The C&A Advantage

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<u>Porsche Driving School is Back for 2016</u>: We are thrilled to be conducting our one-day tax update seminar again in Birmingham, AL. The seminar will take place on September 16, 2016 at the beautiful Renaissance Ross Bridge Golf Resort and Spa. The seminar will follow the two-day Performance driving school at the Barber Motorsports Park outside of Birmingham, AL, September 14-15. The Performance course is Porsche's introductory, though exhilarating, driving course. The seminar will precede the two-day Masters driving course, September 17-18, which is the level 2 course for anyone who has already taken the Performance course. The idea is that everyone will attend the seminar on day 3 but attend one of the driving courses prior to or following the seminar. See the supplement that is enclosed with this Newsletter for more information. **This is a bucket list trip!**

<u>So This is What a Stock Market Correction Feels Like!</u> After four years without a 10% correction, investors have become lulled into thinking that the stock market only seems to go up. Well, not so fast. On Friday August 21, the Dow was down 530. On Monday, the market opened down another 1,000 points yet ended the day down "only" 588. At this point, the 30-stock Dow Jones Industrial Average and the broader S&P 500 are off 14% and 12% from their May 2015 highs. The immediate concerns are the devaluation of the Chinese Yuan, slow worldwide economic growth and the ongoing drop in oil prices. The immediate catalyst was the Chinese devaluation, an attempt to revive a slowing economy. It will make Chinese exports more attractive to foreign buyers (good for China) but will imports more expensive (bad for the rest of the world).

Here are our thoughts on the recent volatility, which should not come as a surprise to long-time Newsletter subscribers and seminar attendees. [*EDITOR'S NOTE: What follows is not meant as investment advice for any individual. Each reader must do independent research and consider his or her own situation and act accordingly.*

(1) Volatility is Great in the Right Setting - We do not usually equate volatility with risk. Unless the time horizon for when we must sell an investment is short (say, less than five years), we actually welcome volatility.

Here is why. First, we don't complain about volatility to the upside. As to sharp price drops, if we are long-term investors in quality companies and we have a basic understanding of

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the underlying values of the businesses we own, then falling prices are a wonderful thing. Falling prices give us a chance to buy additional shares of companies we want to own more of at fire sale prices. Nothing about these fine companies has changed except the lower prices we get to pay to increase our ownership. We all saw that first hand during the 2008 stock market crash and the subsequent rebound. Back then, we often said something along the lines of, "While we don't have a crystal ball, we expect that ten years from now, this will end up being a wonderful time to be buying stocks." We were only wrong in that we didn't quite know **how wonderful** a time it actually was.

With a substantial amount of our family's combined investments in three companies like that, the current volatility has been easy to tolerate. The other thing that makes this market easy to take is that the total portfolio value has been hovering near its all-time high. The three companies included here are MasterCard (credit cards), Henry Schein (dental supplies and equipment), and Berkshire Hathaway (diversified conglomerate but primarily insurance). We own a number of other wonderful businesses, which we usually mention in the Newsletter, though they comprise a much smaller share of the overall portfolio. In some cases, these are newer purchases, and in other cases, they have simply not grown at the rate of the big three.

(2) Volatility is Scary in the Wrong Setting A distinct minority of the family portfolio is invested in a handful of more speculative companies (generally technology and biotech companies). Unlike MasterCard, Henry Schein and Berkshire Hathaway, we do not understand their businesses or the forces that impact them, nor do we have the capacity to judge the odds that competitors will overtake them. Thus, we have bought these companies out of nothing other than pure greed and envy. Not having the same comfort level in the technology companies that we have in the others, we've found our reaction to market volatility was also different.

With prices falling on our core holdings, we aren't thinking about selling. Rather, we are preparing to buy more. But, we are concerned that the aggressive growth stocks that have been driving up the markets may begin to nosedive. This is the same feeling that most investors felt in 2008. If their portfolios were largely comprised of speculations or companies they didn't understand when they bought them, then large drops caused them to panic, sell at the bottom and miss out on the eventual rebound.

(3) The Lesson to Us is Clear - We Should Continue Being Long-Term Investors in Fine Companies and Not Worry Much About Market Volatility - By that we mean investing in companies with strong economics driving their businesses, with top managements (who are shareholder friendly), and with stock prices not already too high when we do invest. If we understand their businesses and have a sense of their underlying values, then falling prices aren't scary - they are an opportunity. If the prospects and management of the businesses haven't changed, the market may have dropped the price of the stocks, but the intrinsic values of the businesses haven't dropped. Eventually, the market will value a company's stock in line with the growth of its business. **There is an old Wall Street adage: "Fortunes are made in bear markets and realized in bull markets."** And look at it another way, if you believe in the notion of "buy low and sell high", you cannot do that if prices never get low.

The problem is that most people invest with their emotions and are too afraid to buy when prices are low. They let greed bring them in near tops and let fear drivethem out near bottoms. By owning strong businesses that you understand and that have fine and friendly managements, it's easier to remain calm and avoid panicking in volatile times like these. Good luck.

This Year's Investment Seminars: At this year's meetings, we will show **how to analyze whether a stock investment is a good value**. That is a particularly useful skill at times like these. **Emphasis will also be placed on how an investor can determine his or her optimal mix of investments (the asset allocation decision) and how it changes over time**. These seminars will be held in **New York City**, December 4-5 and **Chicago**, December 11-12. The New York and Chicago meetings often sell out, and early registration is recommended to

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avoid being disappointed. Most attendees are repeat attendees. Why? They return because they learn, and the meetings are profitable. If you are interested in attending any of these enjoyable seminars, call our office right away for registration information **(toll-free at 1-888-888-4840)**.

Chase Properties, Ltd. is Starting a New Real Estate Fund: Stuart Kline, President of Chase Properties, Ltd., spoke about real estate as an investment at our conferences in Chicago and New York last December. Stuart has been in the business of developing and buying shopping centers in small towns for the last 42 years, typically achieving higher yields than could be obtained in large metropolitan areas. A few years ago, he started a Fund format to allow outside investors to invest with his firm in new acquisitions. In the interest of full disclosure, we have invested with Stuart in his second fund. He has just started discussions with prospective investors for his third Fund. **We are not actively recommeding that anybody invest in this fund, but are responding to many seminar attendees' requests to mention the next fund in the Newsletter.** If you are interested in receiving information, you can call Stuart at 216-464-6626, or email at skline@chaseprop.com.

Financial Illiteracy: According to findings from an organization called the Global Financial Literacy Excellence Center (no joke), we are a nation of financial illiterates. The good news is that the rest of the world is about as illiterate. The bad news is that women are more financially illiterate than men. In the U.S., only 38% of men and 26% of women answered the following three questions correctly:

1. Suppose you had $100 in a savings account and the interest rate was 2% per year. After 5 years, how much do you think you would have in the account if you left the money to grow? (a) more than $102, (b) exactly $102, or (c) less than $102

2. Imagine the interest rate on your savings account was 1% per year and inflation was 2% per year. After 1 year, how much could you be able to buy with the money in this account? (a) more than today, (b) exactly the same, or (c) less than today.

3. Please say whether this statement is true or false. "Buying a single company's stock usually provides a safer return than a stock mutual fund."

What explains these poor results? After all, it's not that compound growth (question 1), inflation (question 2) and diversification (question 3) are difficult to comprehend. The likely answer is that most people just aren't interested enough in learning these concepts – much to their detriment. And, if anything, women should be more astute financially than men considering their need to make their money last over their longer lifetimes. People who aren't financially literate don't understand how investments and markets behave and fall prey to the unscrupulous high-commissioned salespeople promoting life insurance as an investment, annuities and expensive actively managed accounts.

New Tax Return Filing Deadlines for Businesses for Tax Year 2016: As part of the re-authorization of the federal highway trust fund, Congress is tinkering with the business filing deadlines. For tax years starting in 2016, **partnership tax returns** will be due March 15. This is one month earlier than the current rule. Remember, these are for tax returns that won't actually be filed until 2017. The deadline for partnerships and S corporations will now be the same. This has been in the works for a while, and the purpose is to give CPAs time to transfer data from the partnership K-1s onto the 1040 tax returns of the partners. The 1040s will still be due on April 15. The due date for **C corporations** will be pushed back one month to 3-1/2 months following year-end (April 15 for calendar year C corporations). There is an exception for C corporations with a June 30th year-end. For them, the old 2-1/2 month deadline will continue to apply.

Partnerships and S corporations will still be able to request a six-month extension out to October 15, and C corporations will be able to request a five-month extension.

Using Your Rental Home as a Tax Shelter is Difficult Under the Tax Laws, But Under the Right Circumstances, It Can Work: The 1986 Tax Act cleaned up most of the aggressive and abusive tax shelters, but it's still possible

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in some cases for a taxpayer to use the losses generated from their rental properties (depreciation being a big one) against the ordinary income they generate through their practices. Otherwise, the rental losses can only be used to shelter rental income.

Here are the two requirements that **both** have to be met: (1) you or your spouse must qualify as a "real estate professional"; **and** (2) you or your spouse must "materially participate" in managing your rental properties.

To be a real estate professional, you must pass two sub-tests: (a) you spend at least 750 hours per year in real property trades or business in which you materially participate; and (b) you spend more than half of your total working hours in these activities. If audited, you should definitely expect to have to document your hours, so keep accurate records of your time spent on your real estate activities.

Material participation means actively managing the property: If you own a rental property and turn the day-to-day operations over to a third party management company, then you won't meet the material participation test. Your limited hours spent on reviewing the property's financial operations cannot be counted as hours spent towards material participation.

To qualify as material participation, you must be doing real work like advertising, soliciting renters, mowing the lawn, decorating, obtaining insurance, etc. If you are doing these things, then your hours spent reviewing the property's financial operations (the kinds of things a passive owner would be doing) can also be counted towards your hours of material participation.

A Bonus System That Could Work in Your Practice: We have several concerns when it comes to instituting a staff bonus system based on collections or sales. The main concern is whether it will make their collections or sales tactics too aggressive and alienate patients. Another concern is whether the practice's financial information is really the staff's business. Finally, a bonus system is like a contract. Once you've agreed to it, it is difficult to extricate yourself from it if you don't think it's working. We have seen several collection-based bonus arrangements, but the following one seems to be the best mix of rewarding the staff and not alienating patients.

The arrangement would work as follows: The year is divided into three four-month measuring periods. (Annual or semi-annual periods seem too long to make the staff wait, and monthly measuring periods can exacerbate high pressure collection tactics and will be more of a pain to manage.) The doctors would set a collection goal for each month during the 4-month period. Then, collections would be tracked for each month. If, during this period, collections are above the goal for two months, below the goal for the other two months, but net positive overall, then there will be a bonus for that period. The bonus would be 20% of the overall excess amount, and it would be allocated among the staff in accordance with their relative base pay on the theory that the higher paid employees are more responsible for the increased collections. 25% would work too, though it's obviously more generous. If during the 4-month period, the collections are net negative, then there would be no bonus.

How to reduce the incentive for staff to sell services? First, the employees are not getting a bonus for every teeth whitening service or mouth guard they can sell. Instead, the practice will use a conservative approach to diagnosis (never be perceived as selling), present the patient with their different options and let the patient decide. Once they choose their course of treatment, finances are discussed, and there are no surprises. The practice performs the treatment, the patients know what they owe, and the collection effort goes smoothly.

Finally, from the "if you don't ask you don't get" department, the staff might **politely** ask if the patient would like to pay the entire fee at the beginning. You will be pleasantly surprised with the number of patients who agree to do this. Those who don't will agree to pay at the next appointment, and at the next appointment, they come in expecting to pay.

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