**Robshaw & Julian Associates, Inc.**

*Trusted Investment Advice Since 1979*

# Investment Matters

**For the quarter ended September 30, 2013**

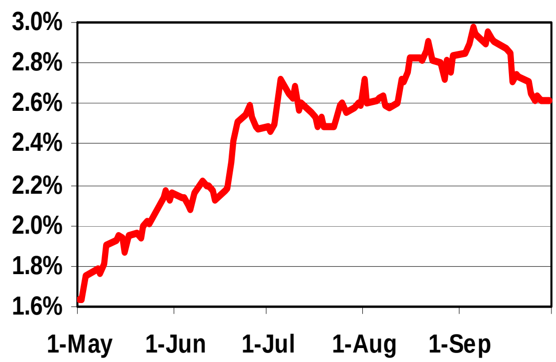
## The Bond Market May Be Getting Back to Normal

Essential to an understanding of the bond market is the concept that, as the price of an existing bond falls, the interest yield on that bond rises. When the price rises, the yield falls.

In just four months this year, from early May until early September, the price of the U.S. treasury 10 year bond declined nearly 12%, driving the yield on that bond from 1.63% to 2.98%. Although prices have recovered somewhat and the bond is now yielding about 2.6%, the fact remains that the trend in bond prices has turned decidedly down in the past year and that the direction of interest rates seems to be up.

Historically, Treasury bond interest rates have gone up for one of two reasons: market participants either raised their economic growth expectations, a good thing, or raised their expectations for future inflation, a bad thing. Sometimes it was both, as an overheated economy is often viewed as a cause of inflation.

But this time there was a more likely third reason: the market suddenly realized, based on comments by Fed Chairman Ben Bernanke, that quantitative easing (QE), the unprecedented monetary stimulation which the Federal




The Yield on the Year Treasury Bond Went Fom 1.6% to 3% in Just Four Months

Reserve began in 2009, will soon be coming to an end. While one can debate the positive or negative economic effects of QE, it now seems obvious that QE was effective in keeping bond yields abnormally low.

Normally, the yield on the 10 year Treasury bond doesn't stray too far from the nominal growth rate of the economy, the measure of GDP growth which includes both inflation and 'real' growth. In the middle of last year however, while nominal GDP growth was running at 4.75%, the 10 year bond was at a 50 year low yield of 1.4%. This large difference was why we reported at the time that, "bonds and other interest bearing securities are priced irrationally high".

By early September, when the 10 year bond was yielding nearly 3%, the reported nominal growth of GDP was 3.1%. With the bond yield so close to the rate of GDP growth it appears that the bond market has priced in the termination of quantitative easing and returned to more normal pricing.

For a complementary review of your investment portfolio and how it may respond to changes in the bond market please call our office at (716) 633-6555 to schedule an appointment at your convenience.

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## It's All About Profits

For investors in stocks, profits are the most important thing. Everything else is either of secondary importance or should be evaluated based on how it is likely to affect profits.

Some things affect profits more than others. Inflation is probably number one. In addition to being disruptive to business, inflation reduces the real value of profits. During the 1970's the rate of inflation sometimes exceeded the rate of profit growth. The result was that real profit growth was negative. This had a profoundly negative effect on share prices. When inflation turned around in the 1980's, stock prices went up strongly for many years.

Economic growth or decline also affects profits. A better economy usually means more profits, and vice versa, but this isn't always true. The correlation between economic growth and profits is far from perfect. Today is a great example. Profit growth has been strong while economic growth has been tepid.

Changes in tax rates and regulatory policies may also affect profit growth, but such effects are difficult to quantify. Policy changes take time, allowing businesses to adjust. They also may have multiple, often unintended, effects,

*Continued on page 2.*

***Profits: continued***

some good, some bad for profits.

Financial instability has profound effects on stock prices but usually much less effect on profits. In a serious financial crisis investors may panic and price stocks as if the entire financial system is about to collapse, a situation which could obliterate profits. This rarely happens on anything other than a local scale. As with most illnesses, financial fevers usually break quickly with little long term effect on profit health. Financial crises usually begin and end quickly making it difficult for any but the most bold and agile investors to time them correctly.

Lastly, it's important to understand that future profits are much more important than existing profits. If expectations about future profits are falling, stock prices are most likely to go down, even as businesses are reporting record profits. It's really all about PROFIT EXPECTATIONS.

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# Not Widely Known

In the city of Detroit, it is now cheaper to buy an average house ($20,204) than an average new car ($31,125).

As of August this year, women have regained all of the jobs lost during the recession (and are now 38,000 jobs ahead of the count in December 2007), while male employment is still 2.14 million jobs below the 2007 peak.

Americans spend 6.6% of their income on food, the lowest percentage in the world and less than half of what they spent in 1970.

The north polar icecap is now (August, 2013) at 192,000 square miles, up 60% in just one year and the largest size since 2006.

The world total fertility rate has declined from nearly five births per woman in 1960 to 2.4 births per woman in 2010.

Although the total world labor force is still growing, labor force growth in developed nations is at a standstill. Future growth will come from Asia (54%) and Africa (33%). The labor force in Europe is shrinking.

Demographer Dick Hokensen at ISI estimates that 90% of the recent decline in the work force participation rate in the U.S. is the result of our aging population and only 10% is due to the weak economic cycle.

As a separate country, Texas would now be the 10th largest oil producing nation in the world, just behind Kuwait and just ahead of Mexico.

Since 1998 the price of college textbooks has risen 142%, three times as much as the CPI inflation index. Other book prices are up only 1.6% over the same period.

Nearly 92% of all new mortgages are now guaranteed by the government, i.e. the taxpayer.

In 1960 only 21.5% of U.S. households owned more than one vehicle. Today, 57% do.

In 2001 only 20% of people making less than $20,000 (in 2009 constant dollars) owned a computer. Today, 48% do.

Currently, about 2.1 of every thousand workers apply for unemployment benefits each week, just slightly more than the record low of 1.9 per thousand in 2007.

In 1998, businesses with less than 500 employees produced 50% of the output of the U.S. private economy. Today that has fallen to 45%.

According to pure-gas.org, there are 245 gas stations in New York State which offer ethanol free gasoline. Nationwide there are 7,351.

The volume of world trade is now 8% above its previous cyclical peak in 2008.

The job layoff rate is the now the lowest since 2000. The rate of people quitting their jobs is up 35% from the recession low.

# The Bottom Line: 9/30/2013

| Market Indicator | Current Value | One Year Change |
|---|---|---|
| **Large company stocks** *(S&P 500 Index)* | 1682 | 19.3% |
| **Small company stocks** *(S&P Small Cap Index)* | 608 | 30.9% |
| **Short term interest rates** *(3 Month T-Bill Yield)* | 0.1% | No change |
| **Long term interest rates** *(10 Year T-Bond Yield)* | 2.6% | From 1.6% |
| **Inflation** *(Consumer Price Index)* | 233.5 | 1.5% |
| **Energy** *(West Texas Intermediate Crude Oil)* | $102.29bbl. | 11.1% |
| **The economy** *(Inflation adjusted GDP)* | $16.7trillion | 1.6% |

QUOTABLE

*"What pays under capitalism is satisfying the common man, the customer. The more people you satisfy, the better for you"*

Ludwig von Mises, Economist

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