Robshaw & Julian Associates, Inc.
Trusted Investment Advice Since 1979

Investment Matters

For the quarter ended September 30, 2015

Correction or Bear Market?

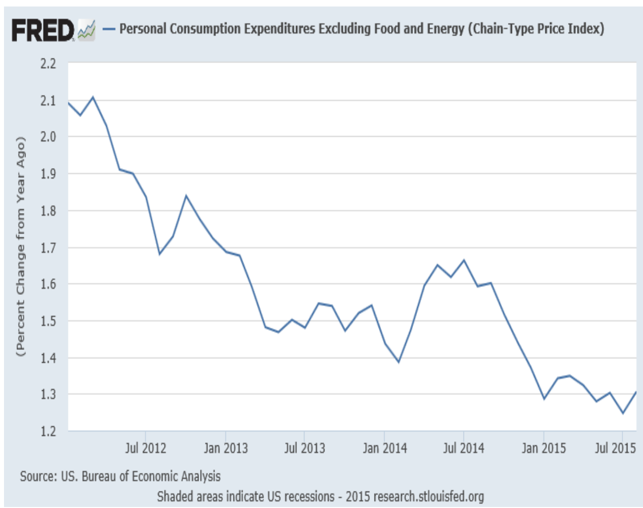
After two brutal 50% stock market declines in the last 15 years most people are very anxious to avoid the next bear market.

The August 11th report that China would allow their currency to find a new lower value led to a 10% decline in U.S. stock prices over the next 10 days. The sudden pullback resulted in a negative 7% return from the beginning of the year, enough to frighten away skittish investors.

Big bear markets in which stock prices decline by more than 40% are extremely rare; only three have occurred in the last 70 years, 1973-74, 2000-2002 and 2008-09. These three, as well as all but one (1987) of the declines greater than 20%, were soon followed by an economic recession. Virtually all of these recessions were precipitated by a severe tightening in monetary policy by the Federal Reserve, a change of policy designed to dampen the growing wave of inflation.

History shows that bear markets are caused, almost exclusively, by recessions which result from the Feds efforts to slow the economy and curtail inflation. Today however, there is no sign of inflation on the horizon.

The Consumer Price Index is up only 2 tenths of 1% over the last 12 months. The core inflation rate is running at 1.2% and has been



THE FEDERAL RESERVE WILL NOT TIGHTEN MONETARY POLICY UNTIL THE INFLATION RATE HEADS MUCH HIGHER

decelerating for six years. Raw material prices have been falling for more than four years. Wages are not accelerating. The economy is not overheated, in fact, it is growing slower than its estimated potential. If the economy continues to grow slowly it will be at least three years before it could begin to generate an inflation problem.

> *Big bear markets are extremely rare*

Many people look at profit trends to predict recessions and it's true that profit growth for S&P 500 companies, has been flat recently. Most of this is due to the energy sector which is struggling to deal with a big decline in oil prices. The rest of the economy is doing much better. Profit growth for all corporations was recently reported at 8% over the past year, faster than the long term average rate of 7%.

When Japan's economy collapsed in 1989 the ripple effect on the U.S. economy was not a big problem. A weak China is not a good thing but it hardly qualifies as a reason to dump U.S. stocks.

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

Stock Market Tidbits

Contrarians take note. When stock market returns are far above average for a period of 10-15 years it is wise to expect below average returns for the upcoming 10-15 years. The opposite is true when long term returns have been significantly below average. Right now, 15 year trailing annual returns for the S&P 500 have averaged 3.8%, the lowest they have been since 1974. Those who invested at the end of 1974 had average returns of 18% per year over the next 25 years.

The recent 12.5% pullback in the S&P 500 Index is not unusual; there have been 100 market pullbacks of less than 20% in the last 70 years. The average time to recover once the low has been established has been about three months.

The number of periods in which one negative year is followed by another amount to only four in the last 89 years.

Recent market volatility is not at all unusual. What is unusual is the past 3-4 years when volatility was far below historical averages.

Seventy-three percent of the years since 1926 have yielded positive stock market returns, with an average annual return of 11.9% for the

Continued on page 2.

Living on Your Retirement Nest Egg: The 4% Rule

In the last issue of this newsletter we emphasized the need for an investment and spending plan to cover your retirement years. In this issue we will focus on how much you can afford to spend.

In recent years the so called '4% Rule' has become popular. This rule is based on withdrawing 4% of your retirement nest egg in the first year and adjusting the amount for inflation in each subsequent year. The buying power of your income will remain constant for the rest of your life. Studies of historical returns show that by following this rule, it is very unlikely you will run out of money before you pass away. In most cases you are likely to leave something for your heirs.

The problem with the 4% rule is that it has not worked every time in the past. If you start taking your withdrawal in a year when markets are overvalued there is a small chance that you will eventually run out of money. 4% of an initially overvalued portfolio can quickly reach 6% if the markets fall hard, and this is too high to last a lifetime. Setting your initial withdrawal too high is one of the most common causes of retirement plan failure.

But there is a simple solution to this complex problem. Rather than calculate 4% of what you have invested at the time you retire, base your calculation on the average value of your portfolio over the previous three years (use monthly or quarterly valuations for the calculation). In a rising market this will reduce your initial withdrawal and help prevent you from taking too much; in a falling market it will prevent you from taking too little or deferring your retirement until markets improve. The need to make this calculation is a good reason to save your investment statements.

There are other spending rules for retirement but they each have serious shortcomings. The oldest one is to spend only what your portfolio produces in dividends and interest. One problem here is that interest rates are highly variable over time. This means that the income which is produced by your portfolio may fluctuate greatly from year to year. Also, when rates are high, investors are tempted to move money into fixed income investments from stocks. When rates subsequently fall their incomes tumble down. Even worse, income strapped retirees looking for higher yields may inadvertently take on an unacceptable level of risk, with possible catastrophic results.

If any of your investments are in IRAs or other tax-deferred vehicles, the government has its own withdrawal schedule you must follow called the Required Minimum Distribution (RMD). This formula was designed to prevent you from extending the tax deferral until the next generation. In the year you turn 70.5 you are required to withdraw 3.65%. The percentage rises every year, reaching 8.77% when you are 90.

You can still follow the 4% Rule even though all your retirement money is in an IRA. Although you must remove the required amount from your IRA each year, you do not have to spend it all. Simply take any extra income and invest it in another (non-IRA) account. Your nest egg will then consist of the two accounts combined.

Tidbits: continued

full 89 years. Only six years produced a return worse than negative 20% while 33 years produced returns above 20%.

Since 1960 the dividend paid by the S&P 500 Index has increased at a rate of 5.5% per year. The current dividend has nearly 2.5 times the purchasing power of the dividend in 1960.

The Bottom Line: 9/30/2015

Market Indicator	Current Value	One Year Change
Large company stocks *(S&P 500 Index)*	1920	-0.6%
Small company stocks *(S&P Small Cap Index)*	650.2	2.4%
Short term interest rates *(3 Month T-Bill Yield)*	0.1%	No change
Long term interest rates *(10 Year T-Bond Yield)*	2.1%	From 2.3%
Inflation *(Consumer Price Index)*	237.9	0.2%
Energy *(West Texas Intermediate Crude Oil)*	$45.09/bbl.	-50.6%
The economy *(Inflation adjusted GDP)*	$17.9 trillion	2.7%

QUOTABLE

"When written in Chinese, the word 'crisis' is composed of two characters. One represents danger, and the other represents opportunity."
John F. Kennedy

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