Roffman Miller Review

A Quarterly Newsletter from Roffman Miller Associates

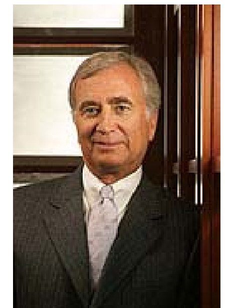
They say that ‘the market climbs a wall of worry.’ If that’s the case, then according to what I hear on the news the market should be skyrocketing.

The reality is that the market, which began 2010 with gains reminiscent of late 2009, turned downward in the second quarter. The Dow Jones Industrial Average finished the quarter down 10%, giving back all of the first quarter’s gains and then some. The S&P500 gave back about 12%, its worst quarter since 2008. For comparison, the EAFE Index (Europe, Australasia, Far East) fell over 13%.

Several of my letters from the past few years have highlighted the sources of fear that investors contend with. This quarter we add to the list:

- The future of the Euro zone
- BP oil spill and its implications
- Flash crashes

There is always something to worry about – it’s the nature of investing, and it shouldn’t be all that unfamiliar to those of us who have been around for a while. In the 1970s, we had, among other things, two oil crises and an onslaught of anti-US rhetoric coming out of Iran. In the ‘80s, there was a double-dip recession, Black Monday, and the junk bond debacle. The ‘90s brought the first World Trade Center bombing, and currency collapses in Europe, then Latin America, Asia, and ultimately Russia, the latter of which proved to be the final straw in the spectacular collapse of Long Term Capital Management, one of the most ‘successful’ hedge funds of the time. The new century has brought us renewed fear in terrorist attacks, bank failures, and high unemployment.



Peter Miller
President

Currently, the overwhelming news focus on these negative events has driven more and more investors into the perceived safety of bonds, and, in particular, US Treasury bonds. As of this writing, the combination of economic woes and Treasury bond demand has driven the yield on the 10-year Treasury down to about 3%. For investors who are looking for cash flow, there are many companies today that pay dividends of 3% and greater. And while there is obviously more *risk* in choosing a portfolio of stocks over treasury bonds, there is a potential *upside* as well – over a ten year holding period, we believe that these companies will raise dividends thereby increasing your cash flow over time, something most bonds won’t be able to do. Additionally, there is the opportunity to participate in the appreciation of the value of the companies should the economic forecasts for the coming decade prove to be a bit on the pessimistic side.

If you are reading this letter, you are likely familiar with our investing style – we are here to meet *your* needs, which usually means including some fixed income to help provide for periodic withdrawals or because an all-stock portfolio is just not appropriate for your individual situation. But I believe some people are still looking at selling their stocks and replacing them with bonds. They are worried about all of those things mentioned above, and more. Our contention is that we can be selective buyers when there is worry in the market, as it gives us opportunity to seek better prices. And, when we return to a better time where there is nothing to worry about, that might just be the signal to sell.

If you would like to discuss our current views on the economy further, or to schedule a review of your portfolio, please give us a call.

-Peter Miller

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The 4 Percent Rule – What is the Right Amount to Withdraw from Your Retirement fund each year?

With stagnant incomes and roller-coaster investment returns over the past decade, individuals on the brink of retirement might wonder what became of all those "rules of thumb" affecting how they handle their nest egg once they walk away from their jobs. They're still there. But the question of how well they work comes down to the individual.

Chief among them is the "Four Percent Drawdown Rule" first revealed in the October 1994 issue of the Financial Planning Association's *Journal of Financial Planning*. William Bengen wrote that retirees who took out no more than 4.2 percent of their mostly stock-based portfolio in the initial year and adjusted their remaining portfolio toward a 60/40 split in stocks and bonds each year, that money could last an average of 30 years. That approach made Bengen's work a gospel in the financial planning industry.

But after this decade, which ended with the worst recession in 70 years, some experts are taking a new look at the 4 percent rule.

1990 Nobel Laureate William Sharpe of the Stanford Graduate School of Business reported last month that this particular rule can be harmful to many simply because of its level of risk tied to stocks and other assumptions including lifespan. He suggests that planners and investors need to do a better job of assessing client risk tolerance and consider more stable investment choices like TIPS (treasury inflation protected securities) among other low-risk options as a foundation for post-retirement drawdowns.

In other words, consider client risk tolerance and the content of the portfolio more, a standard percentage of drawdown less. In fact, Sharpe points out that investors actually risk wasting money by adhering to a percentage drawdown that actually could leave more money behind after a few good investment years – in essence, the annual strict drawdown concept could lower a retiree's standard of life unnecessarily.

So what do you do? You work on the big questions first, not the numbers, and the best time to do this is as far in advance of your retirement date as possible. Here are some conversation starters for key discussions you should have with your financial planner as well as your tax and estate experts:

Set a vision of retirement and revisit it every year before and after you're retired: If you've already been working with a good investment manager or financial planner, you might have already done this. But retirement goals change as most life goals do, so treat the subject organically. Talk about the fun stuff, but state your objectives for a post-retirement work picture if you want to create a new career or simply want healthier finances. Set your lifestyle expectations now and revisit them as necessary.

Track your working-life expenses for 3-6 months and examine how well your current retirement nest egg and other resources could support that spending: This is where your imagined vision of retirement becomes real -- or falls apart. A thorough examination of your current spending habits is a great first step in determining how realistic your preparation for retirement has actually been. It will also provide a picture of what else has to be done.

Consider worst-case scenarios: For many retirees, increasing healthcare expenses and the cost of end-of-life-care account for significant spending. As a result, many retirees may pay for expensive experimental treatments to fight disease or long-term home or nursing home care. Current statistics from AARP show that the average home health care aide makes $18 an hour and a private nursing home room costs $78,000 a year. While public aid picks up medical expenses for those who exhaust their assets in most states, most of us desire more than minimal standards of care. Health care reform is not even close to solving this problem, so it's time to plan.

Build a phased-in retirement: Many companies are becoming more open-minded about keeping older workers on the payroll or actually hiring more workers over age 60. Keep apprised of such opportunities and the skills it will take to take advantage of them – a successful phased-in or post-retirement work plan will require more than sensible financial planning. It may also require training and other personal investments, so keep your ear to the ground and always be ready to consider a fresh perspective on your value in the workplace.

*July 2010 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by **Bob Hofmann**, a local member of FPA.*

Related Facts:

- 64% of Americans over the age of 55 that were surveyed did not know that bond prices rise when interest rates fall (source: Michigan Retirement Resource Center)
- The number of active participants in defined benefit pension plans in the private sector has declined by 26% since 1990 while the private sector workforce has grown by 22% (source: GAO)
- The wealthiest 1% of Americans own 35% of the total net worth in the nation (source: Edward Wolff, New York University)
- 1 out of every 143 deaths in the USA in 2008 resulted in the payment of federal estate taxes (source: Bloomberg BusinessWeek)

Where are those higher interest rates?

By Ryan Crooks

Around this time last year and even just a few months ago, the 10-year Treasury bond traded around 4.00% and most headlines and media reports would have you believe that doing anything but rolling over very short maturity bonds or putting your cash in money market funds yielding just a few basis points would be disastrous for fixed income portfolios. Now, the 10-year is trading just above 3.00% and anyone having to reinvest those short maturities or considering deploying some of their money market funds, after realizing they can't live on the nominal interest provided by either, is faced with the prospect of buying bonds at rates lower than the ones they were unwilling to accept last year or considering buying longer maturity bonds that subject their portfolios to even greater interest rate risk. We continue to experience a very difficult rate environment for anyone trying to achieve some semblance of a 'reasonable' yield on their savings while also protecting themselves from interest rate risk, but it is also a good demonstration of why laddering bonds is so effective.

Mortgage Rates*	
30 Year Fixed	4.63%
15 Year Fixed	4.09%
1 Year ARM	3.20%
US Treasury Rates	
Two year	0.633%
Five Year	1.84%
Ten Year	3.06%
Thirty Year	4.04%

The fixed income market is like all others in that it can surprise everyone even when it seems there is but only one direction for the market to go. The extraordinary government stimulus and the strong market recovery over the last year had most believing that higher inflation and interest rates were only a matter of time. However, excess optimism and events like the European debt crisis, the gulf oil spill, the threat of war on the Korean peninsula as well as others have proven again that the dollar is the world's reserve currency and enjoys a flight to safety in times of uncertainty. Couple this global flight to safety with weak stock market performance domestically over that last couple of months and you can see how the 10-year traded as low as 2.93% at the beginning of the month. Despite how surprisingly low interest rates have gone, we do not want to be surprised again next month, quarter or year if unforeseen market conditions create an even lower interest rate environment. Laddering bond portfolios allows us to capture better yields in intermediate and longer dated maturities in this type of environment while still maintaining liquidity and controlling interest rate risk if and when the trend reverses.

Contact your portfolio manager or call me directly if you have any additional questions on how we go about constructing fixed income portfolios. RC

*Source: Bankrate.com, WSJ

Federal Debt Facts:

In June 2000, the US had about $5.6 trillion of outstanding debt ● That number now stands at $13.2 trillion ● Approximately $1.6 trillion in new debt was accrued over the past year ● Over the past twelve months, there has been a $1.5 trillion rise in outstanding Treasury Notes – the bonds that mature in one to ten years (with rates as low as they are today, perhaps the government should be locking in the long-term rates much like today's homeowners who are refinancing their homes, instead of accruing liabilities that will need to be refinanced much sooner?)

Where does the money go?

- 20% of the US Government budget, about $715 billion, goes towards Defense and related activities
- Another 20% will be spent on Social Security, providing an average $1,117 per month for 36 million retired workers (plus survivor and disability benefits for another 16 million people)
- Medicare, Medicaid, and CHIP, the three health insurance programs, will account for 21% - about $753 billion

Additional Facts..

- The size of the US economy at the end of 2009 ($14.3 trillion) was larger than the combined size of the 3 countries ranked 2-3-4 in the world. The collective size of Japan, China, and Germany was $13.2 trillion (source: International Monetary Fund)
- The size of the economy of Greece (approximately $350billion) is equal to that of the US state of Georgia (source: International Monetary Fund)
- The three summer months (June-July-August) have produced an average total return loss of 0.4% for the S&P500 index over the last 20 years. (source: BTN research)
- Using the Treasury Department's projection of $3.72 trillion of spending, the US government is anticipating spending of $10.2 billion every day during fiscal 2010.
- Americans are expected to spend $1.6 billion a day at restaurants and bars in 2010 (source: National Restaurant Association)

Company Visits

Below is a sampling of the companies we have visited (or have visited us) in 2010:

- DuPont
- Dow Chemical
- Aqua America
- UGI
- Medtronic
- Artesian Resources
- American Express

Have you heard? LeBron is going to Miami.

If that sentence doesn't mean anything to you, then I applaud you for your blissful detachment from NBA pop-culture. For the rest of us, though, who've been deluged with coverage of the biggest breakup of the year (LeBron and his hometown Cleveland Cavaliers), I have identified a small bit of solace in this overdone story: As the 25 year old phenom dominated the airwaves this past week, there must have been less time for the media outlets to cast doom over the economy and in the absence of bad press the stock markets found their way to a five percent gain.

As Peter alluded to in his letter, the news has a clear impact on how we think and act. Surely the news has always had an impact, but I believe that it is the way that news is *delivered* today that makes this period of time different from the past. It wasn't that long ago that news was delivered by tall sailing vessels which took weeks or months to cross the Atlantic. Later, riders on horseback were able to carry news across the states in just a matter of days. Then, the telegraph made transcontinental news almost instantaneous. Once we had the ability to move news across the country without delay, the last challenge was what the communications companies still refer to as 'the last mile.' It is basically the issue of getting that news (or today, data) into homes and the hands of consumers. Newspapers were printed daily and sometimes several times per day, and eventually radio and television became a preferred method. Early television news, though, resembled the telegraph – the message was short and to the point, and when it was over it was over.

Which brings us to today, the era of not only multiple 24-hour news networks but also multiple *delivery systems* for the news (TVs, PCs, satellite radio, smart phones etc.) that allow us to follow events any time, any place. The question I have is, "is that a good thing?" The answer is good fodder for a philosophical debate; our concern, though, is limited to how investors behave in relation to the increased exposure to the news.

CNBC isn't new, CNN isn't new.. neither are the Gulf oil crisis (another Gulf, another time) or the enigmatic Iranian leader bent on bringing the United States to its knees (see: Ayatollah, 1979). But more and more people than ever are exposed to today's rapid-fire headlines. The old theory was that this made the market more 'efficient', meaning that if more people had access to the news then stock prices, for example, would be closer to their 'true value' than they would be if only a select few had access to the news (i.e. all the news would be factored into the price). While that may still be accurate, my observation is that more news leads to more emotional swings by investors, ultimately leading to the classic investor mistakes (which are mostly emotionally driven). And while this is a bad trend for investors in general, we hope to help our clients profit by having more of a steady hand and a more rational decision-making process.

I will end on a positive note – when it seems like the news is full of nothing but economists making dire predictions about recession, national debt, etc, just remember that the weather also gets forecast every day, and how often are they right? **Mark Frombach**

PLEASE SAVE THE DATE!
The 2010 Making Strides Against Breast Cancer walk will take place on Sunday, October 10. Please mark your calendar and plan to join our team as we seek to break our previous fundraising record. The walk begins at the Art Museum of Philadelphia.

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