Outlook

A Quarterly Newsletter from Roffman Miller Associates

"The biggest risk is not taking any risk"

The one thing you can say about the recent market correction and the day-to-day volatility is that investing in stocks is not without risk. For long-term investors we must understand risk and be reminded that patience is the most important discipline and at the same time the hardest one to uphold. It's not market declines that keep people from achieving their goals but fearful emotions that would have us selling assets because they have fallen.

Most of us own a home and have an idea of what it's worth at different times. If we have owned that property for a long time we have seen ups and downs. People don't sell their homes just because prices are down. You know your home well and you sell when it is time, not just because the price is up or down. The same thinking should be applied to owning stocks or as I prefer to say owning businesses.

The market hit an all-time high on May 20th and the recent low was August 25th. I point this out because right after August 25th I watched an interview with Warren Buffett. He talked about now buying more stock in some of the companies he already owns and his message was that he had no idea what the market was going to do in the next 10 days but was confident that in the next 10 years these businesses would be worth a lot more. Now Mr. Buffett is not a young man, in fact I looked it up and he’s 85. I hope he is still investing at 95 but right now he is doing what is the right thing for his shareholders - he is thinking long-term and being patient.

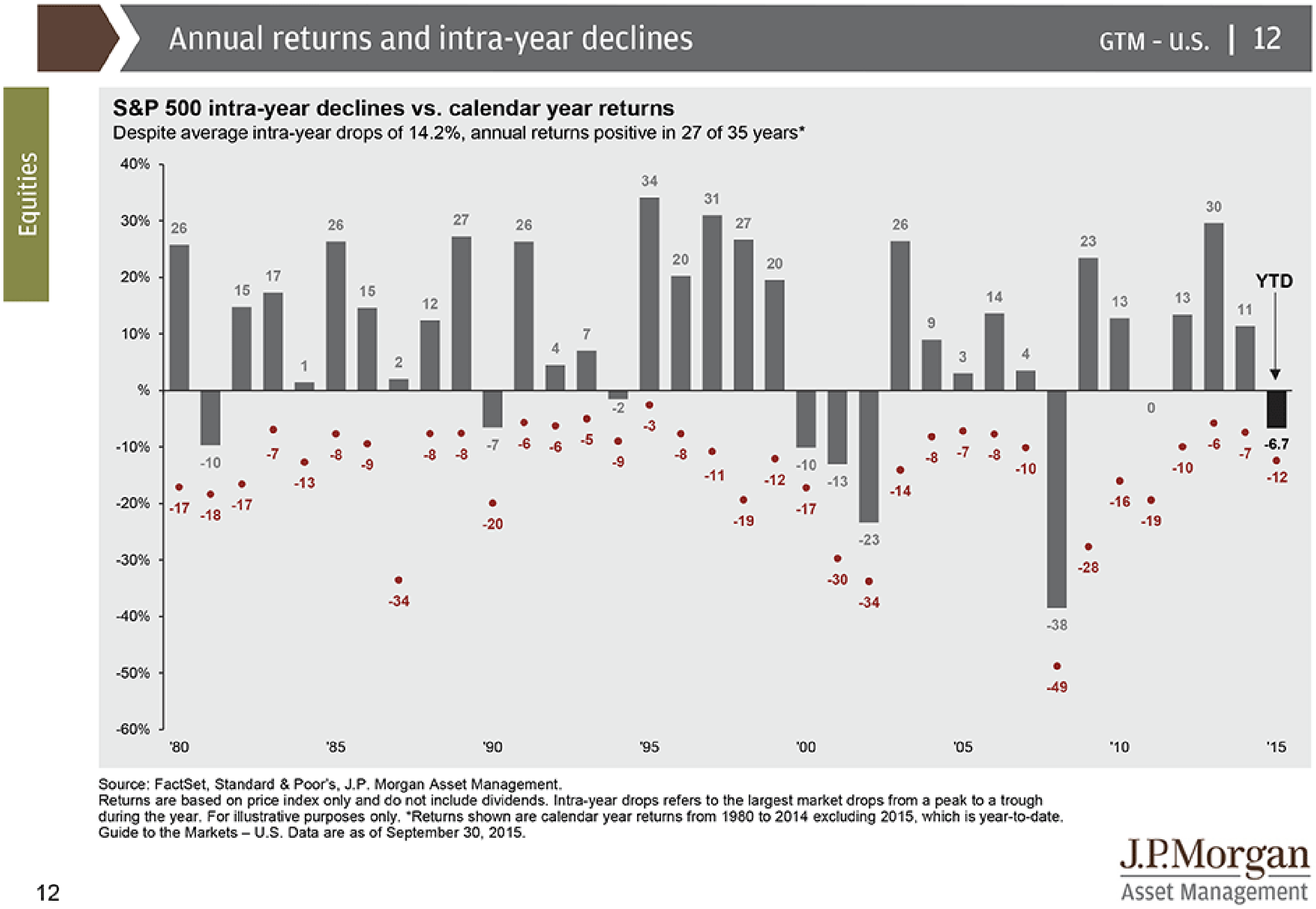
In today's ultra-low interest rate environment taking no risk pays you nothing. My father used to say "you’ll never get to second base if you're not willing to take your foot off first base.” We all take risk every day! No risk is never getting out of bed, and when it comes to investing it’s keeping your money under the mattress.

On a personal note I want to thank all of you who reached out to me after last quarter's letter when I stated I was stepping back from the day-to-day operations. All the kind words and good wishes were greatly appreciated and unexpected. You can see from this letter that I'm still involved and hope to be for many years to come. I still welcome the opportunity to take your calls or emails to answer any questions, concerns or comments.

Sincerely,
Peter Miller
Chairman and Founder

8 October 2015

The Ups and Downs of Investing



We found the slide reprinted above in the latest quarterly issue of J.P.Morgan's *Guide to the Markets* publication. It's a great graphical depiction of what most of us already know - the market is volatile, and in the long-run it goes up. Allow me to explain what this chart is saying. The red numbers at the bottom half of the page depict market pullbacks during a given year. Markets pullback every year but the severity of the pullback can vary greatly. So far in 2015 we've seen a 12% pullback in the S&P 500. As this graph depicts, this isn't abnormal, actually it's quite ordinary. In fact, I'd say pullbacks are healthy for the market.

We haven't seen a pullback this large since 2011 when the S&P 500 fell 19%. The index finished that year with a breakeven result (not including dividends). In 2012 we saw a 10% downtrend in the market, only to see it recover and finish the year with a +13% return. Over the last thirty five years the S&P 500 has had 20 pullbacks of 10% or more. During this time frame intra-year drops have averaged about 14.2%. What we're experiencing today isn't anything new or different; it's simply part of investing.

Long-term investors have always benefited from stock ownership. Over the last 35 years 27 have been positive for the S&P 500. If the stock market moved in a straight line it would produce bond like returns. The yield on a 10 year Treasury has been plus or minus 2% for several years. Unfortunately most people could never retire if their money was invested entirely in bonds. We realize that the volatility of the stock market is tough to handle at times like this. However, if you have a plan and remain with equities for the long-term, you'll be rewarded.

Bob Hofmann, President

…continuing a theme

US stocks rose dramatically on the last trading day of the third quarter, with the Dow Jones Industrial Average up 235 points and the S&P 500 Index adding 36. In spite of that last minute surge, both indexes closed down sharply for the year-to-date period. As of September 30th the DJIA had lost 8.63% and the S&P was off by 6.7% so far in 2015.

At some point during the quarter all the major US indexes reached "correction" levels. A correction is loosely defined as a 10% decline in a stock price or stock market index from its peak. Watching the news headlines over the past month, you might have drawn the conclusion that a 10% reversal in the markets is a guaranteed precursor to a 2008-like collapse. But just look at the graph on the previous page – corrections are, as Bob said, an ordinary and healthy part of investing and there is no correlation between sharp corrections and bear markets. Frankly, I'm tired of the media's overuse of the term *correction* and the significance that they've attached to it.

Bear markets, in fact, do not normally follow corrections; bear markets normally follow recessions. *Bear market*: another media-defined term that commonly refers to a stock market that has fallen 20% or more. But that leads to the question, *how are we defining the market?* Is it the Dow? The S&P? The NASDAQ, the FTSE, EAFE, or the Russell? There are so many benchmarks these days that we might be running out of things to track and some investment companies are combining existing benchmarks to create even newer ones. The point I'm making is that all of this lingo, the benchmarks, the jargon – it's all very distracting from the process of defining your own personal objectives, establishing a long-term plan, quantifying your risk, and implementing a sound investment strategy that improves the odds of achieving your goals.

Before I lose your interest, let's get back to that very understandable first paragraph. The Dow Jones Industrial Average was down more than 8% for the year through the end of September. But, the Dow was up almost 60% over the preceding three years. Without a lot of analysis you could come to the conclusion, by looking at those numbers, that stock prices on average have advanced quite a bit in the recent past and it would be a stretch to assume this would continue without pause. So in the absence of an economic recession, let's just take this in stride and see if we can't make something useful out of it.

From a portfolio manager's perspective, a temporary decline in stock prices is a holiday sale that must be shopped: I don't know how long it will last, I don't know if prices will go lower or higher over the next couple of weeks, and I don't know if I'm really going to buy anything, but I sure better be aware of what's happening because the other shoppers are sure to know. What was interesting about the market in late August and September was that a number of larger, dividend paying company stocks were down more than the market in general. In fact the Dow Jones Large Cap Growth Index was down 3.3% for the year through September 30th. The Large Cap Value Index was down almost 3-times as much, down 9.8% for the year to date. Part of the reason for Value's underperformance, I believe, is leftover sentiment from the 2008 banking crisis – many investors are still so afraid of the market that they have stuck completely to the 'safe' stocks, to be interpreted as bigger companies with bigger dividends which make up the value indexes. Basically the stuff we've owned for 20+ years. What happened in my opinion is that investors pushed the prices on some of those companies too high and they just had to come back into equilibrium in terms of valuation. A good example of that might be Johnson and Johnson, down about 10% at the end of the third quarter.

But I also believe there was some last-minute portfolio juggling by the large institutional portfolio managers who realized that a value-based approach to investing wasn't going to get them through 2015 with their jobs intact, and they sold some of the value plays and raised cash to buy into some growth stories. That depressed some of the big dividend payers and restructuring companies' stocks even further; by the end of the month, for example, IBM's stock was sold so hard that the dividend was paying 3.6% annually. Proctor and Gamble was paying 3.7%. GE's dividend was 3.6%. What all three of those companies have in common is that they're all in the midst of change and there is a high degree of uncertainty about the outcome of those changes. I can tell you that the market volatility we saw in August and September reduces the willingness of large institutions to make commitments for the long-run (ie, they are having a hard time being value investors). It is possible that such short-sightedness has overruled their ability to make decisions based on valuations. But in the end, focusing on valuations and maintaining a long-term mindset is what yields investment success and those institutions will suffer the fate of Aesop's hare.

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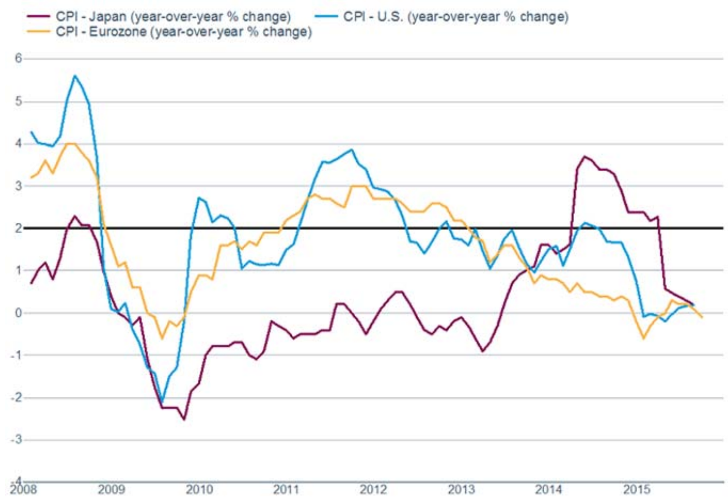
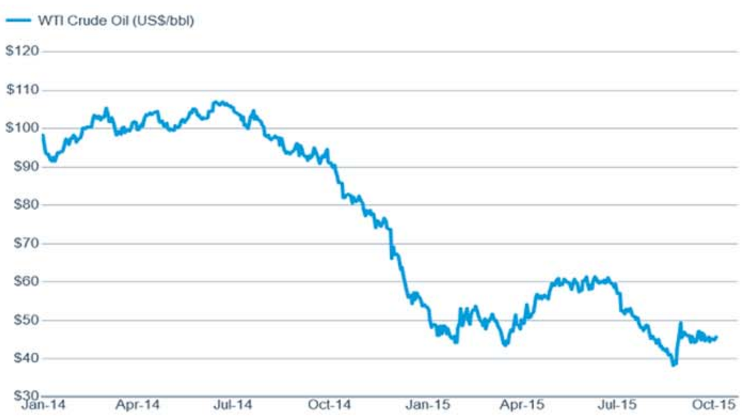
I didn't know what I was going to write about this quarter when I sat down to begin this letter. And, I promise, I'll stop editorializing in a few moments, get back to some basic research, and write about another one of our companies in the next newsletter. But the key concept I was working towards here is that while we must stay diligent about the markets and the current events around the world that affect the economy and our investments, let's not be taken for a scary ride by the media and get distracted from the basic tenets of investing. If you want a dose of good news, take a look at the charts assembled below – interest rates are low, making it easier for companies and individuals to borrow and build on their dreams. Inflation is low and keeps our expenses from growing out of control. The price of oil and unemployment are both lower than we've seen in quite a while. It leads me to believe there's still a place for the tortoise in investing today.

Mark Frombach, Chief Investment Officer





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