

# 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) | Differ- ential | Crude Oil |
|-----------|---------|--------|--------------|-------------|----------------------|----------------|-----------|
| 10,592    | 1,140   | 2,297  | 640          | 3.82%       | 6.55                 | -273           | \$82.64   |



## Investment Strategy Report

### Will Stocks Continue Their Winning Ways in 2010?

The stock market's impressive run from the lows of last March seems to be continuing. Of course, whenever we start a new year, the question is always, will the change in the calendar mean any changes for the stock market? The theme of my last few letters has been that while 1) we are definitely seeing improvements in the economy, 2) will the costs needed to fund these improvements prove to be our eventual undoing? So my investment philosophy remains the same – take advantage of the trends that are in place but make sure that we keep our defenses up.

For the past year, my strategy for reducing portfolio risk has been to use a higher percentage of corporate bond funds and a lower percentage of stock funds in client portfolios. I discussed this approach back in my January 2009 newsletter (it is now easy to view old letters. Check out my updated website (see below)). This strategy has worked extremely well thus far, as two of my top three bond fund holdings were up an average of 40% last year! At the same time, their volatility was less than one fourth the volatility of the S&P 500. This is a win-win situation – maintaining excellent returns while reducing risk. The “there's no such thing as a free lunch” aspect of this approach is that these funds are considered aggressive bond funds and in 2008, were down an average of 23%. So I have balanced these funds with more moderate and conservative bond funds for my more conservative clients, only because I know that the potential exists for these aggressive funds to take occasional hits, although these funds have not suffered a significant decline in over 13 months! Another potential problem with these bond funds is that now that they have more than recovered from the damage suffered in 2008, how much more upside potential exists for them?

A third concern about investing in bonds and bond funds is the risk of rising interest rates. No one wants to invest in a bond yielding 4% if you can get 5% by waiting a month. A recent Barrons article (12/21) surveyed 12 economists and asked them for their 2010 forecasts. Their consensus view for 10 year Treasuries was that rates (currently at 3.80%) would end the year at about 4.3%. This concern for rising interest rates is something that many of my clients have called to asked me about. However, as I have mentioned in the past, while an improving economy can cause Treasury rates to rise, corporate bonds are a different animal. As an example, a year ago, 10 year Treasuries bottomed out at a yield of around 2.10%. Our bond funds have managed stellar returns despite the fact the rates on Treasuries have jumped higher.

And what are these 12 economists saying about the stock market for 2010? Their average call is for the S&P 500 to increase by about 10% this year. Whenever an analyst calls for a 10% increase, that's another way of saying, “I have no idea but historically, stocks have returned 10% annually so that's what I'm going with”. It's also another way of saying that there's no reason to expect that the current trend will change, so let's go with what's working now. I tend to agree that stock prices will continue higher, with only minor pullbacks occasionally encountered. But it does get a little scary that investor complacency is on the rise. We haven't had even a minor pullback since the end of October and no major pullbacks since June. For now, I would say that the stock market is more concerned with the shorter term factors – corporate earnings reports, housing and retail sales, improving auto and airline industries. The longer term issues, such as paying for our trillions of dollars of debt, will probably just get kicked down the road a little bit further.

**Updated Website** – I recently made some improvements to my website, RochesterFinancial.com. In addition to the “improved” look, I have added an *Archives* section to my monthly newsletter page. You can now easily access my newsletters for the past 12 months. If you have any friends or family members who might be interested in my services, directing them to my site would be a good way for them to learn about my business and my investment strategy. Thanks very much. *Jeff Feldman*

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