# Outlook

A Quarterly Newsletter from Roffman Miller Associates

02 October 2014

In December Roffman Miller will begin its 25th year. That adds up to a lot of quarterly letters. The easiest way to write this letter is to report on what happened last quarter. The hardest way is to predict what the markets are going to do in the next quarter. I've always tried to avoid both. The reason is that what happened last quarter and what will happen next quarter are not important. It's just short-term thinking. Investing is all about the long term. Which leads to my second point. After 25 years it's not easy to avoid being repetitive. So this is not the first time nor the last time I will remind you to think long-term.

I recently had the pleasure of attending a small luncheon with the vice-chairman of Honeywell Mr. Andreas Kramvis. A very impressive executive with a breadth of experience, Kramvis studied engineering, specializing in electronics, and has successfully managed companies with global scope across five different industries. He is the author of a book titled *Transforming the Corporation: Running a Business in the 21st Century* which demonstrates how to turn mundane companies into high performance businesses.

Now Honeywell had just completed a five-year plan that seemed ambitious when presented but management was able to exceed the goals set back in 2009. So I was anxious to hear how Andreas felt about the new five-year plan which is also ambitious. He was very clear that he felt extremely confident they would meet or beat their goals. While Honeywell is not cheap if you look at today's measurements, one should think about five years from today. The question is whether management is capable of delivering, and if so the stock is a good long term investment. I think management can and will deliver.

I'm very proud of having been in business for 25 years. However, the important thing is for the company to be in business for the next 25 years. The team we have in place today is what I am most proud of and I am confident that they will continue to deliver the success we have enjoyed in the past and grow an even stronger company than we have today. This is my long-term thinking.

As always I welcome your thoughts and comments and look forward to Roffman Miller's next 25 years.

Sincerely,
Peter Miller
Chairman and Founder

## The Federal Reserve and the Economy

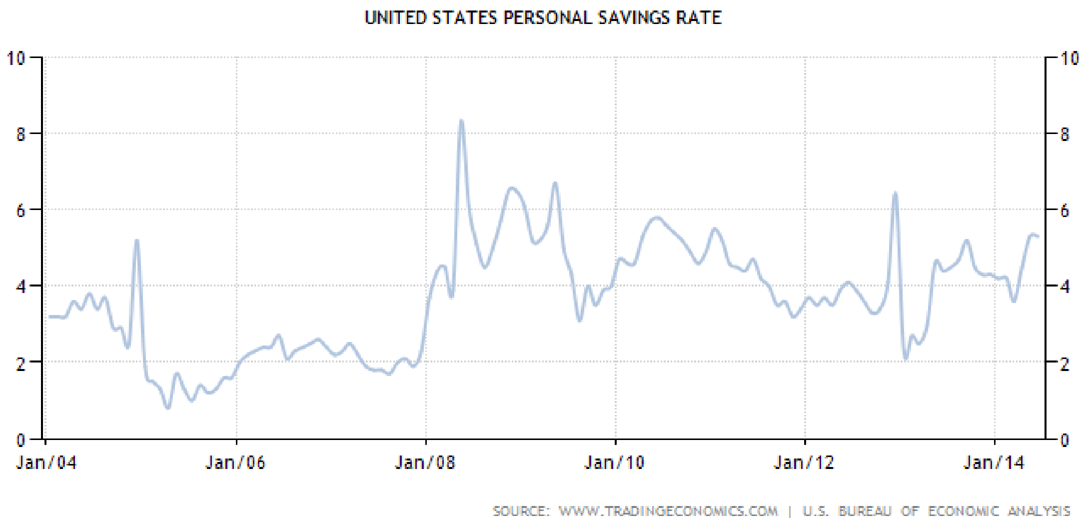
The Federal Reserve has two primary macro-economic goals:

- Stable Prices
- Maximum Employment

Of course overall financial stability is also incredibly important. In order to achieve its goals the Fed has two main tools:

- Short term interest rates and forward interest rate guidance
- Quantitative Easing (QE) – the purchasing of government securities

Over the last six years the Fed has used both tools in dramatic fashion. In fact, short term interest rates have been close to zero for nearly six years and the Fed's balance sheet has ballooned to nearly $4.5 trillion. When the Fed buys government securities through its QE tool, it takes bonds out of the marketplace and replaces them with money. In theory this newly created money is supposed to stimulate the economy through an economic principle called the "velocity of money" (VOM). Under the VOM principle, every dollar that enters the economy circulates




around the economy many times. For example if I buy a cup of coffee for one dollar, the coffee proprietor can use my dollar to buy supplies and the supplier can use that dollar to purchase gas, and so on. As a result, adding one dollar to the US economy has a multiplier effect. In the years following the 2001 recession every dollar added to the monetary base was spent 17.2 times. In the aftermath of 'Great Recession' of 2008, however, a dollar added to the monetary base was spent only 4.4 times. Consequently, the massive QE hasn't had the desired multiplier effect. Why is this time different?

For one, banks have been repairing their balance sheets and hoarding cash. In fact almost $2.8 trillion has been added to bank reserves since the start of the recession. Moreover, households have been hoarding cash as well and US savings are now topping $2 trillion. When money is saved it isn't working its way through the economy and it has no multiplier effect. As a result Gross Domestic Product (GDP) hasn't increased as much as the Fed would have liked.

The labor markets and GDP are both improving but the rate of improvement is slow. As a result, Fed policy isn't likely to normalize anytime soon. This means interest rates and the Fed's balance sheet probably won't change very much in the near future.

Bob Hofmann
President

## Texas Makes the Best Chips, Part I

Things are shaping up to look like 2014 could be the sixth 'up' year in a row for the U.S. stock market. As I write this, the Dow, the S&P, and NASDAQ are all at or near all-time highs. So it would be normal at this juncture to wonder if stocks are overpriced, or if prices can go higher still.

How to value stocks has been debated for the past 100 years or more. Assuming for a moment that stocks on average are correctly priced based on the information at hand and the risk investors are willing to accept, companies today have to show us how they plan to increase profits and return cash to investors in a way that sets them apart from other investment choices. If they can demonstrate an above average ability, they will get our attention and maybe our investment dollars.

Texas Instruments (TI) is a well-known Dallas based semiconductor designer and manufacturer, leveraging over 40,000 patents plus 75 years of manufacturing know-how to lead the world in digital signal processing and analog chip technologies. Thanks to inventors like Nobel Prize winner Jack Kelly, TI's history includes the first integrated circuit and, of course, the first handheld calculator.

The key elements in my evaluation of Texas Instruments as an investment are their research pipeline, manufacturing capabilities, capital allocation policies, their sales and marketing strength, and the general direction of the economy.

Analog chips take signals from the physical world, such as sound or temperature, and convert them to digital signals for our electronic devices. One classic example is the Speak and Spell, a children's toy that converted speech to text and vice versa using a TI chip. That product was commercialized by TI in the 1970s, but research and development hasn't stopped – in 2013, 12% of revenue ($1.5Billion) was spent on R&D, resulting in over one thousand patents awarded in that year alone.

In the early 2000s, TI built multiple 300mm wafer manufacturing plants in the U.S. costing billions of dollars each. Wafers are the round silicon discs that computer chips are manufactured upon (300mm is about 12 inches). Many chips come from a single wafer, and because the surface area of the wafer is an exponential function of the diameter (area = $\pi r^2$), a bigger wafer equals much more manufacturing efficiency. Because of their strong balance sheet, Texas Instruments was able to make this type of investment when others were not, leaving the competition to use smaller, more inefficient wafer sizes. 300mm manufacturing is still relevant today, and in the past five years TI has bought equipment and space from several semiconductor manufacturers who overspent and could not sustain the cost of such an investment. For example, in 2009 TI bid $172million for manufacturing machinery at a Richmond, Va, plant owned by the bankrupt German chip maker Qimonda. That equipment is now used at TI's state-of-the-art 300mm wafer factory in Richardson, Texas. I am told that through the difficult economy of 2008-2011, TI bought a lot of equipment for literally pennies on the dollar.

TI's good decisions are not limited only to what to invest in, but what to divest as well. In 2012 TI decided to exit the business of making cellular baseband chips, an industry they helped pioneer, and focus instead on their analog and embedded processor units. If stock performance is any indicator, the market thought that decision was a wise one.

Until recently, TI had managed their balance sheet without any debt. In 2011 though, they had a chance to buy competitor National Semiconductor and add over 12,000 analog products to their catalog. Some thought that TI may have been overpaying, but in just a few short years TI showed that the benefits led to increased earnings per share and the deal overcame its own cost of capital. Wisely, Texas Instruments had made this large purchase when interest rates were low (TI is paying an average of 2% on its bonds) and at a time where semiconductor sales were starting to turn up in the rebounding economy. The ability to spend money wisely, when needed, on equipment that is at fire sale prices or to ensure market leadership by buying your next closest rival is a key competitive advantage of TI. At times, when the company feels its own stock is cheap, it will buy back shares – the number of shares outstanding has decreased by 38% over the past decade.

Today TI serves over 100,000 customers in 35 countries. They offer more than 100,000 manufactured products, along with software and tools, which are sold by the largest sales and support staff in the semiconductor industry. This remarkable scale led to total sales of over $12 billion in 2013. Most of those sales are in three industries, Industrial (24%), Automotive (13%), and Personal Electronics (37%). As the world rebuilds further from the global financial crisis of 2008, TI's largest customer segments should see increased demands for their manufactured goods which in turn is good for TI.

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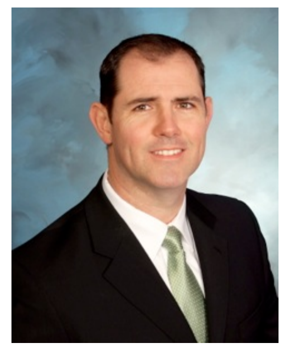
Texas Instruments has ample manufacturing space thanks to the smart investments of the last decade. With those fixed costs behind them, a moderate growth in sales today can increase their operating margins and overall profitability. And because of the low cost of capital required to ramp up manufacturing, more and more cash can be returned to shareholders. Margins are at their highest in over a decade. Dividends are up tenfold over the past ten years, including a 13% increase in 2014 and almost tripling over the past five years.

The U.S. stock market has not seen six 'up' years in a row since the '80s. No one can consistently predict the direction of the markets, but with some effort you can identify opportunities in companies making smart decisions and taking advantage of the economic opportunities. Texas Instruments is in a unique class of companies, able to grow, generate cash, and return it to shareholders hopefully for a long time to come. As we wonder if the markets have any room to go higher from here, remember that the 80's were followed by another pretty good decade.

Mark Frombach
Chief Investment Officer

## Roffman Miller Employee Spotlight



KEVIN COOKE, CFP®, MBA
**Investment Manager and Investment Committee Member**
Kevin joined Roffman Miller Associates in 2014, bringing extensive industry experience to the firm. He began his career as a 401(k) Plan Administrator in 1992. During his eight years with the Vanguard Group he held various leadership positions including Project Manager and Relationship Manager of Vanguard Brokerage Services. In 2009, he started a fee-only practice, Cooke Financial Planning, based in Fort Washington, PA. Mr. Cooke received a BA in Finance from Temple University in 1991 and a Master of Business Administration from Saint Joseph's University in 2001. He became a Certified Financial Planner (CFP®) in 2013.

## Social Security Benefits Update

The Social Security administration recently announced that after a three and a half year hiatus it will again be mailing estimated benefits to most workers. Starting in September 2014, workers who are turning 25, 30, 35, 40, 45, 50, 55, and 60 years old will be mailed a statement three months before their birthday. Workers will receive statements every five years until age 60, then statements will come every year until they start collecting social security benefits.

For the past few years, benefits statements for most workers have only been available online. If you have signed up online for a My Social Security account, you will not receive the paper statement no matter what your age, but you will continue to have access to them online.

The Social Security Administration would still prefer that you set up an online account; this way, you can see your earnings and benefits history update every year. We tried it, and it took less than ten minutes. To create an account, go to www.ssa.gov/myaccount. You will need to have the following information handy: a valid email address, your Social Security number, a U.S. mailing address, and be at least 18 years of age. Online accounts can be deactivated if you wish to go back to paper. Please call us if you have questions.

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