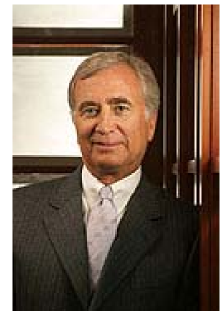
Outlook

A Quarterly Newsletter from Roffman Miller Associates

A Market High or a Market Top?



Peter Miller

I have been writing a quarterly newsletter for more years than I want to admit. You would think that having just finished a great quarter with the Dow and S&P at new all-time highs, this would be an easy matter to write. If you have been reading my quarterly reports for a while you know that I believe that good markets equal short letters. Which means that I really have very little to say. However you are probably more interested in what the market is going to do going forward, and I feel obligated to respond.

I need to remind you that I am not a market strategist which means I am not a market timer. What we do at Roffman Miller is invest in companies that we feel will do well for the long-term. We look for value, and that's what I can comment about. The majority of our companies are neither exceptionally cheap nor historically overvalued. I don't see a speculative slant to the market. Just the opposite, with the individual investor still very cautious after the 2008-2009 recession and the reality of how far stocks can fall. For the last four years individuals have been putting money in bond funds not stock funds. It is only recently that stock funds have had positive inflows but not to the extent that should cause concern. One thing that gives me confidence is that dividend growth is accelerating. Even with the market at an all time high, you can still buy companies with dividends that yield more than bonds. Unlike the interest on a bond, dividends can increase over time.

Before I get overly confident lets remember that there are going to be corrections. A 5 to 10% correction can happen at any time and that is not a reason to change your long-term asset allocation. So my advice is to enjoy the good times and remember that there will be difficult periods. Let's just hope those are brief, like this letter.

Sincerely,
Peter Miller
Chairman and Founder

08 April 2013

Taxation Without Too Much Information

Our Constitution, in what is known as the Taxing and Spending Clause, gives the federal government the power of taxation. *The Congress shall have Power to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.* What our founding Fathers did not state was that the tax code should be understandable by the constituents that would be required to pay the taxes laid out in the tax code. The tax code is tens of thousands of pages long and is not easily digested by the average person. They call it the tax 'code,' as if, on purpose, it was not meant to be deciphered.

In the beginning of the year National Taxpayer Advocate Nina E. Olson released her 2012 Annual Report to Congress, identifying the need for tax reform as priority number one for this administration. The Fiscal Cliff deal, known as the American Taxpayer Relief Act, did little to address the system's problems. The deal focused on tax revenue and included a number of changes to the tax code, including a permanent extension of the Bush-era tax cuts. But except for the automatic spending cuts known as sequestration, the Act left major spending issues unresolved including the debt ceiling and a final version of a budget to fund the federal government in the current fiscal year.

With a deeply divided Congress, we do not see a comprehensive tax reform likely to happen in 2013. That does not say there isn't a ray of hope that Congress will be successful in simplifying the current 70,000 page tax code. Ways and Means Committee Chairman Dave Camp recently announced eleven tax reform groups responsible for reviewing current law and compiling feedback that will be reported back to the committee. "Regardless of party or politics, everyone can agree that comprehensive tax reform should result in a simpler, fairer tax code for families and more jobs for American workers," said Chairman Camp (R-Michigan).

In the meantime, this year we'll see the impact of the following changes:

From the *American Taxpayer Relief Act* and the *Affordable Care Act*

- **Investment tax rates:** The top capital gains and dividend rate remain at 15% for those below the $400,000(single)/$450,000(joint) income thresholds, and are increased to 20% for those with incomes above those amounts
- **Estate tax:** The current $5 million per-person estate tax exemption remains (with the $5 million indexed for inflation) but the rate is increased to 40% from the current 35%
- **Additional Medicare tax:** Anyone earning over $200,000 (or $250,000 if filing jointly) will be required to pay an additional 3.8% tax on the lesser of their modified adjusted gross income or net investment income

Lori Hartman

Interesting and Useful

2013 401(k), 403(b) Contribution Limits:	$17,500 plus $5,500 Catch-Up (over age 50)
2013 SIMPLE IRA Contribution Limits:	$12,000 plus $2,500 Catch-Up
2013 IRA and Roth IRA Limits:	$5,500 plus $1,000 Catch-Up

- One out of every thirteen households in the United States has a net worth of at least $1million not counting the value of their primary residence
- The top 1% of taxpayers paid an average tax rate of 23.4% in 2010 vs. an average tax rate of 2.4% for the bottom 50% of taxpayers (Internal Revenue Service)
- Out of approximately 2.4million Americans who will die in 2013, an estimated 3,800 will have to pay federal estate tax
- They'll pay about $3.7million each

Energy

What country is the world's largest oil consumer? Why the United States, of course. In 2011 the US consumed oil at a rate of 18.9 million barrels per day. The runner-up? China, with 9.8 million barrels per day. Japan is next at 4.5 million/day. Anyway you slice it, in both absolute terms and on a per capita basis we use an awful lot of oil.

Energy prices and energy independence are two big worries for this country. For years our politicians and presidential candidates have had a lot to say about the topic: We need clean energy. We need renewable energy. And investors, sparked by the 2008 spike in crude oil prices, have agreed. But as Joseph Dear, investment chief for the California Public Employees Retirement System said recently, returns from the sector have sputtered. Where do we go from here and is there any good news?

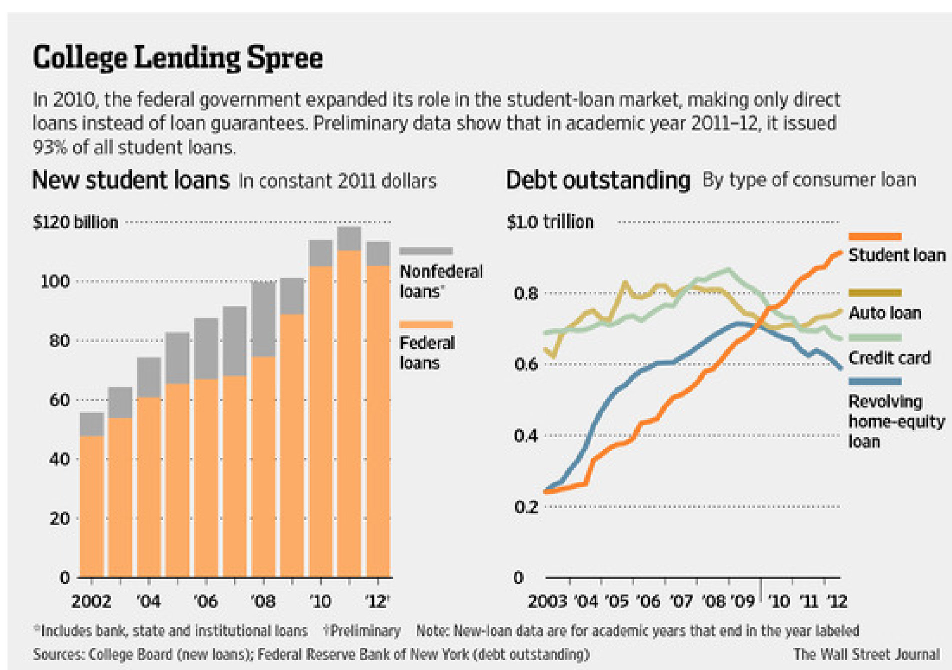
Look for activity at the state level. States don't have the ability to print money and fund idealistic projects like the federal government, so state Energy Plans might give a better indication of where public funds are going to improve infrastructure, availability, pricing, and environmental safety of the fuels that we need. As I did some digging in the New Jersey Energy Master Plan (www.nj.gov/emp), there is more than just conversation happening with natural gas. If you haven't heard it before, natural gas will be the fossil fuel of the 21st century, just as it was coal in the 19th century and oil in the 20th. Natural gas is plentiful in North America, and it burns cleaner than oil or coal.

But the US still needs a dependable supply of oil. It may surprise you to know that the US is moving faster towards oil self-sufficiency than any other major importer. By 2020, we'll import less than half of what we did in 2005. New wells are being drilled in the American West, and new discoveries are still being made in the Gulf of Mexico by US exploration and production companies. By 2020, the US is projected to surpass Saudi Arabia and become the world's biggest oil producer (Source: International Energy Agency). At the same time, companies are building facilities to liquefy natural gas for export, and we may in fact become a net *exporter* of energy.

Energy stocks have underperformed the market in 2011 and 2012 year-to-date. A clear federal policy on drilling, transportation, and trade, along with positive GDP and lower unemployment figures, would help investor confidence in these companies and possibly 're-energize' their stock prices.

The S&P 500 gained 10.6% in the first quarter of 2013, the second best start of the past 15 years. Considering the average return of the market for an entire year has been +9.8% over the past 50 years, I'd say we're off to a good start.

Mark Frombach



Binders - We have plenty of 2013 Statement Binders in stock. Please call RaRa if you need one.

Fixed Income Corner

Here we go again. The U.S. bond and stock markets have followed a very similar pattern over the last three years. Following monetary stimulus injected by the Federal Reserve stock investors get a boost of confidence and carry a strong rally in stock prices from the late 3rd or 4th quarter of the previous year through to the second quarter of the current year while interest rates rise, with broader calls for a normalizing of rates and prognostications of drastic losses in bond portfolios.

Keep in mind that any discussion of a "normalized" rate environment is challenged to begin with because determining what is 'normal' is akin to asking a group of geologists what the normal temperature of Earth should be. Interest rates have been on a consistent downward trend for the last 30 years, with each decade experiencing a lower average yield than the previous, yet they were in a similarly consistent and lengthy upward trend in the decades prior to the 1981 highs.

Following the past few 1st quarters, softening economic trends and moderating corporate results have cast doubt on a sustainable and broad based economic recovery after which the S&P 500 has given up 9%-18% in these periods and bond markets have reacted even more aggressively with rates taking back approximately 140bps in 2010, 170bps in 2011 and most recently last year 85bps. Don't let the 85bps mislead you into believing that was some type of moderation from the previous rate moves. On a relative basis this was just as big a move as the 140bps in 2010.

I mention this bit of short-term market history because of the extreme fear being projected upon any and all fixed income investments and the often too-broadly used concern for interest rate risk as if the bond market is one homogenous entity and as though rising interest rates will *decimate* 3-month treasury bills, or even 5-year corporate bonds for that matter, the same way it would a 30-year bond. These have been the same concerns harped on, during the same set of circumstances, only to leave us again in the same situation. As I write this, 10yr treasury rates have declined roughly 35bps from their recent high of 2.05% and are currently trading at 1.70%. Very similar fears have been at work as well with European headlines out of Cyprus being projected onto the larger concerns in the region (Spain & Italy in particular), softer employment and manufacturing data points and news of Japan's central bank, the BOJ, announcing aggressive action with their own quantitative easing program thereby making U.S. treasuries, even at these paltry levels, look very attractive to some investors. I am very much aware of the fact that by most respects the market is bound by zero and conversely, there is much more risk available to the upside in rates. But I think we also have to keep in mind that while we look for suitable returns in our fixed income investments these days, the Japanese 10yr set a new all-time low of 0.425% following its announcement. Just as importantly I think to keep in mind is that their 10yr has been below 2% for 15 years! I'm not trying to draw a direct correlation between our economic situations but as investors we have to at least be aware of the economic possibilities. I have got to believe that dire warnings of interest rate risk fall on many a deaf ear in Japan these days, if anyone has the courage to sound that alarm to begin with! While we never want to lose site of the risks involved, because they are real, we can not let that blind us to the return side of our task as well. In that respect bond investors who seek income still need to stay invested, accept prevailing rates, and maximize their return by choosing where to invest along the curve while minimizing risk with an acceptable portfolio duration and credit quality.

Ryan Crooks

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