Robshaw & Julian Associates, Inc.

Trusted Investment Advice Since 1979

Investment Matters

For the quarter ended December 31, 2013

The Profitable Wall of Worry

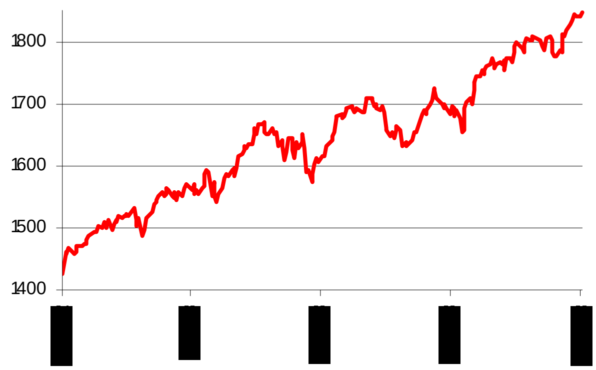
It is often said that the stock market climbs a wall of worry. Last year was an excellent example. There were many matters which skeptical investors focused on to justify staying out of the market. The market, however, ignored them all and rose steadily all year with no major pullbacks.

So what did the 'market' see in 2013 that the skeptics didn't?

At least three important things are happening that stock markets like. First, interest rates are low and the Federal Reserve continues to reassure us that they will remain low for the foreseeable future. Low interest rates push stock prices up. Low rates make stocks attractive relative to money market funds. If the choice is between a no risk investment yielding nearly nothing and a stock investment with a current yield of 2-4% plus potential price growth, it takes a lot of fear to overcome the obvious choice.

Low interest rates also provide cheap money to borrowers. Among the most aggressive borrowers are those who speculate on stock prices. Thus low interest rates provide not only a good reason to own stocks but an inexpensive means for speculators to leverage their investments. These benefits are very powerful.

Second, there is no inflation on the horizon. Inflation hurts stock prices in a number of ways. First, it induces the Federal Reserve to raise short term interest rates. Second, it robs buying power from consumers. Third, it disrupts company finances and hurts profits.



THE S&P 500 INDEX WENT UP STEADILY ALL YEAR WITH NO MAJOR PULLBACKS

Inflation develops when overall consumer demand for economic goods and services grows faster than they can be supplied. Not only does this seem very unlikely at the current low rate of economic growth but exactly the opposite is happening on a worldwide scale. High unemployment and falling commodity prices are clear indications that inflation is not developing now.

Third, profit growth continues to be good. Sales growth is slow but this has created an incentive for business to streamline and automate operations to bring more money to the bottom line. Tough times are also forcing low margin businesses to shut down; those remaining are more efficient and profitable. Low interest rates offer a means for businesses to refinance their debt and reduce their costs. Lastly, low rates enable companies to buyback stock. The same amount of profits then allocated to fewer shares of stock means more earnings per share.

Right now, these positive factors continue. They are the ones which investors should focus on to evaluate the health of the market going forward.

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U.S. Economic Freedom Slips in Survey

Each year the Wall Street Journal and the Heritage Foundation publish the Index of Economic Freedom, which ranks 183 countries around the world on 10 measures that evaluate openness, the rule of law and competitiveness. The ratings system is based on objective criteria as reported by a variety of independent and governmental organizations around the world.

The index is highly correlated with prosperity. Higher ranking countries generally have higher economic output per capita. This year the economic output of the top six counties averages about eight times what the bottom group produces.

Sadly, the U.S. has dropped in the rankings for seven years in a row. We are now ranked number 12 with a score of 75.5. Hong Kong, Switzerland, Canada, New Zealand, Chile, Ireland, Denmark and Estonia all have higher scores.

The U.S. has high scores for labor and trade freedom but does poorly on fiscal freedom (taxes and debt) and government spending. Our scores for monetary freedom,

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Freedom: continued

freedom from corruption, business freedom, financial freedom, investment freedom and property rights are all good, although property rights experienced a significant decline since 2013.

All nine movies nominated for an academy award this year were filmed in jurisdictions which provided tax incentives to the filmmakers.

In the last four years the Federal Reserve had profits of $80 billion. Exxon's profits for the same period were only $40 billion.

Stock Allocation for Retirement

Deciding how much of your retirement nest egg to allocate to stocks when you retire is not easy. There are many things to consider before making your decision.

First, do you have sufficient assets to cover your income needs in retirement? You will need an investment portfolio equal to at least 20 times your initial withdrawal amount to be reasonably confident of producing an inflation adjusted income stream for the remainder of your life. This implies a 5% or lower withdrawal rate.

Second, what other assets do you have which will provide income during your retirement? Most people will receive income from Social Security. Many have defined benefit pensions. These are guaranteed to provide income for life. To figure the value of these income streams as investment assets, multiply the annual income by 20-25. This is what you would have to invest to generate an equivalent income stream. This all represents fixed income since it does not grow in value.

If you add together the amount of your investments and the asset value of your guaranteed income streams, the result is your effective asset base for retirement. For some time now retirement experts have recommended that the fixed income portion should be a percentage about equal to your age. If you are 65 years old, have $600,000 in investments and your guaranteed income streams are worth an additional $800,000 as assets, then 65% of $1,400,000 or $910,000 should be in fixed income investments. Since you already have $800,000 in fixed income, only $110,000 of your investment portfolio needs to be invested in fixed income and $490,000 should be in stocks.

For many people, allocating more than 80% of their investments to stocks at age 65 may seem excessive. Remember however that stock dividends are reliable and likely to grow while interest rates can go up or down over time. Investors who relied on bond interest income in 1981 when rates were over 15% received a rude surprise when they had to reinvest the proceeds years later at less than half that yield.

Third, do you have more than you need to provide sufficient retirement income? If you plan to leave an estate, your investment horizon may be extended by many years. This would allow for a greater allocation to stocks, perhaps as high as 100%. If you need just $100,000 in annual income from your investments and you have $5,000,000 to invest, the 2% dividend yield currently available from stocks covers all your needs, and as a bonus, is highly likely to grow faster than inflation.

Recently, financial planners have stressed the possible effects of bad luck on your retirement plan. Rules of thumb are based on averages; real life is more variable. If you experience a large loss in the early years of your retirement, it may impair your portfolio enough so that it cannot meet your lifetime income needs. Using a lower withdrawal rate or adding a cushion are ways to alleviate this risk.

For a complementary review of your investment portfolio please call our office at (716) 633-6555 to schedule an appointment at your convenience.

The Bottom Line: 12/31/2013

Market Indicator	Current Value	One Year Change
Large company stocks *(S&P 500 Index)*	1848	32.4%
Small company stocks *(S&P Small Cap Index)*	666	40.7%
Short term interest rates *(3 Month T-Bill Yield)*	0.1%	No change
Long term interest rates *(10 Year T-Bond Yield)*	3.0%	From 1.8%
Inflation *(Consumer Price Index)*	234.6	1.5%
Energy *(West Texas Intermediate Crude Oil)*	98.70/bbl.	7.6%
The economy *(Inflation adjusted GDP)*	$16.9 trillion	2.0%

QUOTABLE

"If everybody's optimistic, who is left to buy? If everybody's pessimistic, who is left to sell?"

Bob Stovall, Stock Market Strategist

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