

ADDING VALUE

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Eliminating Catch-22 Situations

As you breathlessly await words of wisdom from our firm about the current stock market situation, we can only implore you to 1). Stop worrying about the stock market and the HPA implosion, and 2). Worry about HIPAA instead. Let us explain. . . .

If we wanted to improve substantially the productivity of the U.S. economy- and certainly the productivity of investors- the most effective step we could take would be to prohibit all efforts to forecast market movements. Far more time is wasted in futile efforts to predict stock market moves than in any other activity- and far more money is lost by investors than is gained by their market forecasting attempts. Furthermore, we know from long experience that investors who try to play the in-and-out game are far less happy with their investments and far more prone to queasy stomachs than those who buy and hold good stocks for the long term.

First, let's examine realistically what we know for certain about equity investing and what we do not know for certain.

The most important things we know for certain are that:

1. Over the years, economic activity grows as the population expands and the productivity of the workforce improves;
2. In that environment, sales, earnings and dividends of successful companies grow; and
3. The value of those successful companies rises in close parallel with their earnings and dividend growth.

Now, stock prices do not advance in lock-step with earnings and dividend growth, because swings of investor mood cause fluctuations in prices above and below the uptrend in any company's inherent value. However, earnings and dividend growth

constitute a very powerful magnet over time, pulling stock prices upward. If you look at any long-term stock price chart, you can see how closely the trend of stock prices follows the trend of companies' earnings and dividends.

The next important thing we know for certain about the stock market, although we don't often want to admit it, is that the stock market fluctuations are basically unpredictable.

During our investment management tenure of 35 years, there have been about 10 bear markets. Every one was triggered by some unexpected development- something no one could have predicted.

Here are some examples:

- In 1973-74, the market dropped 50% when inflation nearly quadrupled from 3% to 11% in just two years, an event totally unprecedented for over a century.
- In 1990, the averages slumped 20% when Saddam Hussein invaded Kuwait.
- In 1998, Russia's currency was devalued resulting in a meltdown in Long-Term Capital Management, an event that almost brought down the banking system.
- In 2000, there was the rupture of the Internet Bubble.
- In 2001, there was 9/11, an unpredictable terrorist attack on the USA.
- In 2008, there was implosion of the House Price Appreciation (HPA) theory, another unprecedented event.

It is true that prior to each of those declines the stock market had risen to a relatively high valuation level, which made it vulnerable to unexpected bad news. But in every case, before the slump, valuations had been high for three, four or five years, and the market had sailed serenely onward.

So, history shows that stock market declines are totally unpredictable in terms of timing. They are also unpredictable in terms of magnitude.

Another important fact about bear markets is their relatively short duration. In general, the average time span of these market drops has been just 8 months and that typically 75% of the declines have been recouped in only 7 months- while a full rebound, on average has come in just over one year. (For those extreme pessimists, the worst contemporary period was the 1973-74 recession which experienced a 48% decline that lasted 21 months; it took 20 months to recover 75% of the decline and over 64 months to recover 100% of the decline.)

Another fact about the stock market is that most of the advance in stock prices over the long term comes in very short bursts. According to a University of Michigan study, 95% of the cumulative gain in the market came in just 1.2% of total trading days during an analyzed period of 1963-1993. If investors had missed those 90 days out of the entire 7,500 trading days, their total return would have been only one-half that of Treasury bills over the 30-year period.

It is also a fact that many of the strongest upsurges in the market have come off of bear market bottoms, when doom and gloom has been pervasive and almost no one had had the courage to buy. Consider the following: at the start of the great bull market in 1982, from August to October, the market soared 42%; from the deep October low in 1974 to the end of January 1975, the market surged 26%; from the October crash low in 1987 to the end of December of that year, the market rebounded 22%; and in the four months after the October 1990 Gulf War low, the market spurted upward 31%.

Trying to pour cash into stocks when the bell rings at bottoms is virtually impossible: first, because no one rings a bell; and second, because very few have the courage to buy heavily in the scary environment that accompanies market lows.

So all the facts of history show that the greatest risk to investors is not being *in* the market when it is slumping; rather it's being *out* of the market when it surges upward. The reason for this, of course, is

the powerful uptrend in the market which we discussed initially. Emotionally, this is a real Catch-22. We *think* we know how to avoid the bad news and we *think* we are prescient enough to call the bottom. Factually, from all the market timing studies we have seen, market timers have achieved at least one quarter less in total returns than long-term holders of stocks. That sounds bad enough, but if you compound a 25% differential in annual total returns over 25 years, you end up with 45% less money.

So after this long discussion, if you are not going to sell stocks today, what should a sensible person do?

First, make sure you own good quality stocks, the shares of strong companies in businesses with good profit margins and favorable growth trends. Second, make sure that the stocks that are owned have realistic valuations relative to the market and their own history. Third, recognize that behind every piece of paper we call a stock is a living, breathing company- a business that, if you have made a good selection, is growing its earnings and dividend just about every year, and therefore is becoming more valuable every year. Fourth and importantly, bear markets are really the long-term investor's best friend-because they produce great bargains. Even if you don't have cash squirreled away to buy more stocks when prices get cheap, you can make advantageous switches to upgrade your portfolio to those truly excellent companies that become reasonably valued only in such down markets.

Most successful investors that I know are realistic optimists. They are realistic about the vicissitudes of the stock market and especially about the wide fluctuations in investor psychology. And they are realistic about their inability to forecast market swings. A realistic optimist successfully navigates the Catch-22 periods of investing.

Now, let's talk about the Catch-22 of the federal Health Insurance Portability and Accountability Act (HIPAA) of 1996, especially as it regards medical powers of attorney and other estate planning documents. HIPAA was enacted to protect your personally identifiable medical information from unauthorized uses or disclosures as it moves through the medical and insurance systems. The act actually

permits providers to disclose certain personal information such as name, general condition, religious affiliation, and location in a facility to family members, relatives, friends, or to others whom the patient identifies. The providers only need to obtain informal permission from the patient, either verbally or by allowing them an opportunity to object. Sounds reasonable, so where's the catch?

As many of you know, my father was rushed by ambulance to the hospital with a hemorrhagic stroke on February 23 and subsequently died on February 29 (probably so that we had to remember this atrocity only every 4 years). Here's the horror story that we encountered. First, one major problem created by HIPAA is its impact on planning for incapacity. Most clients have estate plans that provide for someone else to manage their affairs or make health-care decisions for them if they are unable to do so themselves. This would include their successor trustees of revocable or irrevocable trusts, agents under any financial powers of attorney or medical powers of attorney. A common structure is for these powers to spring into effect upon the incapacity of the individual, as determined by a physician's certification.

The onset of my father's stroke occurred at about 1:15 p.m. He was transported and arrived at the hospital by 1:40 p.m., a laudable and prompt delivery. However, under HIPAA interpretations by both the ambulance company and the hospital, stroke victims are categorized under a pseudonym so neither the ambulance company would admit that he had been transported, nor would the hospital admit that he was delivered. It took over 3 hours for his family to find him, essentially negating any of the speed of delivery to the hospital. Because it was a hemorrhagic stroke, none of the clot busting drugs are effective. Instead, for the 3 hours that my father was in the hospital by himself, the doctors performed CAT scans and evaluated the massiveness of the bleed. When we were finally able to see him, we were given about 5 minutes to make a decision to consent to an operation to relieve the pressure on his brain from the hemorrhage. We did do this and he survived the operation, but not the effects of the stroke.

After the operation and in the ICU Unit, we encountered the second of the series of Catch-22 provisions of HIPAA as interpreted by a very overzeal-

ous hospital staff. No physician would certify to my dad's incapacity, saying that it was a prohibited disclosure of private medical information. Further, my dad's power of attorney was locked in his house, which was protected by a security system. My dad had not revealed his security code to his children and the company refused to disclose it to us. In fact, we were told by the Chief of Police in his jurisdiction that if we attempted to enter his house, we would be arrested for breaking and entering. So, a deteriorating situation gets even worse. In essence, the person named to act as agent for the individual is prevented from assuming the role because they cannot produce the document (it's locked in the house), and since the individual is incapacitated and the physician refuses to sign a notice of incapacitation (the hospital per the General Counsel stated that this is a conflict of interest for the medical institution), the patient remains truly incapacitated and therefore cannot give permission in any way: well, it's a classic Catch-22 if there ever was one.

But, it gets worse. The living will or advanced medical directive that many clients have describes what kind of medical treatment they want or don't want and who they authorize to make these decisions for them. However, these documents seemingly do not become effective until the individual is certified as incapable of making their own decisions. The preliminary (before incapacity is determined) authorization to release medical information to the named person seeking to act as agent under these documents is very important. Without this preliminary authorization, the beneficiaries, or the successor trustee, etc. might have to petition the court for the appointment of a guardian, who could then give the representative access to information to make the determination. This is an expensive and time-consuming process. And again, not a problem to deal with at a time like this.

In our situation, despite numerous phone calls to the PCP (who was on staff at the hospital), we were unable to get (or they were unwilling to give) any information about our father's prognosis. Therefore, no one asked us, not once, what my father's wishes were regarding any advanced medical directive. We reached the end of this stand off when a new 23-year-old nurse and a reasonable ICU medical director agreed to talk to us. Based on a short conversation on prognosis and an equally short expression

of my father's fervent wishes, we removed him from all life support systems. He died within 5 hours.

However, the story still doesn't end with my father's death. Security at the hospital had removed my father's possessions at admission. They would not release his possessions (including glasses and dentures) even after his death without a power of attorney (which was obvious to us was never going to happen). We waited at the hospital for over 3 hours calling any administrator-on-duty at any affiliated hospital to get this policy overridden. Finally, we were escorted from the hospital by an armed guard because, after almost 12 hours in the hospital and having witnessed my dad's death, we were "getting agitated".

So, after the second long discussion of this newsletter, what should a sensible person do?

First, it seems as having possession of an original HIPAA-compliant authorization (please note that these are not standard documents) that grants preliminary authorization (before incapacity is determined) and has no termination date eliminates most

question of the providers cooperating with the named agent. Second, make sure that you have the original documentation for any adult (including parents and unmarried, adult children over 18 years of age) in your immediate accessible possession. (A process we are in the process of rectifying as soon as possible). Third, recognize that behind every piece of paper that you provide may be a living, breathing bureaucrat that may be incapable or unwilling to use their brain to read the document.

In summary, we live in a world that is unpredictable in terms of timing and in terms of magnitude. Life does indeed come at you fast. Actually, it is easier for us to deal with the vagaries of the stock market than to deal with the vagaries of zealous, sanctimonious bureaucrats. So while we are of utmost faith that the stock market will improve and continue its upward trajectory, we are not so sanguine about the healthcare bureaucracy.

Sincerely,

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