Outlook

A Quarterly Newsletter from Roffman Miller Associates

Chairman's Letter

When we started Roffman Miller in 1990, the last thing on any of our minds was that Donald Trump would one day be President. If you know our history, you can understand why. I must admit that President-elect Trump did persevere through some very tough times and come out on top. So much for long-term predictions.

On Election Day 2016, I was convinced that the results would turn out differently. Like most of us I listened to the media and got it wrong. When I was asked what the market would do after the election, I was wrong again, not expecting this rally. So much for my short-term predictions on the market.

The good news is that 27 years ago I was convinced that if we owned a diversified portfolio of great companies we would do well over the long-term. I was never any good at predicting the short-term moves in the market. That is why we have always focused on the companies we own and how well they were positioned to grow over time. Management at those companies has always been a key factor because it's the people that make businesses work.

The same thing is true about the people who now run Roffman Miller. While they have a strong foundation to work from, it's their day to day commitment that makes the firm work. I have all the confidence in this team and I know they will stay committed to the fundamentals that guided us so well in the past.

After 26 years of writing a quarterly letter, I find myself repeating things too many times. I feel it is time that others take over this page and say the same things in their own way. I'm not going away, but at this point in my life I am learning more about retirement than I ever knew when I was counseling others. Fortunately, I've taken some of my own advice over the years; I have planned well, and I'm thoroughly enjoying my new experiences. But I also meet others with different perspectives and stories to tell – stories of success, stories of failure, etc. In the future, I'll write about what I know now, retirement, because I believe there are still some things we can all learn from this new experience.

As always I welcome your thoughts or concerns. I'm always going to be part of Roffman Miller because I will always care about your financial future.

Sincerely,
Peter Miller
Chairman and Founder

11 January 2017

Is a Qualified Charitable Distribution (QCD) Right For You?

As you probably know, once you turn 70 ½ you're required to take Required Minimum Distributions (RMDs) from your IRA each year. These distributions count as taxable income. It's Uncle Sam's way of forcing you to begin paying tax on your IRA money. However, if you're planning to donate to a charity, a Qualified Charitable Distribution, or 'QCD', may be a smarter way to support your charitable cause.

A QCD allows you to make tax-free donations of up to $100,000 (per taxpayer, per year) from your IRA. In 2006, the rules allowing tax-free QCDs first appeared as a temporary measure. This on-again, off-again provision finally became permanent in 2015.

So what's the big deal - if I make a charitable donation I can already take a deduction, right?
Well, yes, assuming you itemize deductions on your tax return. The biggest benefit of QCDs is that the RMD is *not included* as income and therefore doesn't increase your adjusted gross income (AGI). This reduction in your AGI and other tax benefits of QCDs may not be so obvious. For example:

- Charitable donations are only deductible up to 50% of AGI. QCDs avoid this limitation.
- If your state income tax doesn't allow for deductions of charitable donations, you essentially get it anyway because the QCD doesn't count as income as an RMD would.
- If you take the standard deduction (instead of itemized deductions) you still get the benefit of the QCD.
- The calculation to determine the taxation on your Social Security benefits is based on a modified AGI. By excluding the RMD from AGI you may reduce the amount of Social Security subject to taxes.
- The tax code is full of "phaseouts" and "floors" related to AGI. For example, medical expenses are only deductible above a 7.5% of AGI floor. Most miscellaneous deductions are deductible subject to a similar 2% of AGI floor.

Four Important Points:

1. You must be at least age 70 ½ on the date of distribution.
    - Caution first time RMD takers. People may take their first RMD in the year they turn 70 ½. So if you turn 70 ½ in July of 2017, you're allowed to take your first RMD as early as January of 2017 but this would disqualify it as a QCD since you have not yet turned 70 ½.
2. While it's permissible for the check to be mailed to the account holder, the check must be made payable directly to the charity.
    - Schwab has updated their IRA Distribution Form to easily add the charity's information.
3. The charitable entity must be public and meet the IRA definition of a qualified charity.
    - Private foundations, charitable supporting organizations, and donor-advised funds are not eligible for QCDs.
4. You can't double-dip. If you designate your RMD as a Qualified Charitable Distribution you can't also claim it as a charitable tax deduction, you simply exclude the amount from taxable income.

Kevin Cooke, Investment Manager

Note: *This information is general and educational in nature. Please consult your tax professional for specific advice.*

Important Notes:

- *2016 Tax Form Mailings from Schwab* - (1099-DIV, 1099-INT, 1099-MISC, 1099-B, 1099-OID)
    - 1st Mailing – Early February
    - 2nd Mailing – Mid / Late February
- *1099R* - Mailed Mid / Late January

Reminder – Please update your investment manager with your marginal & effective tax rates each year and any tax-loss carry forwards. Realized gain / loss can be viewed on the Schwab website under the 'Positions' tab for each account.

A Hot Idea

Does anyone remember the term, 'irrational exuberance?' Those were the words that were uttered by Alan Greenspan that came to symbolize the excesses of the late 1990s stock market, when earnings didn't seem to matter and every internet-related IPO was going to make you rich. For those of you who waited 17 years for Microsoft to get back to $60 per share, or are still waiting for GE to get there, you know what I mean.

Stock prices today are beginning to reflect some of the optimism of a new administration entering the White House. Beginning just after the election, certain sectors of the market lifted off and separated from the general market. That's not to say the whole market didn't enjoy some of the ride; the S&P 500 rose 4.64% between the election and the end of the year, nearly half of the entire year's gain. Financials, though, rose 16.5% on average during the 'Trump rally' at year end. Some holdings that we follow, like Discover Financial Services (parent company of the Discover card), rose as much as 28% in the final two months. Telecommunication companies (AT&T, Verizon) also saw their prices advance by double digit percentages post-election, and the Energy sector did well also. The common theme here is that these industries are heavily regulated by the federal government and investors feel that the incoming administration, along with a potentially friendly congress, will ease the burden and allow companies to operate more freely (which theoretically means more profits).

While we cannot ignore the large global economic forces that change the way companies operate, like the internet or the rise of Chinese consumers, it is risky to bet on a particular premise (like lower corporate taxes or deregulation) that may or may not come to fruition. It remains today, as it did in the late '90s, most important to focus on how a company's management adapts to the current business environment, and what is a reasonable price to pay for that business.

I recently met with Starbucks CEO Howard Schultz and his management team in New York. This company probably doesn't need an introduction, but Starbucks is a restaurant company that operates over 25,000 stores worldwide, employing 300,000 employees ('partners' is how they're referred to), and serves 90 million customers *each week*. Starbucks Corporation has a succinct goal: To elevate the coffee experience, exceed customer expectations, and as a result elevate the value of the Starbucks brand.

Starbucks has been around since 1971. When the company went public in 1992, there were 192 stores. Today the company believes there is still much more room to grow; but the competition today is tougher than ever, and the retail environment has changed forever.

How many of Starbucks' competitors do you see in a day? If you're not driving past one Dunkin Donuts after another, or a McDonald's, then you're seeing their commercials on TV and receiving their coupons in your Sunday newspaper. You typically don't see Starbucks advertising though. From the beginning Howard Schultz understood that his coffeehouses were not just about the product; they were about creating a feeling of connection – a third place to go between the other places you spend your time, home and work. Marketing and advertising were approached differently than in the past. Over the years they have gotten the formula right - $20 billion in annual sales proves that.

Still, keeping customers loyal is challenging if you don't stay out in front of the competition. It is estimated that one out of every six adults in the US received a Starbucks gift card during the 2015 holiday season. That's powerful. But it's not by accident. When Starbucks noticed that the retailing methods of the past, like advertising and couponing, were no longer going to be as effective, they went digital and mobile. Now, loyal cardholders can register their gift cards with their mobile app and earn rewards for their loyalty. When it seemed harder to get people to actually leave their homes or offices to shop, Starbucks created mobile-order-and-pay. Now, from your cell phone, you can place your order, pay for it, earn rewards, and avoid standing in line by just dropping into any nearby store for pickup. Not only does that remove barriers to sales, but now Starbucks knows your buying patterns and can tailor its marketing to your individual tastes. There are no more mass email advertisements to Starbucks' Rewards members... the company uses artificial intelligence to anticipate the best way to get you to spend more, through individualized incentives using discounts and rewards. The program is working, and same store sales have grown an average of 7% per year over the past five years.

Starbucks trades today at about 23x next year's earnings. That's a bit pricey when compared to the average S&P 500 stock. The difference however is in what Starbucks plans to accomplish over the next five years: open 12,000 new stores and grow revenues 10%/year. If things go as planned, that would lead to 15-20% annual earnings per share growth, roughly double the growth rate of the general market. This is an ambitious plan; it involves opening one new Starbucks every 17 ½ hours in China over the next 1,800 days – just think about the logistics required to do that (securing land, permits, material, training employees, etc.). And it involves a new concept store, *Reserve*, which will attract more late-night business with a larger footprint, more tables, a better food selection, and a spirits bar. Those are just two parts of a larger plan.

Given the talented management team at Starbucks, I believe they can accomplish some ambitious goals. The company is just as shareholder-focused as it is customer-focused: in 2016 the board increased the dividend by 25%, and over the past five years the dividend has increased by over 290%. That's something to get exuberant about.

Mark Frombach

Fixed Income Corner

In our October newsletter, I pointed out that the U.S. Treasury 10-year rates had risen about 35 basis points (.35%) off the historic lows reached in early summer. By mid-December 2016, following the election, the 10-year rate rose approximately 124bps (1.24%) off the July lows. This rapid rise in rates caused "unrealized losses" on bonds to start appearing on your account statements. I thought now was a good time to remind investors that the returns on your bond holdings do not change as long as the bonds are held to maturity, despite changes in value as interest rates rise and fall during your holding period.

I think the best and least emotional way to think about your bond returns and explain what we mean when we say, ' you are not losing any money on your bonds (if held to maturity)', despite seeing some red on your statements, is to consider the *tax treatment* instead of *returns*. That is after-all what unrealized and realized gain/loss represent, an assessment of tax liability, not necessarily the returns or performance you will receive as a holder from the time of purchase until maturity.

The example I have below shows the amortization schedules for a fictitious 7-year bond with a 5% coupon, purchased at a yield to maturity of 2% and premium dollar price of $119.42. I first show the straight-line amortization, where the premium is simply divided by the time until maturity and the annual amortized premium is applied to reduce annual interest payments, because that's how most people who have any exposure to amortization have seen it applied, and how it was practiced until the IRS standard changed. Next, in **bold**, is the constant-yield-to-maturity method which is how Schwab calculates your adjusted cost-basis.

Until I can show you some market price scenarios in our next newsletter, I will leave you with this thought: market price declines due to interest rate increases are merely speeding up the amortization process for bonds we already expect to mature at PAR ($1,000) anyway.

Please feel free to contact me to discuss any of these topics in further detail.

Ryan Crooks, Investment Manager

XYZ 5% 01/01/2024 (2.00% YTM)	**Purchase Price**	**1yr**	**2yr**	**3yr**	**4yr**	**5yr**	**6yr**	**Maturity**
Straight-line Amortization	$1,194.16	$1,191.39	$1,188.61	$1,185.84	$1,183.06	$1,180.29	$1,177.52	$1,000.00
C-YTM Amortization (Adj. Cost-basis)	**$1,194.16**	**$1,168.04**	**$1,141.40**	**$1,114.23**	**$1,086.52**	**$1,058.25**	**$1,029.41**	**$1,000.00**
Income Deduction (Annual Amort.)		*$26.12*	*$26.64*	*$27.17*	*$27.71*	*$28.27*	*$28.84*	*$29.41*
Annual Income (5% x $1,000)		$50.00	$50.00	$50.00	$50.00	$50.00	$50.00	$50.00
Net Income		**$23.88**	**$23.36**	**$22.83**	**$22.29**	**$21.73**	**$21.16**	**$20.59**
Net Income Yield		**2.04%**	**2.05%**	**2.05%**	**2.05%**	**2.05%**	**2.06%**	**2.06%**

Company News - Select news from names we follow

Boeing - Announced a 30% dividend increase and a new $14 billion share buyback. Boeing has consistently paid a dividend for more than 75 years.

McCormick & Company – Announced a 9% dividend increase. This marks the 31st consecutive year that the company has increased the quarterly dividend.

Roffman Miller ASSOCIATES, INC. Wealth Management

Contact Information
Roffman Miller Associates, Inc.
1835 Market Street
Suite 500
Philadelphia, PA 19103

Tel: 215-981-1030 Toll-free: 800-995-1030 fax: 215-981-0146
www.roffmanmiller.com info@roffmanmiller.com