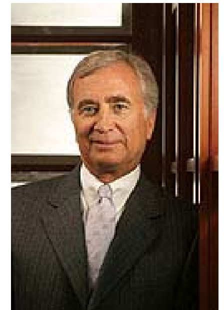
Roffman Miller Review

A Quarterly Newsletter from Roffman Miller Associates

Happy New Year!

So many things have happened in the economy and the markets around the world during the past year that I feel like I could fill a book with everything I've observed. In the end, the Dow Jones Industrial Average advanced 22.7% for the year and the S&P500 gained 26.5%. If you are like me, though, you are now less interested in what happened over the past year than in what is *going* to happen in 2010. Of course, if you were expecting this letter to contain everything that I am certain will happen in the new year, its going to be a very short letter indeed.



Around this time each year, the finanical press is filled with ideas about what could or should happen over the coming twelve months, followed by details of how to take advantage of whatever the circumstances. Where to invest now? Domestic stocks? International? Growth? Value? Perhaps real estate or hard assets? The reality is that no one can reliably predict the future. Experience, however, is a great teacher. Experience teaches us that certain events usually follow others. It also teaches us that unforseen events such as oil shocks, politial coups, terror attacks, bank meltdowns (and subsequent bailouts) can have a severe impact on the markets in the near term but they can not be modeled in the traditional sense. Based on what I've learned over my career, it is best to begin with a sense of what could happen in the future (let's call it a 'base case' scenario) and then invest to take advantage of all of the best possible outcomes, balanced with a conservative approach to improve your chances of surviving the worst, and sometimes unforeseen, outcomes. Given the many things we discuss that may occur over the coming years, here are four that will have a great impact on how we invest:

> *Stocks outperform bonds*
> Dividends are currently competitive with bond yields, corporations have slashed expenses, and stocks could reverse the decade long trend and outperform high quality fixed income for the next five to ten years
>
> *Taxes go up*
> While it might be considered a roadblock to economic recovery if taxes were raised today, eventually 2009's bills must be paid
>
> *Inflation returns*
> Maybe not to any great degree in 2010, but we must be prepared for some re-flation if and when employment and wages improve
>
> *The power in Congress shifts*
> Whenever bold decisions are made, as they were in 2009, the opposition's base becomes motivated to change the decision makers

One thing we can all rely on each year is the need to file tax returns. Towards the end of January, Roffman Miller will mail each client a summary of realized gains and losses for taxable accounts. This summary will help your tax professional to complete the 1099 schedule D. 1099s from brokerages will be mailed by February 16.

If you are still interested in a book about what happened in 2009, I'm sure plenty of them will be hitting the store shelves soon. In the mean time, please consider scheduling an appointment to come and meet with us to discuss your investments for 2010 and beyond.

-Peter Miller

8 January 2010
2k10 Volume 1

Goals

By Mark Frombach

What a difference a year makes. Just twelve short months ago, it was widely reported that the U.S. was plunging head-first into the second coming of the Great Depression. Lacking confidence and feeling illiquid, investors sold nearly every asset class down to multi-year lows. Today, as the calendar reflects the beginning of a new year and a new decade, many investors are taking the recent market rally as an opportunity to look backwards and check the performance of their mutual fund or money manager against the common stock indexes. By necessity, I am a student of individual investor behavior and this is a classic move by investors who will focus more on 'how they did' than on a) whether or not their goals were met and b) what they learned that may help them in the future.

Investment goals come in many forms. Take for example one investor, we'll call him Investor A, who began 2008 with the simple goal of beating the market. I will save space here on the debate over what constitutes 'the market' and just assume our investor is referring to the S&P500 Index. So after beating the market by, let's say, 2% in 2008, investor A then has only 65cents left for every dollar he invested. Is he satisfied? Clearly, he met his goal of beating the market. On the other hand, a 35% loss is quite disappointing, and our investor may begin to wonder if he set a reasonable goal. Other goals such as 'saving for retirement' or 'withdrawing 5% each year without running out of money' are also very common. If you set your goal and began investing in January 2008, at some point over the past two years you probably thought you had done something wrong. On the other hand, if you started in early 2009 you may be looking back and thinking you are a genius. The lesson here is that our goals can be more complex than we think. They are loaded with constraints, they change over time, and they're subject to our own emotional highs and lows.

I was asked many times in January and February of 2009 why we were not doing a lot of trading or re-positioning in response to the then current economic crisis. Most of the time, and I am generalizing here, my response was that our positioning for crisis is largely done ahead of time and that is what allowed us the confidence to go forward in early 2009 without a lot of sudden moves. Having goals defined and prioritized helps – for example if a certain amount of cash is required from a portfolio each year, investors need to establish that source of liquidity first and then think about the longer term goals. If the two don't work in harmony, then some sort of compromise must be struck.

Clearly, the recent crisis could have been worse. On the other hand, although we expected some sort of post-crisis rally, the speed and magnitude of the markets' return was astounding. Much to Peter's point on the previous page, investors do need to have a sense for history, and take heed of the years of experience already recorded on Wall Street in order to avoid repeating the mistakes of the past. Many of the best lessons of the past take the form of adages, some of which I have shared in previous newsletters. Last year I began to write down the many lessons I was reminded of, lest we forget them going forward. Here is a sampling:

- Diversification is not a dead concept, but neither is it a magical shield that will save you in a falling market.
- Markets do have floors; it is when they seem like they don't that a bottom is typically reached.
- Both common stocks and gold may be good long-term hedges against inflation, but one must be careful of what you pay and always remember that one has earnings power and the other is just a shiny metal.
- Quantitative economic forecasting models will always miss something because it is impossible to quantify human behavior. As a corollary, you can't model for government intervention. In other words, sometimes the entire crowd rushes for the exit just because that's what the person in front of them is doing. At other times, when the numbers all indicate that a company or industry is going to collapse, the lender of last resort can come in and save them.
- Watch the money flows. If a large percentage of investor dollars has been flowing into __________ (fill in the blank) over the past two years, it's probably not a good idea for you to start investing in _________. The crowd is not necessarily wrong, but is usually late.
- Look at historical metrics when evaluating companies' securities. Measure value relative to today's peers and to a securities' own history; look at absolute ratios (like price/sales) as well as those that can be more subjective (like price/earnings).
- Write down your goals and share them with someone. You'll have a better chance of achieving them.

Hopefully, throughout the crisis, we've been able to provide some valuable assistance in establishing and staying on track for your individual goals. And, hopefully, this is the last newsletter for some time where 'crisis' is a key theme – it is time to put the past behind us, learn from it, and go forward and reach our goals.

Fixed Income Corner

By Ryan Crooks

The theme for the fixed income markets in 2009 was the same as the stock market, which was the reversal of investors' extreme risk aversion of the previous eighteen months. Typically, investors' first timid steps toward once again taking some risk to achieve return on their capital is in the corporate bond market. Many fixed income investors made the move into corporate bonds as a necessity as money markets rates fell to near 0%, and CD's no longer offered the attractive risk-free yields that they did when banks were at their most desperate to attract deposits and repair their own balance sheets. Also, many equity investors who still bared the scars from the stock market collapse used corporate bonds as a stepping stone before once again taking on the full brunt of equity market risk. This is partly why corporate bond spreads can be such a strong leading indicator of future economic and market performance.

Fixed income mutual funds saw record amounts of cash come into their coffers as they went to work buying bonds and driving down yield spreads which were at record levels following the banking crisis. As faith replaced hope for a continued rebound in the stock market, investors committed more money to both stock and bond markets. The cycle of risk *assumption* among the different investor classes continued through to the end of the year where corporate bond spreads remained at dramatically improved levels from 2008 (*Editor's note: that translates to, "buyers drove the prices of bonds up"*). According to the Merrill Lynch U.S. Corporate & High Yield Master Index, corporate bond spreads narrowed to 288 basis points (2.88%) over comparable treasuries from 804 basis points at their most stressed levels earlier in the year.

As far as they have come, there is still room for spreads to tighten even further as corporate issuance slows after a record amount came to market in 2009, motivated by historically low rates and government incentive programs, corporate balance sheets improve and treasury issuance continues to expand drastically. As good as this prospect may seem, it will create challenges as well. Primarily, ours will be to manage credit risk in an environment that may not adequately compensate us for it while also capturing market returns and meeting client income needs. With that in mind, we will continue to keep portfolios diversified by industry and company, make sure an adequate premium is offered for taking on credit risk, use alternative fixed income products where warranted, and balancing position sizes relative to the individual portfolio. *Ryan is an Investment Manager with Roffman Miller*

FDIC Insurance Coverage Update

By Paulette Greenwell

FDIC insurance used to be something my generation never really thought much about – you'd always see the bank tagline, 'Member FDIC', but since everyone was a member what was special about it? The housing crisis of the late '80s and the most recent bank crisis both brought back into focus the need for maintaining confidence in the banking system.

As a review the FDIC – or Federal Deposit Insurance Corporation – is a U.S. Federal Agency that protects depositors against loss in their deposit accounts if their FDIC-insured bank fails. The FDIC does not insure money invested in stocks, bonds, mutual funds, life insurance policies, annuities, or municipal securities, even if these investments were bought from an insured bank.

FDIC Insurance coverage limits for all deposit accounts, including checking and savings accounts, money market deposits and CDs are currently $250,000 per depositor (this includes principal and interest). This temporary increase (from $100,000) was set to expire in 2009, but has been extended to December 31, 2013. Coverage will then revert to $100,000 except for IRAs and certain other self-directed retirement accounts.

Investments available at Charles Schwab & Co. that are FDIC insured are bank Certificates of Deposit and the Bank Sweep feature. You can buy CDs from multiple banks in a Schwab account. Deposits at each insured bank are insured separately, so two CDs from two different banks but held in the same Schwab account are each eligible for the $250,000 per depositor limit.

If the cash feature in effect for the Schwab brokerage account is the Bank Sweep Feature, cash balances are automatically swept to deposits at Schwab Bank and are FDIC insured. Keep in mind that all deposits held at Schwab Bank are added together to determine your total amount of FDIC insurance coverage. (note: not everyone is currently using Schwab bank.. please call us to discuss the benefits)

FDIC insurance is based on certain ownership categories and depositors may qualify for more coverage depending on the categories. For more information or to use the FDIC's Electronic Deposit Insurance Estimator (EDIE) go to www.fdic.gov.

Paulette is an Investment Manager and Managing Director of Roffman Miller

All That Glitters.. is it really Gold?

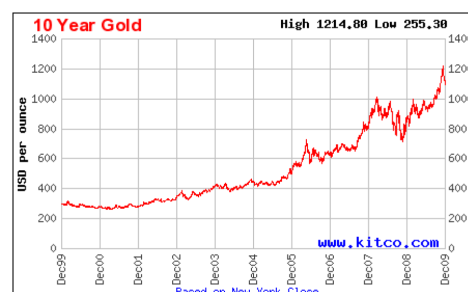
In times of economic uncertainty, some investors find comfort in gold. Throughout 2009, you undoubtedly saw and heard the advertisements indicating that gold is 'more than a paper investment' and 'never goes to zero.' What is an investor to do?

Consider the following: the price of gold did outperform the major stock indexes over the past decade, as the chart below suggests. Now think back to the last time that happened, the 1970s. When gold ultimately peaked at around $850/oz in January of 1980, how many excited buyers could have expected they'd have to wait 28 years, until January 2008, to break even?

Gold, unlike the part-ownership of a corporation that common stock represents, has no output. No sales, no profit margin, no expenses to cut, no net income. No management, for that matter. Gold has value simply because humans assign it value. It doesn't have nealy the industrial demand of silver or some other precious metals. But it is beautiful, and humans have clung to it for centuries.

The growing middle classes of India and China represent a long-term demand for the yellow metal. But think about where the real buying pressure might be right now – if you were a central banker of any country and you could simply print money, *for free*, and then buy as much gold as you wanted, wouldn't you? Some analysts believe this upward pressure on the price of gold will drop quickly when it is no longer acceptable for governments around the world to continue to print money in the name of crisis-aversion.

Many of todays investors are choosing gold ETFs as the vehicle of choice for buying gold, rather than buying the one ounce American Gold Eagle coin, the form of boullion from the U.S. Mint. We always advise prospective gold buyers to buy a few coins, hold them in your hand, keep them for a while, and see if you are really comfortable buying gold. One drawback to this is that the coins are only available through a network of dealers, selected by the Mint, at what amounts to a 10-25% premium over the actual price of gold. So for every coin you buy today, someone is pocketing $125 or more. Exchange traded funds are a more efficient place to buy, and they'll also store your gold (for a fee). A concern there is what happens when the gold market turns and the sellers outnumber the buyers?



No matter what the investment, sentiment has always turned negative at some point and the usual consequence is falling prices. The largest gold ETF holds about $40billion worth of gold, or about 3 years worth of global mining production. If the hype over gold recedes, how will they sell 3 years worth of gold into a market that lacks buyers? By lowering the price, of course.

They say that all the gold ever mined would roughly fill two olympic-size swimming pools. Seems silly that we make such a big fuss over just that. We're not saying that it is inherently good or bad to own gold, just be careful what you pay.

Thank you for all the feedback from our 2010 holiday card! Many of you indicated that we should have pointed out who's who, so here you go…
In the back, from left to right
Susan, RaRa, Jennifer, Ryan, Tucker, Tish, Lori
And in front
Paulette, Bob, Peter, Mark

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