Outlook

A Quarterly Newsletter from Roffman Miller Associates

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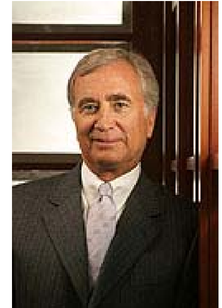


Peter Miller
President

If all one did was focus on the problems we have in this country and around the world then it would be hard to understand why the stock market is having a very good year. As investors we are always going to have headwinds or reasons not to own stocks. But we are not just buying the market, we are buying businesses. We expect the people running our companies to understand the problems they face and work through them. Unlike our government, well run companies are not divided but united in working to do what is best. Great companies think long term just as a good investor should.

I wanted to comment on a recent article from The Wall Street Journal titled "Managers Take Time Out From Stocks." The story talks about the double-digit gains in the market and how some managers are considering watching the rest of the year from the sidelines. This might sound like a good strategy but it is simply market timing. Getting in and out of the market at the right time seldom works as planned. When you get out of the market you stop receiving dividends, many times create taxes, and most importantly change your long term asset allocation. The biggest problem is knowing when to get back in. If the market goes up then you are reluctant to buy at higher prices. If the market goes down you may be right in the short term, but the lower it goes the more fearful you are about getting back in. If you wait for all of the problems to go away you will always be on the sidelines. There are many people who got out in 2008 that are still not back in the market. Stick to your long-term plan and let your own personal needs and goals determine changes in your asset allocations, not the short term up and downs. Put yourself first and remember the market doesn't know what is best for you.

I always say that good markets equal short letters, so you may be surprised that this is one of the longest quarterly newsletters we have done. When it came to editing, I felt all the articles were worth the read and if anything should be left out it probably should be the one I wrote. As always, we welcome the opportunity to review your investment plan. Please feel free to contact me directly if you have any questions or concerns.

-Peter Miller

Stock Markets, Presidential Elections, and Your Portfolio

Every four years we get the same questions:

"It's an election year, what will the stock market do?"

"If so-and-so wins the election, what will happen to the market?"

"What do we do when we know the result of the election?"

Since no one can tell you precisely what the markets will do in response to a presidential vote, let's explore instead how presidential cycles of the past have affected the market and see if there is anything to learn from them.

To shed some light on the first question above, the table below shows the return of the S&P 500 Index in each Presidential election year since 1928:

S&P 500 Stock Market Returns During Election Years					
Year	**Return**	**Candidates**	**Year**	**Return**	**Candidates**
1928	43.6%	Hoover vs. Smith	1972	19.0%	Nixon vs. McGovern
1932	-8.2%	Roosevelt vs. Hoover	1976	23.8%	Carter vs. Ford
1936	33.9%	Roosevelt vs. Landon	1980	32.4%	Reagan vs. Carter
1940	-9.8%	Roosevelt vs. Willkie	1984	6.3%	Reagan vs. Mondale
1944	19.7%	Roosevelt vs. Dewey	1988	16.8%	Bush vs. Dukakis
1948	5.5%	Truman vs. Dewey	1992	7.6%	Clinton vs. Bush
1952	18.4%	Eisenhower vs. Stevenson	1996	23%	Clinton vs. Dole
1956	6.6%	Eisenhower vs. Stevenson	2000	-9.1%	Bush vs. Gore
1960	.50%	Kennedy vs. Nixon	2004	10.9%	Bush vs. Kerry
1964	16.5%	Johnson vs. Goldwater	2008	-37%	Obama vs. McCain
1968	11.1%	Nixon vs. Humphrey	2012	???	Obama vs. Romney

Marshall D. Nickles, EdD, expanded upon this data in his paper *Presidential Elections and Stock Market Cycles*. His research shows that a profitable strategy would be to invest on October 1st of the second year of a presidential term and sell on December 31st of year four. He goes on to say, "however, just when you think you have figured it all out, you find another pattern that can suggest different possibilities. For instance, another analysis shows a highly intriguing reoccurrence in the stock market index; during the entire twentieth century, every mid-decade year that ended in a "5" (1905, 1915, 1925, etc.) was profitable!"

The point he is making is a classic observation in behavioral finance – we may *see* patterns, but that doesn't mean they are relevant to the decisions we are about to make.

"*If so-and-so wins, what will happen to the stock market?"* It may shock you, but no matter what party has won in the past the stock markets have followed a four-year presidential cycle with strong, repeated patterns.

Year 1: The Post-Election Year

The first year of a presidency is characterized by relatively weak performance in the stock market. Of the four years in a presidential cycle, the first-year performance of the stock market is, on average, the worst.

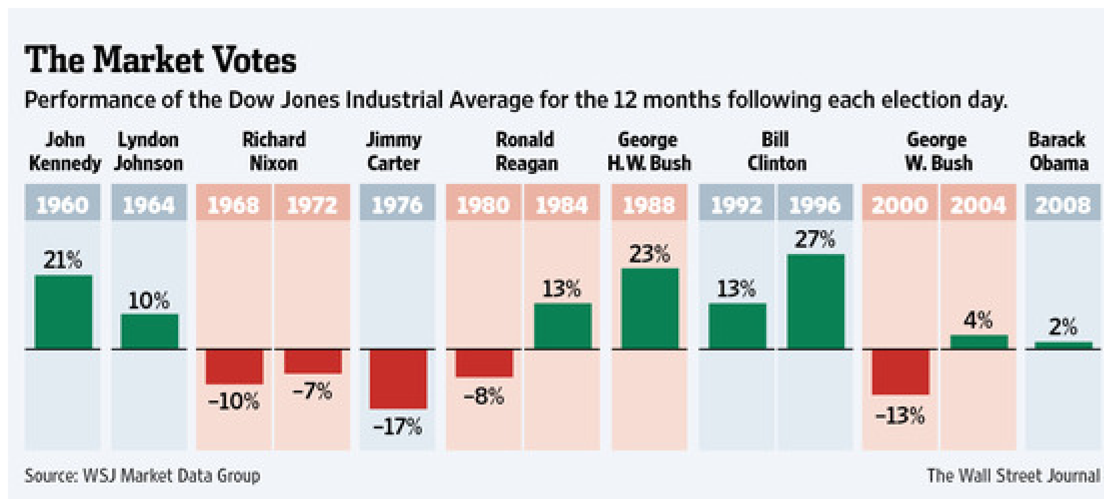
Year 2: The Midterm Election Year
The second year also sees historically below-average performance. Bear market bottoms occur in the second year more often than in any other year.

Stock Market Return by U.S Presidential Term Year	
1948-2008	
Year	Average Annual Return
1	7.41%
2	10.21%
3	22.34%
4	9.79%
Source: S&P 500 Total Return Index	

Year 3: The Pre-Presidential Election Year
The third year is the strongest on average of the four years.

Year 4: The Election Year
In the fourth year of the presidential term and the election year, the stock market's performance tends to be above average. (editor's note: before the 2008 election, the average return in an election year was about +12%; even including 2008's steep market decline, fourth years have produced gains over 80% of the time from 1948-2010)

"What do we do when we know the result of the election?" Conventional wisdom holds that the stock market does well when a Republican wins because, in theory, candidates from the GOP tend to favor lower taxes and less spending. But the policies of Presidents don't always match their campaign ideologies, and post-election returns don't always fit a clear pattern. This suggests that there is only so much a president can dictate when it comes to the economy and stock market. For example, the Dow Jones Industrial Average fell 7.5% in the 12 months after Ronald Reagan, a



Republican, won the presidential election in 1980. But it rose 12.8% the year after he was re-elected in 1984.

The Dow soared 23.3% in the year after George H.W. Bush, also a Republican, was elected in 1988. But the average also jumped 12.6% after Democrat Bill Clinton was elected in 1992 and rose 26.5% after he was re-elected in 1996.

Data from Citigroup points to better returns under Democratic presidents over the course of their terms. The market also tends to do better when a challenger wins.

The most important conclusion to draw from all this information is what we quoted earlier, "we may *see* patterns, but that doesn't mean they are relevant to the decisions we are about to make." In other words, the past is sometimes just that.. the past. Future investment returns will be determined by asset allocation and investment selection, not the person who sits in the Oval Office.

The real question might be, "Should I be doing anything differently with my money right now?" If you established a smart investment strategy to start with, the answer is probably "No."

- Susan Arnold, Investment Manager

The 4% Spending Rule Revisited

Good news for the unemployed, many jobs will be opening up soon. Over the next five years, an estimated 17 million Americans will retire. Bad news for the retirees, half of them have no meaningful savings at all. But, if you are considering retirement *and* reading this letter then congratulations, the odds are good that you're in the other half! You have a lifetime of savings (as only you can define it) and soon that nest egg has to start paying the bills for you. But how much can you safely withdraw each year without worrying about running out of money?

In the mid-1990s the topic of 'safe withdrawal rate' became very popular among researchers in the field of finance. The first major piece published in the Journal of Financial Planning by William Bengen in 1994 relied on actual investment returns and retirement scenarios over the preceding 75 years and concluded that if retirees could limit withdrawals to no more than 4.2% of a balanced investment portfolio in the first year of retirement, and adjust that amount every subsequent year for inflation, they would stand a great chance of their money outliving them.

As an indicator of the importance of this study, it was reprinted in the Journal's 25th anniversary issue in 2004. And, dozens of papers (hundreds, more likely) since have been published re-examining the topic. In fact, Bengen himself later expanded his research to include a more diversified portfolio of investments and concluded that one could stretch the initial withdrawal rate to 4.5 or even 5% in the first year.

Challengers to the 4% rule say that it is overly simplistic. In fact, for the majority of years between 1926 and 2011, the yield or income return on a portfolio of 50% stocks/50% bonds exceeded 4%. That meant you could safely follow the 4% rule and not worry about running out of money because principal was never being spent. Over the last several years, however, the yield on such a balanced portfolio has been steadily decreasing: from a peak of over 10% in 1982, the yield had dropped to 2.8% by year-end 2011 (Vanguard).

The limitations on the 4% rule do not end with the low current bond yields. The original research was based on tax-deferred portfolios (IRAs, for example), but for taxable accounts Bengen estimates in his 2006 book that a 20% effective tax rate can reduce your maximum annual withdrawal rate by almost 12%. And, the rule is based on a 30-year planning horizon, so those with longer plans must adjust accordingly. Also, the rule does not account for any bequest at the end of your plan.

Economic heavyweight William F. Sharpe, winner of the 1990 Nobel Prize in Economics, challenged the 4% rule in a paper he published in 2008. His conclusion? "Despite its ubiquity, it is time to replace the 4% rule with approaches better grounded in fundamental economic analysis." And then, later in 2008, fundamental economic analysis itself became a big question mark.

So where does that leave all of us who still yearn for the answer to, "what is my safe withdrawal rate?" First, I'll borrow a few words from Rob Arnott at Research Affiliates: "Investors who are prepared to save aggressively, spend cautiously, and work a few years longer (because we're living longer), will be fine. Those who do not follow this course are likely to suffer perhaps grievous disappointment." Fairly succinct. But for those of you who are where you are, having already accumulated your lifetime of savings, I have some words of my own that are based on real life retirements:

1. Bad decisions can severely hamper your chances of success. Whether is was taking on too much risk, not seeking professional advice when you needed it most, or giving in to fear and selling in a panic, poor decisions can get you into a jam that you can't get out of.
2. Plans are nothing; planning is everything. Ok, those weren't exactly my words (thank you President Eisenhower) but they elucidate the point that plans are not stagnant. The process of planning, in this case planning your retirement income, never stops because events will happen during your lifetime that will surprise you. Ask anyone who retired in 2007 and then had to suffer through 2008 as their first year withdrawing from their savings.
3. Leave a margin of safety. People get sick. Houses flood. Things can happen that cost large chunks of money. What's wrong with roping off 10% of your nest egg as a 'safety net', and then basing your 4% withdrawal on the rest?

When constructing a retirement income portfolio, I like to have five years of 'visibility' on where the retirement income is coming from. That usually means having enough current income *plus* bond maturities in a given year to support spending needs for that year. Then, hopefully, if we run across a crisis similar to what happened in 2008, clients will feel comfortable about their income and will be less likely to change their overall investment plan (i.e. make a mistake) based solely on the current market conditions. The idea of a 'margin of safety', as explained above, is also not a bad idea.

In summary, the 4% rule is not a rule but a guideline. Incorporate it as part of your thinking when you look at the size of your retirement savings and what those savings can provide for you on an annual basis. Every investor's financial situation is unique, but if

you are planning on stretching your next egg out over several decades of retirement, it's a good decision to limit your withdrawals to 4 or 5% in the early years. Leave yourself a margin of safety for emergencies, and then see how it goes the first year or two. A well-constructed retirement portfolio, some good advice, and a commitment to your plan will help those savings to last.

Mark Frombach
Chief Investment Officer

Operations Report - Email Based Wire Fraud

The FBI has issued a warning that wire transfer fraud is up and on the rise. Fortunately, there has been a 90% failure rate in such cases so far in 2012. Most of these cases are international wire requests, making them easier to spot, but once any request is approved the funds sent cannot be retrieved.

Fraudsters are using legitimate email addresses to request wires. Typically they first email the financial advisor or brokerage firm to request an account balance. If they are successful in gathering that information they then email a wire request. Since neither we nor Schwab accept requests without a signature under any circumstance, an unsigned form would not be accepted. However, some fraudsters can access client signatures from old documents and copy and paste them onto the request forms. This is why we use, and encourage you to use, our new email encryption service *Sharefile*.

Charles Schwab is in contact with us on a consistent basis regarding any changes to security or in the event they detect any suspicious transactions. They offer us educational webcasts, live events and telephone calls to keep us up to date. As your advisor one of our priorities is protecting your privacy and personal data.

If we have a standing authorization request from you for wire transfers then we can normally sign on your behalf. However, for third-party requests (a *third-party* request is a wire from your account to someone other than you) you will be required to provide an original signature each time.

In order for any wire request to be processed we are going to take the following steps:

- **We will contact you directly to confirm any international wire requests**
- **We will contact you directly for all faxed and emailed third-party wire requests**
- **We will randomly contact clients for any domestic wire requests or anything we think looks suspicious**

We also want to encourage moving money via Schwab's ***MoneyLink***, an electronic funds transfer system similar to 'direct deposit.' There is no charge to set this up and funds are available the following day (for comparison, a wire transfer can happen on the day you request it, but each transaction costs $25).

Please contact us immediately with any changes or issues with your email, or in any event of the theft of your personal data. We appreciate your patience and understanding in this matter.

- Jennifer Tinney
Operations Manager

Fighting the Bears

It’s hard to avoid the bears these days. Whether it’s geopolitical concerns, unemployment or the upcoming fiscal cliff it seems the bears have plenty of ammunition. The bear market which began in October of 2007 and ended in March of 2009 was one for the record books. The market lost over 50% in this bear market and it was the worst market since the 1973 to 1974 bear market. In the 1973 to 1974 crash the market was down 48% and the down trend lasted a year and nine months. It took about four years for the market to reach its previous peak and by 1977 the market was at a new all-time high. In late 2007 the Dow Jones Industrial Average (DJIA) reached an all-time high of 14,200. Today the DJIA is about 13,400 and only about 6% off of its previous high. It’s been about five years since the bear market began in 2007.

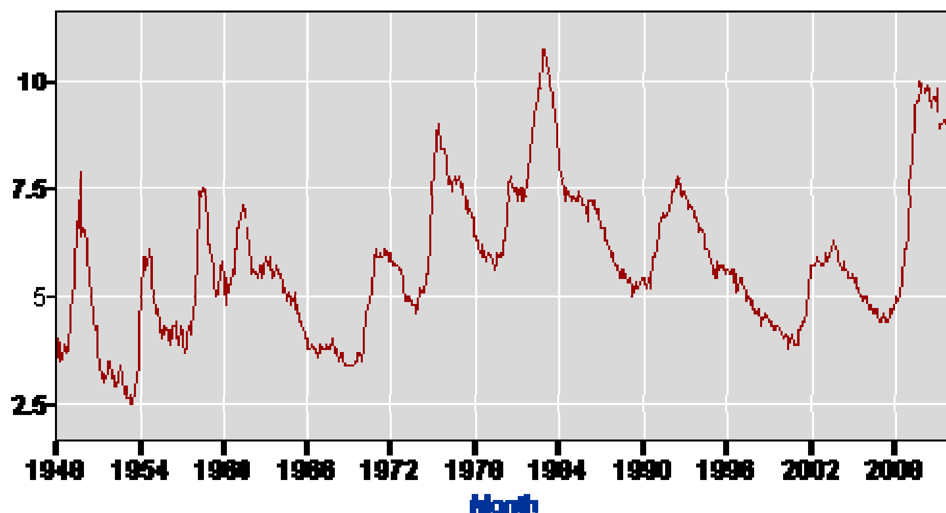
Today the market is close to its all-time high but many of our companies are in much better shape today than they were in 2007. For example let’s look at Microsoft. In 2007 Microsoft had revenues of about $51 billion, a trailing P/E of 20, a dividend yield of 1% and a share price of about $37 at its peak. Today Microsoft has revenues of $71 billion, a trailing P/E of 15, a dividend of 2.95% and a share price of $30. My point is that you can’t only look at the number on the DJIA and assume that stocks are over valued. At Roffman Miller we look at each company individually because we are not investing in the market as a whole; we are investing in a select group of businesses.

The bears out there are focusing on our economy and our 8% unemployment. Undoubtedly the unemployment numbers are too high but our country has battled this problem before. Looking back, unemployment peaked at 9% in May of 1975 and it was 10.4% in January of 1983. In June of 1992 unemployment was 7.8% and it reached 10% in October of 2009. In fact unemployment was north of 7% at some point in every decade since the 1940’s. The Bureau of Labor Statistics data base only goes back to 1948. My point is that periods of high unemployment are normal. Our country has always battled through these tough times and we do so again.

At Roffman Miller we are optimistic about the future. We see great value in selected companies. Our economy is improving and once unemployment comes down I believe we will see the foundation for a new bull market

- Bob Hoffman, Vice President

US National Unemployment Rate



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