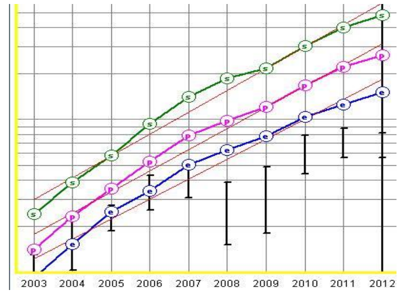
Rocky Mountain Chapter



FIRST QUARTER (JANUARY – MARCH) 2014 eNEWSLETTER

OVERVIEW OF UPCOMING EVENTS AND CLASSES THIS SPRING:

- Small Talk, January 22, February 10, March 24, April 16, via Webinar
- Intro to the Stock Selection Guide (SSG), February 1
- Beginning ToolKit and Lab, February 22
    - Lab Only, February 22 afternoon
- Judgment on the SSG, March 15
- Advanced ToolKit and Research Tools, April 12
    - Research Tools Only, April 12 afternoon
- Portfolio Management, April 26

AMAZING FACT

The constituents of the S&P 500 generate close to 40% of their profits outside the U.S. This international exposure means that profits can grow at a different rate than the domestic economy, even in the long run.

THE POWER OF COMPOUNDING… A MOTIVATING STORY

> *"Long ago, when the inventor of chess showed the game to the king, he was so impressed by the new game, that he wanted to reward the inventor. At that time, the inventor replied, "My wishes are simple. I only ask for one grain of rice for the first square of the chessboard, two grains for the second square, four grains for the third square, eight for the fourth square and so on for all 64 squares. So just double the number of grains in the next square compared to the earlier square." The king was amazed to hear that the investor had asked for such a small reward. He happily agreed to the inventor's request. However after a week, the king's treasurer informed him that the reward would add up to a huge number—far greater than all the rice that could possibly be produced in many centuries! Do you know how much rice it would be when one reaches the 64th square of the chessboard? As said earlier, in the first square of the chessboard there is only one grain. But when you come to the 64th square, it is 18 million trillion grains of rice. This is more than enough to cover the entire surface of the earth. That is the power of compounding."*

THE STORY: Bud and Lou were best friends who started working at the age of 22. Both joined the same company at the same time, received the same salary, and their salaries grew 5% per year until they reached 50 when income leveled off as is typical of real life. Both were good at their jobs, worked hard, and planned to retire at age 65. But at 22, retirement seemed a very long way off.

Bud's parents taught him the virtues of saving and investing for the long term. They always said that when bill paying time rolls around each month, never forget to **PAY YOURSELF FIRST**. So he understood the importance of investing early and the benefits of compounding. So Bud initially spent less money on entertainment and made sure that he invested 15% of his salary every year. He put his money in the stock market which returned 10% per year on average though it gyrated up and down meanwhile. At the end of 10 years, his portfolio was worth $58,598.

In contrast, Bud's friend Lou lived high off the hog, spending all his earnings every year. Lou's philosophy of life was "carpe diem" and he thought setting aside money for the future a waste since the future is unpredictable. Any day may be your last and "you only go around once". So Lou put nothing aside for the future since one never knows but what there may be no future.

Now Bud wasn't exactly pinching pennies as he only saved 15% each year, but Lou finally convinced him that it may be best to live it up now as tomorrow may never come. So after ten years of saving and investing, Bud threw in the towel and joined his friend in spending all his salary every year. But he wisely decided to let his portfolio ride "as is". So he put his brokerage information in his safe deposit box and joined Lou at the beach. After a while, Bud forgot all about his investments and enjoyed life to the hilt.

Time passed and the friends learned that sometimes there is a future after all. The year they turned 55, Lou read an article on how much you would need to retire comfortably. So he decided that he'd better start saving for retirement. At 22, retirement seemed so far away and there were so many things to buy and do that even a modest 15% savings rate seemed onerous. At 55, Lou was making $80,000 and felt he had to set aside 50% to invest in the stock market. Boy, that was a big chunk out of his salary, but he thought he'd just have to tough it out as retirement was now only ten years away. So Lou began his austerity program in preparation for retirement and ten years later, at age 65 he had a nice portfolio of $637,497.

Meanwhile, Bud continued to spend his salary in total. At 55, he too was making $80,000 except he decided to continue spending it all let come what may.
Bud reached 65 years old and, like Lou, finally realized he needed retirement income in addition to social security. So he remembered his safe deposit box and went to see what happened to his savings. He recalled that it was worth around $59,000 the last time he checked…some 34 years ago! To his pleasant surprise, that $59,000 portfolio neglected for 34 years had grown on its own to an astounding $1,497,049!

Both Bud and Lou saved and invested for ten of their working years. Bud did so over the first ten years of his working life when his salary was at its least. Lou did so the last ten years of his working life when his salary was greatest. Bud's saving rate was a modest 15% while Lou's saving rate was a life-style restricting 50%. Yet Bud's nest-egg was so much larger than Lou's. The power of compounding is awesome! *(NOTE: See the spreadsheet for this story at the end of the newsletter)*

So Bud's parents were right about the virtues of saving and investing long term. What if he'd followed their advice throughout his working years? If Bud had continued to save

15% of his salary over his working life, he'd have had $3,343,539 by the time he reached 65 years of age.

There is more to this story.

In retirement, Bud and Lou plan to live off the dividends generated by their portfolio nest-eggs. A reasonable dividend yield from a diversified portfolio is about 3%. Lou will have to be content with a dividend income of $19,125 which is much less than the salary he was earning upon retirement. Bud will have an income of $44,914 which is much more than Lou, but still less than his pre-retirement salary of $80,000. Both Lou and Bud will have to reign in their expenses substantially. But if Bud had followed his parent's advice over his entire working life, he'd have a retirement income from dividends of $100,306! That is $20,000 more than his salary at retirement!
Lessons learned which should be passed on to children and grandchildren:

- Start saving and investing as early as possible
- Adopt a moderate savings rate of 15%, stick with it and no excuses
- Invest in a diversified portfolio of stocks
- Reinvest all dividends until retirement
- Invest in good businesses with good management, but only buy at a good price
- Save and invest over your entire working life

This story was suggested by a similar story on www.flame.org.in , a non-profit educational group in India.

WORDS OF WISDOM
A Watch List is composed of good companies with good growth prospects led by skilled managers but currently unavailable at a good price. We maintain the list waiting for a good price. How long will we wait? As **Warren Buffett** says, *"We don't get paid for activity, just for being right. As to how long we'll wait (for a good price), we'll wait indefinitely."*

"As a market timer your cash balance is a function of what you think the market is about to do. However, the investor's cash balance is a by-product of investment opportunities you see in the market. If you can't find good companies (quality and growth requirement being met) to own at the right price (valuation commensurate with quality, growth, and projected return), cash or short-term bonds are good alternatives until a new opportunity presents itself. Again, this is not about market timing, but you should not be buying stocks just for the sake of being fully invested" – **Vitaliy Katsenelson**

		Bud				Lou		
AGE	SALARY	% SAVED	AMT SAVE	PORT		% SAVED	AMT SAVE	PORT
22	$20,000	0.15	$3,000	$3,300		0	$0	$0
23	$21,000	0.15	$3,150	$6,780		0	$0	$0
24	$22,050	0.15	$3,308	$10,766		0	$0	$0
25	$23,153	0.15	$3,473	$15,315		0	$0	$0
26	$24,310	0.15	$3,647	$20,493		0	$0	$0
27	$25,526	0.15	$3,829	$26,371		0	$0	$0
28	$26,802	0.15	$4,020	$33,028		0	$0	$0
29	$28,142	0.15	$4,221	$40,553		0	$0	$0
30	$29,549	0.15	$4,432	$49,040		0	$0	$0
31	$31,027	0.15	$4,654	$58,598		0	$0	$0
32	$32,578	0	$0	$64,458		0	$0	$0
33	$34,207	0	$0	$70,904		0	$0	$0
34	$35,917	0	$0	$77,994		0	$0	$0
35	$37,713	0	$0	$85,794		0	$0	$0
36	$39,599	0	$0	$94,373		0	$0	$0
37	$41,579	0	$0	$103,810		0	$0	$0
38	$43,657	0	$0	$114,191		0	$0	$0
39	$45,840	0	$0	$125,611		0	$0	$0
40	$48,132	0	$0	$138,172		0	$0	$0
41	$50,539	0	$0	$151,989		0	$0	$0
42	$53,066	0	$0	$167,188		0	$0	$0
43	$55,719	0	$0	$183,906		0	$0	$0
44	$58,505	0	$0	$202,297		0	$0	$0
45	$61,430	0	$0	$222,527		0	$0	$0
46	$64,502	0	$0	$244,779		0	$0	$0
47	$67,727	0	$0	$269,257		0	$0	$0
48	$71,113	0	$0	$296,183		0	$0	$0
49	$74,669	0	$0	$325,801		0	$0	$0
50	$78,403	0	$0	$358,382		0	$0	$0
51	$80,000	0	$0	$394,220		0	$0	$0
52	$80,000	0	$0	$433,642		0	$0	$0
53	$80,000	0	$0	$477,006		0	$0	$0
54	$80,000	0	$0	$524,706		0	$0	$0
55	$80,000	0	$0	$577,177		0	$0	$0
56	$80,000	0	$0	$634,895		0.5	$40,000	$40,000
57	$80,000	0	$0	$698,384		0.5	$40,000	$84,000
58	$80,000	0	$0	$768,223		0.5	$40,000	$132,400
59	$80,000	0	$0	$845,045		0.5	$40,000	$185,640
60	$80,000	0	$0	$929,550		0.5	$40,000	$244,204
61	$80,000	0	$0	$1,022,505		0.5	$40,000	$308,624
62	$80,000	0	$0	$1,124,755		0.5	$40,000	$379,487
63	$80,000	0	$0	$1,237,230		0.5	$40,000	$457,436
64	$80,000	0	$0	$1,360,954		0.5	$40,000	$543,179
65	$80,000	0	$0	$1,497,049		0.5	$40,000	$637,497