeing now in Washington.

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Todd's Background

Todd has been serving clients since 1992. Prior to that time, he attended Boston University School of Law and obtained his law degree in 1989. He practiced law from 1989 to 1992 in Dallas, TX with a large international law firm in the areas of taxation, securities, and corporations. He graduated from Kansas State University in 1986. Along with insurance, Todd began offering investments to clients in 1993. He obtained the prestigious Certified Financial Planner® (CFP®) designation in 2002 and also holds the well-respected Chartered Life Underwriter and Chartered Financial Consultant designations from the American College.