Outlook

A Quarterly Newsletter from Roffman Miller Associates

Happy New Year!

2010 was a good year for the stock market. After much turbulence early in the year, good news surrounding retail sales, manufacturing, and trade helped drive a rally in the final quarter. That, combined with the news of an extension of the Bush-era tax cuts lead to double digit gains in the Dow and the S&P for the second year in a row.

Now, as we enter 2011, optimism about the U.S. recovery continues to grow. Anecdotally, there are fewer headlines today than six months ago referring to the ñdouble dipò or the threat of our economy slipping back into recession. Most major banks, in fact, have raised GDP forecasts over the past few weeks.

Peter Miller
President

We believe it will be another good year for stocks. Yes, there will be unseen events like 2010ôs BP oil rig explosion, the ñflash crashò and the ongoing European debt crisis that roil the markets. But as 2010ôs results can attest, investors can quickly put short-term events behind them and focus instead on longer term opportunity.

Part of the tradition of welcoming in the new year is to look back at what weôve done in the past, and look ahead to those things we intend to do. Keeping with tradition, Iôve recently read through my 2010 letters to clients. I went back further, to 2009, and it was there that I was really struck by one of my letters. Many of you will remember that in the depths of the recent recession, we sent as a supplement to our newsletter a four-page letter to clients reiterating our premise on why we invest and stay invested, even through difficult markets. Markets like that test our patience, our will power, and our beliefs, and we felt it necessary to share our thoughts at the time on the market and the economy. It took four long pages. In the end, though, our convictions were only tested and not broken. Contrast to today, and the letter you hold in your hands which is, even by my standards, quite short. So the lesson is: bad times, long letters; good times, short letters.

Hereôs to a new year full of short letters.

-Peter Miller

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2010 Making Strides Against Breast Cancer Walk

The 2010 Making Strides Against Breast Cancer walk was a success! About 60 members of Team Roffman Miller walked the five-mile route. We ended the morning with brunch at Illuminare, raising over $4,000 along the way. We hope to see all participants return next year, and maybe a few new faces too.

Congress passes 2010 Tax Relief Act

Provides individual, business, and estate tax relief across the board

On December 17, 2010 President Obama signed into law the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010* (2010 Tax Relief Act). This sweeping new tax law includes a two-year extension of the Bush-era tax cuts, including extension of the current, lower individual tax rates and capital gains/dividend tax rates. The new tax law also includes a temporary estate tax compromise, as well as the extension of many popular individual and business tax incentives, an alternative minimum tax (AMT) "patch" for 2010 and 2011. Here is a review of the major provisions:

Individuals

Income tax rates. Among the most valuable tax breaks for individuals in the new law is a two-year extension of individual income tax rate reductions. The new law retains the current 10, 15, 25, 28, 33, and 35 percent individual tax rates for two years, through December 31, 2012. The new law also extends the full repeal of the limitation on itemized deductions and the personal exemption phase-out for higher-income taxpayers, through December 31, 2012.

Capital gains/dividends. The new law extends reduced capital gains and dividend tax rates for two years, through December 31, 2012. For 2011 and 2012, individuals in the 10 and 15 percent rate brackets can continue to take advantage of a zero percent capital gains and dividend tax rate. Individuals in higher rate brackets will enjoy a maximum tax rate of 15 percent on capital gains and dividends.

Marriage penalty relief. Married couples filing jointly will benefit from provisions designed to provide relief from the marriage penalty. For 2010, the standard deduction for a married couple filing a joint return is twice the single taxpayer's amount. The 2010 Tax Relief Act extends the increased standard deduction for married taxpayers for two years, through December 31, 2012. The 2010 Tax Relief Act extends the expanded 15 percent rate bracket for married couples filing a joint return for two years, through December 31, 2012.

Payroll tax cut. The new law provides a payroll tax cut for employees. Effective for calendar year 2011, the employee share of the OASDI portion of Social Security taxes is reduced from 6.2 percent to 4.2 percent, up to the taxable wage base of $106,800. Self-employed individuals will get an equivalent tax break, paying 10.4 percent on self-employment income up to the wage base (reduced from the normal 12.4 percent rate).

AMT patch. The new law provides an AMT "patch" for 2010 as well as 2011 at higher exemption amounts. The 2010 Tax Relief Act raises the exemption amounts for 2010 to $47,450 for individuals, $72,450 for married taxpayers filing joint returns, and $36,225 for married taxpayers filing separately. For 2011, the amounts are increased to $48,450 for individuals, $74,450 for married taxpayers filing jointly, and $37,225 for married taxpayers filing separately.

Estate and gift taxes

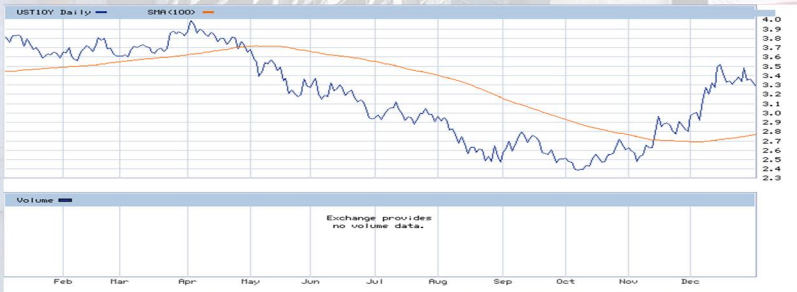
Beginning in 2011, the estate tax had been scheduled to revert to its pre-2001 levels of a 55 percent tax rate and a $1 million exclusion. For 2010, estates were subject to no federal estate tax but heirs had to take inherited property under a modified carryover tax basis regime.

Estate tax. The new law revives the estate tax through 2012, but at a reduced maximum estate tax rate of 35 percent and a $5 million exclusion. The revived estate tax applies to estates of decedents dying in 2011 and 2012. However, for 2010, the new law gives estates the option to apply the estate tax at the 35 percent/$5 million level, with a stepped-up basis, or to elect no estate tax but with modified carryover basis. The new law also allows "portability" between spouses of the maximum exclusion (for a combined $10 million benefit) and extends some other taxpayer-friendly provisions originally enacted in 2001.

Gift Tax. The 2010 Tax Relief Act keeps the gift tax rate at 35% for 2011 and 2012, but the gift tax will be significantly different in 2011 and 2012. The gift tax exemption for 2011 and 2012 is increased from $1 million to $5 million for individuals. So, individuals who used their entire $1 million gift tax exemption prior to 2011 will be able to gift an additional $4 million in 2011 and 2012 without incurring a gift tax. The exemption will also be reunified with the estate tax exemption, starting 2011. Starting 2012, the gift tax exemption will be indexed for inflation. - Susan Arnold

The Bond Roller Coaster

No, Iôm not speaking of a new ride at Great Adventure or Hershey Park. Far less exciting but just as hair-raising, the bond market took us for a nice ride during 2010. Not knowing what the chart below represents, many people might assume it is a chart of the S&P 500 or the DJIA or any other equity-based index due to the volatility. But in fact it is the 2010 yield chart for the benchmark 10yr Treasury:



It is a reflection of the dramatic shifts in investor mentality over the last year that occurred in all markets. The bond markets came into the year assuming the stock market recovery would continue unfettered with improving economic fundamentals, and inflation, the eternal nemesis of every bond investor, not far behind. After hitting an all-time low of 2.035% in December of 2008, the yield on the 10yr Treasury hit 3.99% in April of 2010 leaving investors to believe that there was only one way for rates to move and that was higher. Conversely, this lead many investors to treat duration (longer maturities) like the plague, maintaining a portfolio of the shortest maturities possible only to see rates rally over the next 6 months to their post-crisis low of 2.38% by October. It was quite demoralizing for many bond investors, especially those who rely on their investment income to meet day-to-day living needs, to feel like they were finally going to see the days of capturing relatively easy and stable 5, 6, or even 7 percent yields once again, only to see that promise disappear in a very short time due largely to fears of a double-dip recession and the European debt woes. Now if investors threw in the towel at this point, convincing themselves that they just needed some yield at any cost, and began to buy longer maturities to meet their income needs, they were ôreatedô to the marketôs second change of course during the fourth quarter which was steeper than the mid-year rally, negating several years of coupon payments due to price depreciation of bonds just purchased.

It was quite a ride in 2010 but I think investors need, as always, to learn from their experience and I think the most valuable take-away from 2010 would have to be that you need to prepare for all scenarios because that crystal ball has still proven to be elusive. I cannot tell you if you should be preparing for the ñnew normalò, as Mr. El-Erian from Pimco has coined it, which calls for modest return expectations in all asset classes, or if hyper-inflation and dramatically higher interest rates are around the corner. The truth, as in most cases, probably lies somewhere in between and considering it is impossible to know when these changes take place, we continue to prepare and position clients for both scenarios.

Ryan Crooks

S&P500 Facts

- The S&P500 gained 15.1% in 2010 including the impact of reinvested dividends
- 107 stocks out of the 500 finished the year with a price lower than where it started
- The S&P has gained an average of 9.7% per year over the past 50 years
- The largest 10 S&P stocks make up 19% of the total capitalization of the index

Oil

- Oil ended 2009 at a price of $79.36 per barrel
- The closing high during 2010 was $91.51
- Oil ultimately finished the year at $91.38, a 15.1% increase over 2009ôs price (coincidentally, about the same gain as the S&P500; for comparison, shares of ExxonMobil gained about 10% in 2010)

Source: New York Mercantile Exchange

Company Visits

Below is a sampling of the companies we have visited (or have visited us) during the past quarter:

- Johnson and Johnson
- McCormick & Company

Out Like a Tiger, In Like a Rabbit

The title above, of course, is a reference to the Chinese astrological calendar, the 12-year cycle that characterizes each year with one of twelve animals. Each animal, as I understand it, represents characteristics of the person whose birth date falls in that particular year. Hence a strict adherent to the calendar might say it would be easy to understand a new acquaintance just by knowing the year of their birth. And while that may sound overly simplistic to some or even absurd to others, investors and market watchers are quite often susceptible to many of the same simple guidelines.

Which brings me to today- aside from being the year of the rabbit, 2011 is the third year of the Obama presidency. The "presidential cycle" is statistically one of your best bets if you are prone to using the calendar as your main research tool for investing. Here are the numbers leading into the recent recession: the average total return for the S&P500 in year one of a presidential term is about 8%. Year two, almost 10%. In year three that number spikes to over 21%, and then falls back to 12% for year four. Is there a simple explanation for this? Many believe that administrations of both parties are willing to allow corrections of excesses to take place in the first two years of a term, and then pull out all the stops with economic stimulus to make sure the economy and the market are recovered when re-election time rolls around again in year four.

There are always exceptions. 1987, for example, was the third year of Reagan's second term (and also a year of the Rabbit). Total gain in the S&P: +2.3%. Other third years were 1971 (+6.1%) and 1979 (+2.3%).

So while it is always important to have a sense of historical context and to know what others in the marketplace may be thinking, what matters more is the environment at hand.

Many fears were allayed in 2010 as consumers returned to stores and auto dealers and businesses started to spend again on equipment and inventory. But 2011 still presents investors with challenges. The U.S. has an unprecedented debt load. Unemployment remains at alarmingly high levels. Home sales , while stabilizing, are not overwhelmingly positive.

The debate over whether the recent federal stimulus worked or didn't will continue for years. In the meantime well managed corporations will grow and thrive, overcoming the many obstacles that face them. We anticipate that this will mean attractive returns for stockholders. So, while we can't simply look at the calendar and report to you that 2011 will be another great year, we are optimistic – the market just might pull another rabbit out of its hat.

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