**Robshaw & Julian Associates, Inc.**

*Trusted Investment Advice Since 1979*

# Investment Matters

**For the quarter ended March 31, 2010**

## Sector Performance Foretells Economic Recovery

| Sector | Bull Market Gain |
|---|---|
| Finance | 139% |
| Consumer Discretionary | 119% |
| Industrial | 110% |
| Materials | 102% |
| Information Technology | 92% |
| **S&P 500 Index** | **73%** |
| Telephone | 58% |
| Energy | 56% |
| Health Care | 55% |
| Staples | 54% |
| Utilities | 39% |

The stock market is a leading indicator of the economy. It typically peaks or bottoms about six months before a significant turn in the economy. But with the economy still struggling, many observers have suggested that it's different this time — that a better economy will be long delayed.

Analysts assign stocks to ten sectors representing different parts of the total economy. There is a sector for materials (metals, chemicals), industrials (machinery), financials (banks, brokers and insurance), health care (pharmaceutical and hospitals), energy (mostly oil and gas), utilities (electric and gas), staples (food, household products), information technology (computers, communications equipment), consumer discretionary (autos, housing and retail stores) and telephone (services).

Each of these sectors is represented by an index mutual fund. By looking at the relative performance of these funds we can obtain a more detailed picture of what the stock market is forecasting. The table above illustrates the performance of each of the Vanguard Group sector funds from the market bottom on 3/9/2009 until the end of the recent calendar quarter.

Finance, Consumer discretionary, industrial, materials and information technology all have outperformed the overall stock market. Except for energy, these are the sectors which traditionally lead the market in predicting an economic recovery. Telephone, energy, health care, staples and utilities have all underperformed. Again, except for energy, these sectors are less sensitive to changing economic expectations. Based on these differences, it is clear that stock investors are counting on a better economy, one which includes both stronger manufacturing and a stronger consumer.

> *"By looking at the relative performance of these (sector) funds we can get a more detailed picture of what the stock market is forecasting"*

But with the finance sector in the top spot at 139%, it is just as clear that the market has also been driven by relief that the financial system didn't collapse , as was feared early last year.

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## America's Growing Debt

A recent study suggests that America's national debt may soon reach a level which depresses long term economic growth. Two economists, Carmen Reinhart of the University of Maryland and Kenneth Rogoff of Harvard, studied the link between national debt levels and economic growth over the last two hundred years. Developed nations with gross public debt exceeding 90% of annual economic output tended to grow more slowly than those with lower levels. The difference was 1-2% per year.

Annual economic output or GDP for the U.S. was $14.5 trillion in 2009. The historic real growth rate for the U.S. economy has been about 3% per year, 2% from increases in worker productivity and 1% from population growth. A 1-2% decline from this level would imply economic stagnation.

For the U.S., gross national debt includes treasury securities held by the public as well as intra-government obligations arising from Social Security, Medicare and other similar programs. It currently stands at $12.25 trillion, up from $7.7 trillion only five years ago.

Gross federal debt is now 84% of GDP, the highest level since a short-lived spike at the end of World War II. The Congressional Budget Office

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***Debt: continued***

projects that over the next five years the economy will grow to $17.6 trillion and that deficits will add $5.2 trillion to the national debt, raising gross debt to $17.5 trillion. As a result of these developments the debt to GDP ratio will increase to 100%.

As alarming as this projection may be, it fails to take other government liabilities into consideration. In addition to the securities included in gross debt, the federal government owns or guarantees about $6 trillion in mortgage related assets or securities. State and local debt ($2.3 trillion) and unfunded state government pension obligations ($1 trillion) are also not tallied with gross national debt.

*Surveys of households show employment increases over the last three months have averaged 370,000.*

## Is 100 Minus Your Age the Right Equity Allocation For Your Portfolio?

Of the many rules of thumb for allocating your investment portfolio to stocks and fixed income investments, none are older than the idea that the equity weighting should equal 100 minus your age.

But, in today's world, with trust accounts for 70 year old widows holding 60% in stocks, this old rule seems hopelessly outdated and conservative.

When the rule first evolved most people relied on modest savings to carry them through a short and largely inactive retirement. A person who retired at age 65 was unlikely to live 15 or 20 more years, and even if they did, they stayed close to home, spent little and relied heavily on family members for support.

Today, retirement is much longer and more active. Virtually all retirees receive Social Security income and many receive a pension from their former employer. Many retirees also have investment portfolios derived from employee 401k plans. All of these "assets" need to be considered in arriving at a suitable portfolio mix.

Pensions and Social Security income checks are like interest payments from fixed income securities. In a sense your entitlement to this income represents a 'fictional asset' which you own. If you calculate the asset value of these income payments and add it to the market value of your investment portfolio, it then makes sense to apply the 100 minus your age rule.

Let's say you are age 65 and that during retirement you expect to receive $24,000 per year from Social Security and $11,000 from your company pension. At an interest rate of 5%, it would take $700,000 in 'fictional assets' to produce this $35,000 in income. Additionally, let's assume that you have an investment portfolio worth $800,000. In total you have $1,500,000 in assets available to support your retirement.

Applying the 100 minus your age rule to these assets would call for 35% of $1,500,000 or $525,000 as a suggested equity allocation. This means that 66% of your securities portfolio would be in equities. While this appears aggressive, it makes perfect sense when all your 'assets' are counted.

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*On March 12th, Moody's Investor Service announced that the triple A rating of U.S. treasury securities may be at risk in coming years as the nation copes with its growing debts. Moody's also issued a similar warning for the United Kingdom.*

## The Bottom Line: 3/31/2010

| Market Indicator | Current Value | One Year Change |
|---|---|---|
| **Large company stocks** *(S&P 500 Index)* | 1169 | 47.6% |
| **Small company stocks** *(S&P Small Cap Index)* | 360 | 62.0% |
| **Short term interest rates** *(3 Month T-Bill Yield)* | 0.2% | No change |
| **Long term interest rates** *(10 Year T-Bond Yield)* | 3.8% | From 2.7% |
| **Inflation** *(Consumer Price Index)* | 217.6 | 2.7% |
| **Energy** *(West Texas Intermediate Crude Oil)* | 83.76/bbl. | 69% |
| **The economy** *(Inflation adjusted GDP)* | 14.5trillion | No change |

QUOTABLE

*"The four most dangerous words in investing are: This time it's different."*

John Templeton

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