

The Sensenig Capital Advisor Letter

Sensenig Capital Advisors \ Wealth Management

March 2012

Who Has The Midas Touch?

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Over the course of a lengthy and illustrious business career, Warren Buffett has offered thoughtful opinions on a wide variety of investment-related issues—executive compensation, accounting standards, high-yield bonds, derivatives, stock options, and so on.

In regard to gold and its investment merits, however, Buffett has had little to say—at least in the pages of his annual shareholder letter. We searched through 34 years' worth of Berkshire Hathaway annual reports and were hard-pressed to find any mention of the subject whatsoever. The closest we came was a rueful acknowledgement from Buffett in early 1980 that Berkshire's book value, when expressed in gold bullion terms, had shown no increase from year-end 1964 to year-end 1979.

Buffett appeared vexed that his diligent efforts to grow Berkshire's business value over a fifteen-year period had been matched stride for stride by a lump of shiny metal requiring no business acumen at all. He promised his shareholders he would continue to do his best but warned, "You should understand that exter-

nal conditions affecting the stability of currency may very well be the most important factor in determining whether there are any real rewards from your investment in Berkshire Hathaway."

As it turned out, the ink was barely dry on this gloomy assessment when gold began a lengthy period of decline that tested the conviction of even its most fervent devotees. Fifteen years later, gold prices were 25% lower, and even after thirty-one years (1980–2010), had failed to keep pace with rising consumer prices. By year-end 2011, gold's appreciation over thirty-two years finally exceeded the rate of inflation

SECTION HIGHLIGHTS

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(205% vs. 195%) but still trailed well behind the total return on one-month Treasury bills (398%).

Perhaps to compensate for his past reticence on the subject, Buffett has devoted a considerable portion of his forthcoming shareholder letter (usually released in mid-March) to the merits of gold.

With his customary gift for explaining complex issues in the simplest manner, Buffett deftly presents a two-pronged argument. Like a sympathetic talk show host, he quickly acknowledges the darkest fears among gold enthusiasts—the prospect of currency manipulation and persistent inflation. He points out that the US



Source: American Bullion Inc.

dollar has lost 86% of its value since he took control of Berkshire Hathaway in 1965 and states unequivocally, “I do not like currency-based investments.”

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Buffett completes the argument by asking the reader to compare the long-run potential of two portfolios. The first holds all the gold in the world (worth roughly \$9.6 trillion) while the second owns all the cropland in America plus the equivalent of sixteen ExxonMo-

bils plus \$1 trillion for “walking around money.” Brushing aside the squabbles over monetary theory, Buffett calmly points out that the first portfolio will produce absolutely nothing over the next century while the second will generate a river of corn, cotton, and petroleum products. People will exchange their labor for these goods regardless of whether the currency is “gold, seashells, or shark’s teeth.” (Nobel laureate Milton Friedman has pointed out that Yap Islanders got along very well with a currency consisting of enormous stone wheels that were rarely moved.)

When Buffett assumed control of Berkshire Hathaway in 1965, the book value was \$19 per share, or roughly half an ounce of gold. Using the cash flow from existing businesses and reinvesting in new ones, Berkshire has grown into a substantial enterprise with a book value at year-end 2010 of \$95,453 per share. The half-ounce of gold is still a half-ounce and has never generated a dime that could have been invested in more gold.

Few of us can hope to duplicate Buffett’s record of business success, but the underlying principles of reinvestment and compound interest require no special knowledge. Every financial professional can point to individuals who have accumulated substantial real wealth from investment in farms, businesses, or real estate, and sometimes the success stories turn up in unlikely places.

Where are the fortunes created from gold? **S**

Source

Weston J. Wellington, a vice president with Dimensional, is another of the firm’s in-house research experts. He works closely with financial advisors in the US, Canada, Europe, Australia, and Latin America, showing them how a science-based “equilibrium” strategy is the most reliable way to achieve investment success and why their clients are unlikely to hear about this approach from the usual sources of financial advice. One of the firm’s most engaging speakers, Weston is an accomplished writer as well, with a regular column on Dimensional’s password-protected website, *Down to the Wire*.

A Holistic Approach to Wealth Management

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Wealth management is not a new term. Most people have heard about this concept but are unclear what exactly it encompasses. So we ask, “What separates a wealth manager from an investment advisor?” If you’re unsure how to answer this then you are certainly not alone. In fact, a recent study by leading consulting firm, CEG Worldwide, concluded that out of almost 2,100 so-called wealth management firms across the country only 7% were truly engaging in actual wealth management. The rest were mainly investment-oriented. Therefore, what is this mystifying profession and what should clients be looking for in a “true” wealth manager?

WEALTH MANAGEMENT DEFINED

It’s important to realize that wealth management is a highly defined process that consists of several key components. Genuine wealth managers use a consultative approach to construct integrated solutions that encompass all types of financial needs.

In its simplest form, wealth management comprises three phases:

- Using a consultative process to establish close relationships with a client in order to gain a detailed understanding of their goals and their most important financial wants and needs.
- Offering customized solutions designed to fit each individual’s needs. This might include; investments, insurance, estate planning, retirement planning, and charitable giving.
- The wealth manager works in close consultation with clients and their other advisors—such as their CPAs, estate planning attorneys, and insur-

ance providers—on an ongoing basis to identify their specific needs and design custom solutions.

THE WEALTH MGMT. FORMULA: WM = IC + AP

At its core, the wealth management (WM) approach is comprised of investment consulting (IC) plus advanced planning (AP).

The first element of the equation, investment consulting, plays an integral role in the long term success of your goals and objectives. Your investments are the engine behind the other planning of your financial affairs. We leverage the experience and time-tested philosophy that Sensenig Capital has developed over many years to provide you with a custom, tailored approach. While many firms have seen fit to outsource the management of their client portfolios to third-party vendors, we gain an edge by fully and intelligently understanding the investments we recommend to you and why. Affluent clients expect this, and, in our opinion, there should be no substitute.

The second component of the equation is advanced

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planning. The intention here is to ensure that your financial house is in order so that you can fully achieve your goals. Industry research is clear in that financially successful people are concerned with much more than just their investment assets. In fact, preserving wealth is often more important than growing wealth. Thus, the various components of advanced planning speak to the key concerns of many clients, including wealth enhancement through income tax mitigation, wealth transfer via estate planning, and wealth protection through insurance.

THE WEALTH MANAGEMENT PROCESS

It takes a strategy to make the most of the opportunities that wealth can bring to your life. However, it cannot be just any strategy; it has to be your strategy. That's why we created a "Discovery" process in which we dedicate considerable time and resources in getting to know more about your investment and advanced planning needs.

Discovery involves seven key areas of exploration centered on your particular needs, as shown in the illustration below. Our inquiry goes much deeper than the traditional fact-finding used by many advisory firms so as to reveal what really matters to you. This approach is an alternative to the traditional financial planning

model that can oftentimes be expensive and cumbersome. Discovery sets the stage for an ongoing process that deepens our relationship with you and enhances critical communication about your life as it changes.

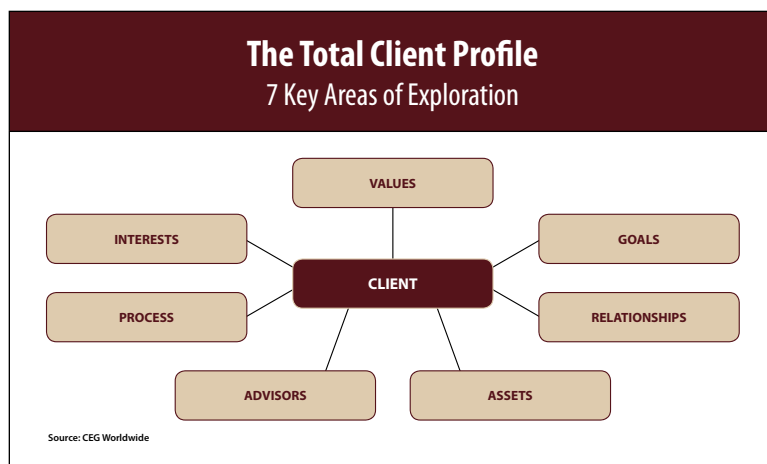
THE TRUSTED PROFESSIONAL NETWORK

No one person can be an expert in an entire range of advanced planning needs and solutions. In a typical situation, your attorney might never collaborate with your accountant and the accountant may never seek the opinion of your investment advisor, and so on. Rather than each professional working in isolation we feel they should be working together to benefit you in a greater capacity. In order to address the totality of your financial challenges with the best possible strategies we have built a professional network of specialists to assist us.

This network is made up of independent professionals spanning in expertise from specialized income taxation to detailed estate planning, insurance, and various other areas of proficiency. We have carefully selected each person to reflect the same level of service and professionalism that our clients expect. Among other things, we look to work with someone based on competency, integrity, and their ability to remain objective in looking out for your best interests. Of course, if you

are interested in the wealth management process but already work with someone else that is perfectly fine too.

Over the years we have come to understand the unique issues that affect affluent clients. We believe that consultative wealth management can serve to provide you with a holistic method in managing your complex financial affairs. **S**



The 10 Coverages Most People Overlook

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There many circumstances that could be financially devastating to you and your family's financial well-being. For example, in the event of a fire, theft, law suit, or natural disaster you would want to recover your losses and remain financially secure. Statistics show that 51% of insurance claims are not covered because of changes in life events and the subsequent failure to review outstanding insurance protection. With that in mind, the following are the most common coverage's people overlook.

1. LIFE INSURANCE: Ben Franklin once said the only two things in life you can count on are death and taxes. Most people buy a life insurance policy and file it away, never to be looked at again. In the meantime, beneficiaries may require updating, the amount of insurance might need to be adjusted, or the policy cash value could run out. You should review existing life insurance periodically because your life changes and consequently your insurance needs change.

2. UMBRELLA LIABILITY: This is one of the most overlooked policies for people who maintain a higher net worth. This type of policy protects your assets and future income beyond the standard limitations of your primary liability policies. Typically, umbrella policies are in increments of \$1 million and provide protection beyond standard home, car, and boat plans. An umbrella liability policy is highly recommended for people who have a net worth above the standard limitations.

3. BROADENED COVERAGE FOR EXPENSIVE ITEMS: If you have expensive items, your homeowner's policy

may be inadequate. Items such as jewelry, collectibles, fine art, and musical instruments may exceed the limits of standard homeowner coverage.

- **Jewelry Coverage:** Every home insurance policy places a limitation on jewelry. Most policies only include \$1,000 of coverage, which does not cover a common loss known as "mysterious disappearance" (i.e., stone falling out of ring). Listing your jewelry items individually is the best way to ensure that items are insured up to the specified dollar amount.
- **Coverage for Collectibles:** Every home policy has a special limitation on collectibles like coins, stamps, and baseball cards. Listing your collectibles separately may be a good idea because some collectibles are not covered under the standard policy. Coverage may be modified to include "All Risk Coverage", which would cover breakage, mysterious disappearance, and other perils not normally covered under personal property.

ABOUT THE AUTHOR

George W. Meschter

Meschter Insurance Group

George is President of Meschter Insurance Group, and started out from a young age learning about the insurance business from his father.

Today he attends to the insurance needs of larger commercial accounts, and keeps abreast of changes in the broader insurance industry. He is a founding member of Premier Insurance Network, an insurance consortium. He also serves on local boards, including the Schwenkfelder Library, Harleysville Savings Bank, and the Perkiomen School.

4. REPLACEMENT COST ON DWELLING AND PERSONAL PROPERTY: This type of coverage guarantees the dwelling or personal property will be replaced, without depreciation, in the event of a loss. Replacement cost, not market value (what you could currently sell your home for) is the benchmark used to insure your dwelling.

5. IDENTITY THEFT COVERAGE: Identity theft is the fastest growing crime in America. This type of coverage reimburses you for expenses related to restoring your identity if it were stolen. Most homeowners policies offer identity theft coverage, but as an endorsement for an additional charge.

6. BUSINESS IN THE HOME ENDORSEMENT: In today's world many people operate businesses out of their home. This type of coverage provides liability and/or business property coverage for certain home-based businesses. If a business client is injured on your property a standard home policy may not pay for the loss. Therefore, you need separate coverage. Make sure you include your home business inventory.

7. FLOOD INSURANCE: Flood coverage is not provided on a traditional homeowner's policy. It is a separate policy that would need to be provided. It affords coverage from an overflow of a body of water and/or surface water. You do not need to be in a flood prone area to purchase a flood policy and may want to consider this type of coverage if you are concerned about the potential for surface water damage.

8. DRAIN/SEWER BACKUP: Most homeowner's insurance policies don't automatically include coverage for damage caused to your home (typically your

basement) due to sewage backing up or rainwater that floods in due to the failure of your sump pump. If you have a finished basement this coverage may be especially important. Even without a finished basement you could have damage to your furnace, water heater, or water softener and this coverage would apply.



Source: ScottonMoney.com

9. RECREATIONAL VEHICLE COVERAGE: Many consumers are unaware that coverage can be added to a variety of recreational vehicles including boats, ATVs, snowmobiles, golf carts, etc. This is a type of policy people with higher-value recreational vehicles should certainly consider.

10. LOAN/LEASE: Loan/Lease covers the difference between the amount owed on lease or loan and the amount normally paid by a car insurance policy at the time of a total loss. For example, if your vehicle were totaled in an accident the insurance company, for several reasons, may not pay the entire value of an outstanding loan. Loan/lease insurance would cover the additional value not paid. ■

Can You Afford to Time the Market?

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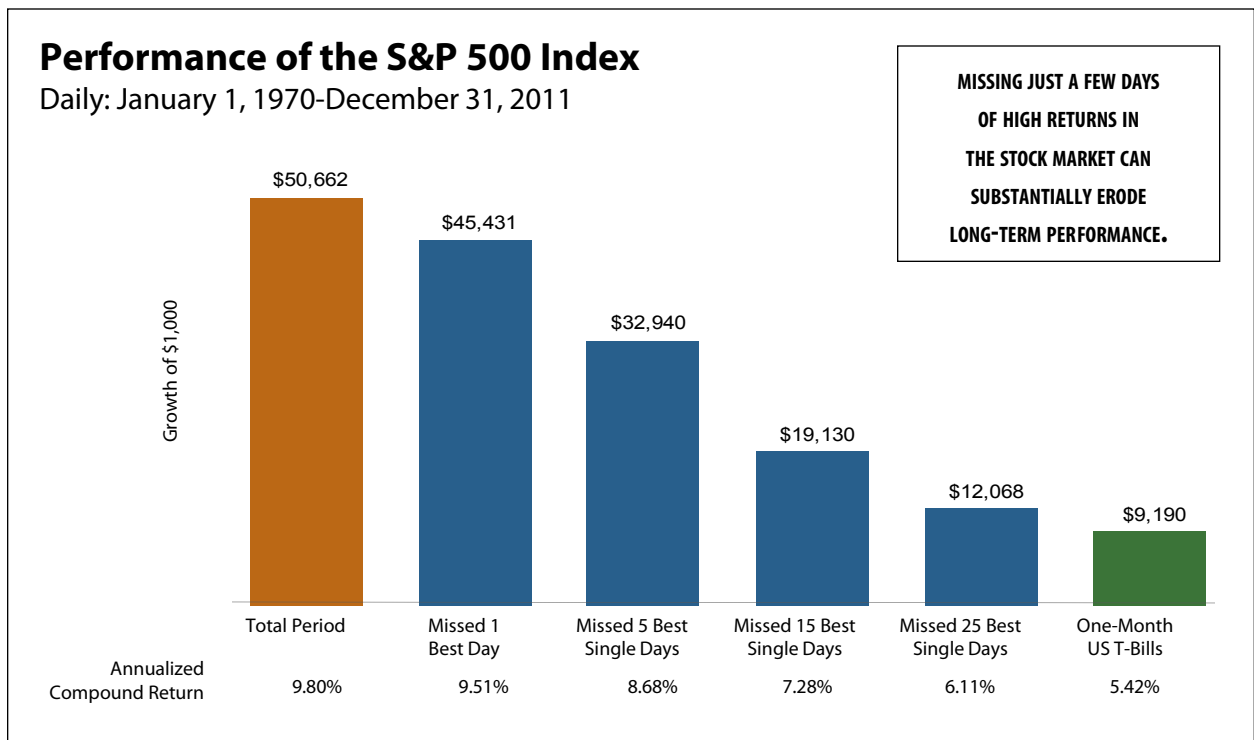
The harsh reality of market efficiency has not stopped speculators and other traders from attempting to read the future. On paper, market timing offers a seductive prospect: By predicting market direction ahead of time, a trader might capture only the best-performing days and avoid the worst.

The chart below tells the other side of that story. Large gains may come in quick, unpredictable surges. A trader who misinterprets events may leave the market at the wrong time. Missing only a small fraction of days—es-

pecially the best days—can defeat a timer's strategy.

For example, since 1970, missing the best 25 trading days would have significantly cut S&P 500 Index annualized compound return.

Trying to forecast which days or weeks will yield good or bad returns is a guessing game that can prove costly for investors. This further highlights the validity of having a plan in place that addresses your tolerance for risk in order to avoid abandoning your plan based on short-term market conditions. **S**



Performance data for January 1970-August 2008 provided by CRSP; performance data for September 2008-December 2011 provided by Bloomberg. The S&P data are provided by Standard & Poor's Index Services Group. US bonds and bills data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). Indexes are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Dimensional Fund Advisors is an investment advisor registered with the Securities and Exchange Commission. Information contained herein is compiled from

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Creating wealth is one thing. Preserving it is another.

You want your financial resources to help achieve what is important to you in life—but making sound, effective financial decisions is difficult in our increasingly complex world. Many find the media as their source for investment guidance. Unfortunately, much of the daily media hype only serves to distract investors from achieving the results they seek. Where can you turn for a solid solution to the problem?

Sensenig Capital exists to help financially successful people organize, preserve, and manage their wealth, allowing them to focus on what they are most passionate. How do we accomplish this? It begins with you.

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