Outlook

A Quarterly Newsletter from Roffman Miller Associates

President's Letter

I've been reading a book about the collapse of SAC Capital Advisors. This is the infamous hedge fund that was owned by Steven Cohen. The U.S. Attorney's Office for the Southern District of New York accused SAC of "systemic insider trading" which resulted in "hundreds of millions of dollars of illegal profits and avoided losses at the expense of members of the investing public." At its peak SAC managed approximately $15 billion. But as many of you know, SAC was shut down by the authorities in 2013 and fined a record $1.8 billion.

It wasn't easy catching SAC. The FBI and the SEC approached the investigation the way they approach organized crime. They used wire-tapping and they flipped witnesses to turn employees into informants. This strategy helped to uncover the largest insider trading crime of all-time. In 2008 SAC's largest stock position was in Wyeth and its fifth largest was Elan. Wyeth and Elan partnered together to create a drug called bapineuzumab or bapi as it became known. Bapi was an experimental drug that was attempting to combat Alzheimer's disease, and it showed a lot of promise in early testing. A portfolio manager at SAC was receiving secret details about the clinical trials. This portfolio manager convinced SAC to invest heavily in both Wyeth and Elan.

In July of 2008 Dr. Sid Gilman presented stage 2 results of the Bapi drug trial at the International Conference on Alzheimer's disease. Unfortunately the news was disappointing. The next day Elan's stock fell forty percent and Wyeth fell eleven percent. Miraculously, eight days earlier SAC began to sell all of their stock in both Wyeth and Elan. By the time the conference started SAC no longer had a long stake in either company but instead had short positions in both stocks. As a result SAC made a profit of $275 million. It turns out this was no miracle. A portfolio manager at SAC was given non-public information about the drug trial and the rest is history.

Last year hedge funds experienced record outflows as wealthy investors fled the struggling industry. It's interesting to see that even the $37 billion Harvard Endowment fund is eliminating their internal hedge fund programs and returning to a more traditional style of investing. As you know Roffman Miller is not a hedge fund. Traditional investing is what we do. Our founding investment principles have been in place for over twenty-five years and they're not going to change. We believe in owning great companies for the long-term. For some, investment fads come and go. At Roffman Miller our disciplined approach to investing will remain for many years to come.

Sincerely,
Bob Hofmann
President

How our Fiduciary Standard Protects You

You may have heard media reports about a new fiduciary rule for retirement accounts. Understandably, you have questions about how this might impact your accounts. The rule was designed to ensure recommendations made by financial advisors to their clients regarding their retirement accounts are always made in the best interests of the client without any conflicts of interest.

The good news is that this doesn't affect your accounts at all. As a Registered Investment Advisor, we are already under the highest fiduciary standard – so enacting the rule or rescinding it doesn't change our status. We have had this higher standard in place all along and will continue to do so; it's always been part of our DNA.

As your financial advisor, we have been serving you as a fiduciary all along.

A "fiduciary" who manages an investor's assets has a legal and ethical obligation to put the investor's interests first. That means helping the investor make decisions in his or her best interests. This fiduciary standard has always been at the core of our firm's mission to our clients.

Here's how we protect you and your investments:

- **We always put your needs first.** We are committed to the highest professional and personal standards, and this commitment remains as strong as ever. Our sole focus is on your financial needs and goals and how we can best help you pursue them.
- **We always act in your best interests.** We are committed to putting your needs and goals before those of our firm. We strive to avoid any conflicts of interest, and if they arise and are unavoidable, we disclose these to you immediately. We provide a high level of transparency around any fees or expenses associated with our accounts so that you always know what you own and what you're paying for it, and so there are never any surprises.
- **We are an independent and objective resource**. As an independent firm, we provide you with objective, unbiased advice based solely on your needs and goals. We provide guidance that is truly objective, unencumbered by any potential conflicts of interest. We have no vested interest in promoting a particular product or service. Our only interest is that your financial objectives are met.

UNDERSTANDING THE FIDUCIARY STANDARD

In financial services, there have traditionally been two types of standards: the suitability standard and the fiduciary standard.

The suitability standard is defined as determining whether an investment product or strategy is "suitable" for the investor based on his or her financial objectives and risk comfort level. Many advisors operate under the suitability standard where the advisor simply determines whether a recommended product or strategy is suitable for the client.

The fiduciary standard is a higher level of responsibility for the advisor. The fiduciary standard goes beyond suitability and requires that any advice on products and strategies be provided in the best interests of the investor. The fiduciary standard of care requires that the advisor take into consideration whether the fees are reasonable, whether there are any conflicts of interest, and whether the investments are adequately diversified.

OUR COMMITMENT TO YOU

As your advisor, we adhere to the fiduciary standard, and we believe this model of disclosure and transparency is in your best interests. In our view, you deserve to have your needs put first and the strategies and investments we recommend should align according to those needs.

Our fiduciary standard mandates that every single recommendation we make must be based on your best interests. By adhering to the fiduciary standard, we believe we can provide you with the highest standard of care for all your investment and retirement needs.

SAFEGUARDING YOUR FINANCIAL DREAMS

When it comes to managing your money, your financial relationships should be built on a foundation of trust, integrity, and transparency. We remain committed to earning and maintaining your trust through expert advice and effective strategies custom tailored to your unique needs. We define our success by seeing you succeed in achieving your financial goals, and our focus remains on serving your interests first and foremost.

Management Matters

I recently had the opportunity to visit McCormick & Company at their headquarters located in Sparks, Maryland. Many of you will remember my January 2015 article about McCormick and know that the company offers a collection of enduring consumer brands like Old Bay, Zatarain's, and Lawry's, and they also provide flavorings and recipe research for a majority of the world's largest food companies. The business grows via a three-part plan: 1/3 of the growth comes from the existing products, 1/3 comes from new innovations, and 1/3 comes from acquisitions. Management at McCormick believes that this business model will provide 4-6% sales growth and 9-11% earnings per share growth over the long run, and this is the type of consistent-minded company that Roffman Miller really admires. As with all companies, however, management changes occur and this happened recently at McCormick: in 2016, Lawrence Kurzius was named the new CEO.

Mr. Kurzius met with us for lunch here in Philadelphia back in October, 2015, just a few months before the announcement of his promotion to CEO. Lawrence tolerated all of my questions over lunch, and he knew McCormick inside and out; that made sense, he was President and Chief Operating Officer at the time. But now as CEO, instead of day-to-day operations he is in charge of the firm's overall strategy and allocation of capital. So my recent visit was to confirm that the business plan was the same (or better) and all the things we admired about McCormick in the past would be present in the future. The meeting was a good one and I was able to see some updated testing labs, tour the spice mill, and develop a better understanding of Lawrence Kurzius as a CEO.

Visiting and speaking with management is about getting answers to questions but it is also about the intangible things like *how* they answer questions and what degree of confidence we have in those answers. Sometimes there are leaders who appear to be such an integral part of the company that people can't separate the two. Think about Apple and the death of Steve Jobs. Jobs was a visionary leader, for sure, and there were many doubts that the company could carry on his without him. All of history is not yet written on this subject, but Jobs died in 2011 and the company has continued to thrive. Imagine the pressure his successor, Tim Cook, has been under to demonstrate that Apple could continue without Jobs – there were many opportunities for staking his own claim as the next great visionary. Those are also opportunities to make great mistakes. Instead, Cook has been understated and seems to be doing a good job.

We had a bad experience when McDonald's appointed long time executive Don Thompson as CEO. His tenure as CEO followed a long, successful transformation of the business, and then he oversaw an almost three-year period of flat performance that shook investor confidence. The McDonald's board realized their error and installed Steve Easterbrook as CEO in 2015. Not only do we now have all-day breakfast, but there are many other positive changes at the company and it has been reflected in the stock's performance.

Even at a great company, management is the intangible factor that can lead to above average or, on the other hand, below average performance. Recent CEO changes that we monitored are at Starbucks and Honeywell. We've met with both new CEOs in the past six months, and because each is following a strong leader who is attributed with the success of the company over the previous decades there was some trepidation about holding the stock through these transitions. We have finished our analysis and both, we believe, will do a good job of leading a great company forward.

When Microsoft CEO Steve Ballmer departed, investors cheered. I think there is a similar situation brewing at GE these days. The company has made great strides to transform to a leaner, more relevant company, but investors still have doubts that Jeff Immelt can get them to the next level and will probably react positively when he leaves. At Disney, the opposite is true: the board has again extended the contract for CEO Bob Iger, leaving one to assume they have not found the right person to continue his creative legacy.

Good products and services matter. But so does good management. We continue to keep an eye on both.

Mark Frombach
Chief Investment Officer

By the Numbers

At the end of the third Quarter 2016, Cash and Short Term Investments on the Balance Sheets of Standard & Poor's 500 Companies (ex-Financials) amounted to $1.54 Trillion dollars. That is a Year-over-Year increase of 7.6% from the third Quarter of 2015.

The top 20 companies in the S&P 500 ranked by cash balance made up nearly 52.5% of the $1.54 trillion total. Below are some examples of companies holding large quantities of cash:

Rank	Company	Cash Balance	YoY growth of Cash
#1	Microsoft	$136.9 Billion	37.8%
#2	Alphabet	$83.1 Billion	14.1%
#5	Apple	$67.2 Billion	61.4%
#6	General Electric	$52.5 Billion	(47%)
#7	Johnson & Johnson	$40.4 Billion	8.4%

If longer term investments (usually these are securities that are very liquid but earn more interest than the short term cash) were included in the cash balance totals, two of these change dramatically:

Apple $237.6 Billion
Microsoft $147.4 Billion

The numbers are staggering considering that for many publicly traded companies, their total market capitalization might only be a fraction of what the companies above have in cash. These companies have the flexibility to pay outright for acquisitions or increase shareholder wealth through stock buybacks or cash dividends. Since many companies collect revenue internationally and hold large sums overseas, cash holdings may be repatriated and brought back to the United States sooner if congress were to allow for either a tax holiday or some sort of tax break. That alone could fuel more cash dividends, buybacks, capital investment, or acquisitions.

We looked at the five companies above and wanted to bring together the idea of shareholder wealth creation through the stock buybacks and dividend payouts for Fiscal Year 2016:

	Stock Buybacks	+	**Dividends**	=	**Total**
AAPL	$29 Billion		$12.1 Billion		$41.1 Billion
GE	$22 Billion		$9 Billion		$31 Billion
MSFT	$14.8 Billion		$11.3 Billion		$26.1 Billion
JNJ	$7.3 Billion		$8.6 Billion		$15.9 Billion
GOOGL	$3.7 Billion		$0		$3.7 Billion

(Source – FACTSET, 10-K's)

Company News – select news from companies that we follow

MCD – Announced that by mid-2018, it will serve fresh beef, prepared when ordered, for all Quarter Pound Burgers in the majority of its store locations.

CL – Announced a 3% dividend increase effective in the 2nd Quarter of 2017. The company has paid uninterrupted dividends since 1895.

SBUX – Howard Schultz steps down as CEO for the 2nd time in his career. He passes the torch to Kevin Johnson as new CEO. Also, the company plans to hire a total of 25,000 veterans by 2025.

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