Rochester Financial Services

Fee-Only® Financial Management Services

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Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
13,391	1,459	3,101	873	1.91%	7.20%	$1,663	$92.81

Investment Strategy Report

After Surviving a Tumultuous 2012, Will We Be As Lucky in 2013?

We survived the fiscal cliff this past week and the stock markets rewarded us with a grand start to 2013. The Dow Jones jumped 308 points, its best point gain ever for the first trading day of a new year, after the D.C. politicians came to an agreement late Tuesday to avoid the fiscal cliff - for now. We all know that this was another example of kicking the can down the road, putting off the painful decisions about spending cuts until some time in the future. But for now, and at least until the end of February, when we will be faced again with debates about extending the debt ceiling, all seems well on Wall Street.

I say that we "survived" 2012 because a year ago, there was much to be concerned with. I pulled up some emails I got from clients near the end of 2011, as examples of what the prevailing sentiment was at the time. Here's one from 11/10/11: "Everything I've heard on TV and radio as well as read tonight indicate that the European crisis is only going to get worse. In the US, there is continued uncertainty about the economy and a lack of confidence in the administration and/or Congress to fix the situation. Perhaps it would be best to sell everything." Or this one from 11/19/11: "With the markets around 12,000 and such crazy instability in Europe, does it make sense to pull a big chunk from stocks ...". Since November 2011, the S&P 500 is up over 20%. I would think that I helped these clients as well as others stay the course through the market volatility of the last 14 months. A constant theme of my newsletters during this time was that yes, there are problems throughout the world and yes, we need to exercise caution, but the global economy is recovering, and maintaining a proper exposure to stocks should prove to be a good strategy over the long term.

I was pleased with our performance last year because not only did we achieve stock market-like returns, we were able to achieve this while being exposed to only a fraction of stock market risk. On average, my clients' portfolios had a beta of about 0.3, which means that as a whole, our portfolios dropped only 0.3% for every 1% drop in the stock market. This goal of achieving good returns with lower risk was accomplished due to the help of the true champions of 2012, the bond funds. The weighted average return last year of the bond funds I use at Schwab was over 12%. As I have discussed before, my bond fund strategy involved what I call a barbell approach, balancing more traditional bond funds with more moderate, higher yielding funds to produce a blended return that can do well in either a rising or declining interest rate environment. As it turned out in 2012, all the funds did well. I expect them to continue to perform in 2013, but a rise in interest rates, which appears to have already begun, will keep me on my toes.

Our stock funds also did well last year. Diversifying into emerging markets definitely helped as my top holding in that sector was up over 27%. I avoided European stock funds, which turned out well for the 1st half of the year, not so much the 2nd half as Europe settled down somewhat (although you can never be sure). Some of our US stock funds outperformed the S&P 500, while others, mostly our balanced funds were a few percentage points behind (as to be expected). My major faux pas of 2012 was hanging on to the gold funds too long. After they got off to a great start last January, they proceeded to tank. I jettisoned them last May which proved to be a few months too late. I will try not to make that mistake again.

As we begin 2013, it seems that we are in a similar situation to last year. Although we somehow managed to get over the fiscal cliff, we will most likely be faced with a nasty debate in Congress next month about raising the debt ceiling. Growth in the US will continue at barely a positive rate. While Europe has avoided the headlines in recent weeks (no news is good news) and things seemed to have settled down over there, you know that when we least expect it, Germany will refuse to pay for the debts of Greece, Spain, Italy (pick one) and investors will panic. China, while seemingly beginning to emerge from a 2 year bear market, seems to be always at risk. But the positives still should be able to keep the stock market moving in the right direction. Housing stocks soared last year due to the economic recovery. Auto sales are at levels not seen since the boom years. Financials, which can be seen as a barometer of our economic health, also had a great year last year. It may be another year in which we have to ignore the headlines and continue to pay attention to the fundamentals. *Jeff Feldman*

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