Robshaw & Julian Associates, Inc.

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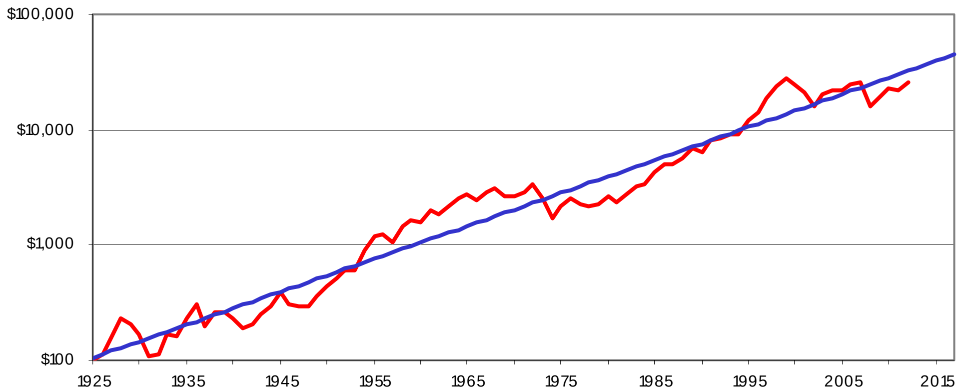
Investment Matters

For the quarter ended September 30, 2012

Reversion to the Mean



$100 INVESTED IN IN THE S&P 500 IN 1925 HAS OVER $25,000 IN PURCHASING POWER TODAY.

The chart on this page was first presented by Jeremy Siegel in his 1994 book “Stocks for the Long Run”. It shows the cumulative real return of the S&P 500 Index (the red line) from the end of 1925 to the end of last month, a period of nearly 87 years. Although this period included the Great Depression, numerous recessions, World War II, Korea and Vietnam, the returns have been astounding.

$100 invested in the S&P 500 Index at the end of 1925, with dividends reinvested, would today be worth over $25,000. This is after subtracting the effects of inflation. On an annual basis this works out to a real return of 6.6% per year. This is much better than real estate and far better than bonds. The real return from gold is near zero. Clearly, stocks have been the best investment for the long run.

But the purpose of the chart is not just to show what happens if you invest your money in stocks and don’t touch it for nearly nine decades; no one can do that. Notice the blue line which runs through the chart. That line represents the center of the trend of real inflation-adjusted stock returns. It slopes upward at a rate of 6.8% per year.

The intent here is to point out that there has been a consistent underlying trend of real stock returns. When returns fell behind the trend, they always caught up. When they got too far ahead of the trend they always fell back. Now, after years of weakness, stock returns are below the trend line; this argues for better times ahead.

> “...stock returns are not random

Skeptics may view this trend as a random walk. They would argue that stock returns are not bound to continue to follow the historic pattern. But stock returns are not random. They represent the results produced by bright, hard-working people trying their best to maximize business returns in a free-market economy. As long as you expect that to continue, real stock returns will always return to their old trend.

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It’s Those Boomers Again

Recent articles suggest that individual investors, weary of high volatility and poor returns are giving up on stocks. If so, it is a very peculiar response to a bull market.

The facts are clear. In the past five years stock mutual funds, the preferred equity investment of individual investors, have experienced an outflow of funds of nearly $500 billion. During the same period, bond funds have received nearly twice that amount of new money.

From the data it looks like typical investors are abandoning stocks. There are some good reasons for this assumption. Stock market returns since the peak of the technology bubble in 2000 have been far below historical norms while bonds have done better than average and better than stocks. Stocks have also experienced more volatile returns, including two gut wrenching 50% declines in the 12.5 years period.

But there is something missing from this explanation. Investors usually dump stocks after a punishing decline, something which hasn’t happened for years. In fact, from the stock market low in 2009 until now, a full three and a half years, stocks prices have more than doubled and

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Boomer: continued

total stock market returns have exceeded 25% per year. Bonds returns, while less volatile, have averaged one third to one half as much.

Perhaps market performance is not the whole explanation. Maybe it's the baby boomers.

The baby boomers are the pig in the demographic snake, a population bulge which has driven economic and cultural trends for nearly 67 years. The peak of the wave is now entering retirement. Suddenly, sixty-something boomers are realizing they can't take as much risk as they did previously. It's natural that they would adjust their asset allocation by selling stocks and buying bonds, no matter what the markets are doing. Because they are so many and because the majority of them are doing the same thing, it causes what appears to be a generalized shift out of stocks.

Baby boomers may be doing what comes naturally. Other, younger, investors would be wise not to follow them.

Not Well Known

Harvard researchers have found that electric power plants reduced their greenhouse gases by 8.76% in 2009 alone. Most of this was due to a shift from coal to natural gas driven by falling gas prices.

The Pew Research Center reports that after four decades of heavy Mexican migration to the U.S., net migration has fallen to zero. In addition to a less attractive U.S. economy, Mexican population growth has moderated, resulting in fewer desperate young people looking for work.

In 1998, natural gas was used to generate about 15% of our electricity while coal provided over 50%. Today, both provide equal amounts, each about one third of total production. The remaining one third comes from hydro, nuclear and other sources.

Anna Schwartz, an economist who was nearly as accomplished but not as famous as her husband Milton Friedman, passed away on June 21st at age 96. In an interview a few years ago she commented on the bank bailouts: "Everything works much better when wrong decisions are punished and good decisions make you rich."

Fifty-nine percent of all current college degrees are awarded to women, up from only 39% on 1966.

In Hong Kong there are 64 billionaires, about one for every $4 billion of national economic activity. In the U.S., it takes eight times as much economic output or $32 billion in GDP, to produce a single billionaire.

Over the past 22 years the percentage of U.S. workers employed by new start-up businesses ranged from 1.0% to 1.2% of all U.S. workers. From 2007 until 2011 the percentage declined to 0.75%, the lowest on record.

The Index of Economic Freedom, published by the Wall Street Journal and the Heritage Foundation, rates 179 countries on various factors related to economic freedom. The 2011 survey puts the U.S., with a score of 7.60, in 10th place, behind Australia, Canada, Chile and Ireland. In 2000, the U.S. ranked third with a score of 8.65.

Domestic oil production is running at the highest rate in 15 years, largely due to new technology and new fields which have opened up in Texas and North Dakota. Foreign sources now provide just over 40% of our requirements, with most of that coming from Canada and Mexico.

The Society of Manufacturing Engineers predicts that the shortfall of skilled factory workers might increase to three million unfilled jobs in the next three years due a pending wave of Baby Boom-age retirements and a strong rebound in U.S. manufacturing.

An average worker in India must work almost 55 minutes to earn enough money to purchase a half liter of beer. A U.S. worker earns enough for a beer in about 5 minutes, the lowest in the world.

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The Bottom Line: 9/30/2012

Market Indicator	Current Value	One Year Change
Large company stocks *(S&P 500 Index)*	1441	30.2%
Small company stocks *(S&P Small Cap Index)*	468	33.4%
Short term interest rates *(3 Month T-Bill Yield)*	0.1%	No change
Long term interest rates *(10 Year T-Bond Yield)*	1.6%	From 1.9%
Inflation *(Consumer Price Index)*	230.1	1.7%
Energy *(West Texas Intermediate Crude Oil)*	$92.06bbl.	15.1%
The economy *(Inflation adjusted GDP)*	$15.6 trillion	1.7%

QUOTABLE

"Artificially low interest rates change people's speculative behavior in ways we may come to regret."

James Grant

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