INVESTMENT
UPDATE

ROMANO
BROTHERS & CO.
WEALTH MANAGEMENT
Protecting Your Prosperity. Securing Your Future. Since 1962.

Holiday 2012

A ROCK AND A HARD PLACE REDUX

Readers of this column know that I have routinely referred to this market environment as "investing between a rock and a hard place." This is because if one wasn't comfortable with the risk/reward ratio offered by equities, he or she could normally take refuge in the relative safety of fixed income securities generating a respectable five percent yield or so. Can't remember those days? Let me take you with me for a stroll down memory lane for a case in point. For fun I just pulled out my Romano statement from exactly five years ago, and the return on our money market fund in December 2007 was 4.63%! Clearly, there were respectable alternatives to being invested in equities at that time.

There is little sense to dwell in the past as we all must face the realities of being in an extended period of near zero percent interest rates, but this exercise underscores the "rock and a hard place" environment. Additionally, it seems that we will be stuck in these conditions for some time. The Federal Open Market Committee made two significant announcements in their October statement. First, the implementation of QE 3, in short, the purchasing of additional treasury securities designed to "put pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative." They also telegraphed that they anticipate that the "exceptionally low levels for the federal funds rate are likely to be warranted through mid-2015."

Anticipation of QE 3 in large part accounted for the rally in equities during the first three quarters of the year, with the Standard & Poors 500 index returning 16.44% (inclusive of dividends) over that 9 month period. In trader talk terms, QE 3 validated the "risk-on" strategy, directing cash flows into equity purchases. But traders operate on shorter term horizons, and as managers of your wealth we are concerned with longer term opportunities (and obstacles). So while we participated nicely in the rally mainly through the dividend paying equities we've focused on over the last two or so years, we have been constrained by gradually accumulated higher cash positions as a result of the rock/hard place environment.

However, we have recently become vindicated. We have commented in the past that Fed announcements don't trump market fundamentals. We see a lower growth environment for the foreseeable future due to global economic headwinds posed by Europe, slowdown in China, and fiscal constraints and political stalemate (i.e. the fiscal cliff) here at home. Post election, this has once again taken center stage as the market has corrected 7.8% percent from a high on the Dow of 13,610 on October 5 to its present level of 12,543 on November 15 (the date of this writing). Once again, caution rules the day.

The second part of the announcement anticipating a zero rate environment for the next three years is a bit puzzling in our view. Lower rates are commonly thought to be stimulative as they decrease borrowing costs—so for example, consumers might buy houses or businesses might make capital expenditures for expansion. However, it seems that this effect works best when rates are "on sale" for an unknown but perceived limited amount of time. What incentive do I have to stretch and buy a house today if I know the same favorable rate environment will be available to me a year or two from now? Why not wait until then to see if prices have bottomed?

We hope the Fed hasn't shot itself in the foot. That aside, we must take them at their word, meaning that we must expect low rates and low growth as well as a continuation of the rock/hard place conundrum. This has led to a new term which has emerged in conversations with many of you, as I have labeled the current market a "hold your nose and wade in" environment. Simply put, in order to generate any palpable rate of return, we have to accept more risk and do things we never had to do in the past. That might mean accepting greater volatility via a higher allocation to income producing equities, extending the average maturity of fixed income portfolio, or tolerating more credit risk.

Redux continued on next page

REDUX

To be clear, all of this is done in balance but it highlights the paradox investors face as the definition of a "conservative" portfolio is being redefined. In our view, this is yet another "unintended consequence" of the Fed's interest policy.

This holiday season takes on additional meaning for us as we close out a banner 50th anniversary year in business and celebrate all that we have accomplished together. Not only did we get a chance to celebrate with many of you in August, but we also rebranded the company name and logo, built a Skype room, and recently launched our revamped website **www.romanowealth.com** as we prepare for the next 50 years.

But the highlight for me not just for this year, but of my 17 years with the firm, was the production of the film "The Romano Brothers Story" which was unveiled for over 400 of you at our August event. We've included it as a part of this package as we close out this commemorative year. We hope you can take a few moments to watch it as each of you has a starring role as it documents our journey together.

Indeed we have much to be grateful for and we wish the same for you and your families this holiday season. We look forward to continuing to grow together.

Sincerely,

Joe Romano
PRESIDENT

FIXED INCOME RETURNS TO STAY LOW FOR FORESEEABLE FUTURE

With interest rates firmly entrenched at historically low levels, fixed income portfolio performance will be negligible for a few years. There are two ways to measure the return of a bond portfolio; total return and average yield.

We prefer to focus on the average yield a portfolio is generating. Essentially, if you invest in a bond that has a 5% yield to maturity and hold it for the duration, you will realize a 5% annual return. If your portfolio is comprised of twenty separate issues purchased at yields ranging from say 3% to 5%, you may have an average yield of 4% if you hold all issues to maturity. This seems pretty simple. We like to focus on this return because it is the truest measure of how the portfolio will perform over its lifespan. In today's low rate environment we are forced to add new positions to portfolios at lower yields than in the past. This will lower the average yield of the portfolio, but it should not have a drastic impact as long as one has locked in higher returns from years past.

The total return of a portfolio measures the yield when a bond is purchased as well as its change in price due to fluctuations in interest rates and the credit worthiness of the issuer over time. Since interest rates have drifted lower over the years, bond prices have moved steadily higher. This has had a positive impact on the value of portfolios and is the reason you may have seen a portfolio with an average yield of 4% produce year to date performance of 6%. As rates decline the value of your existing bonds will increase, however the price appreciation would only be captured if the bond is sold. This typically would not be a sensible thing to do since you would be forced to reinvest proceeds at the much lower rates. Over the life of a bond, market price increases or declines net out to exactly zero. To capture gains from price changes, it would require a consistent and uncanny ability to predict the course of interest rates and a low capital gains rate.

Herein lies the conundrum fixed income portfolios will be faced with over the next few years. With little room left for rates to decline further and, therefore, little possibility of further price increases, the total return one can expect their portfolio to produce, will be 1% to 3% which is where short to intermediate term issues are currently priced. Another hindrance to total return performance will be when rates eventually rise; existing bond prices will fall creating the perception of negative total returns. However, newer bond purchases can be made at higher yields boosting the average yield of the portfolio which will be of greater interest to most of our clients.

Consequently, we will continue to focus on a portfolio's average yield and dismiss price changes due to interest rate fluctuations. We would welcome a rise in rates, allowing for an increase in portfolio yields in spite of the short term negative effect it would have on total return performance. Investors should keep this in mind and expect price volatility once rates inevitably rise.

Doug Geisser
VP FIXED INCOME PRINCIPAL

THE RECEPTION AREA AT NORTH SHORE CENTER BEFORE OUR AUGUST GALA

ROMANO BROTHERS CELEBRATES 50 YEARS

It was the party of the century—or half of it. On August 16 Romano Wealth Management celebrated its 50 years of success by inviting those who made it possible to a golden anniversary event. Held at the beautiful North Shore Center for the Performing Arts in Skokie, nearly 400 clients, staff and family enjoyed an evening of friendship, food and music. Everything from a wine tree to a heart-thumping musical presentation from the 60's pop favorites, the Buckinghams, made it a night to remember.

PAT GILLIS, TODD GILLIS, DIANE GILLIS AND LINDA BOERWINKLE

JOHN AND DEE FISH

Clients from 14 states and the United Kingdom filled the NCSPA. Laughter, grateful thanks to Romano for their wise counsel over the years, shared memories and a general feeling of fulfillment were the hallmarks of the evening. John Davis, a client and former Evanston accountant traveled from Chanute, KS and said he 'was honored to be included'.

JUDY TRAMEL, BETH GEIGER, AND BILL TRAMEL

MICHAEL BERNARD, TINA GARRISON, AND MARIE FERN

Before introducing the Buckinghams who broke on the musical scene about the same time Romano Brothers debuted in the financial world, Chairman Richard Romano thanked the assembled guests for their loyalty and friendship throughout the years. The audience then enjoyed the film, *The Romano Brothers Story: 50 years*, a visualization of the American Dream...where hard work, single- minded dedication to an ideal and good people created an institution which will continue to thrive for the next 50 years.

LOOKING AHEAD—THE NEXT 50 YEARS

Come Skype With Us!

Did you know that 31% of Romano Wealth Management clients live outside of Illinois?

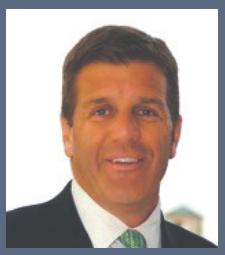
While Romano executives keep in touch in many ways, the company has recently made Skype available for even closer communication. This computer-to-computer model makes it an easy step to viewing your Romano representative in a live conversation.

PORTFOLIO MANAGER DEB CROSS SKYPES WITH DICK ROMANO AT RWM SOUTH—HIS HOME NEAR NAPLES FL

"We want all our clients to know that the next 50 years at Romano will be directed to many initiatives to enhance the client experience," according to Romano president, Joe Romano. "We've introduced a new logo, an outstanding new website **www.romanowealth.com**, eblasts, all geared toward making your time spent with Romano more fulfilling and informative," Romano added.

We invite our clients suggestions for facilitating stepped-up communication. With our new Skype set-up you can enjoy face-to-face conversation from the beach to the ski slopes. We look forward to hearing from you!

WE SALUTE!



JOE FLANAGAN

Joe Flanagan, a Romano Wealth Management client since 2001 is an entrepreneur in the fullest sense of the word. Nine years ago he realized that many small firms were limited in their growth because they did not have sales forces to match their dreams. Flanagan acquired Acquirent (acquire and client) a company dedicated to helping companies build world class sales teams enhancing company growth. Today the company is a leading provider of outsourced sales solutions from small startups to Fortune 500 companies. The company hired 40 new employees in 2012 and expects to hire 60 in 2013. *Inc. Magazine* recently recognized Aquirent, naming the company to its prestigious *2012 Inc. 5000*, a compilation of the fastest growing companies in America. Flanagan wryly says that Romano Wealth has protected him from being too aggressive in the market. "Running a business and raising a family keeps me busy all the time. Romano's in depth knowledge of market opportunities has saved me, from being me."

SUSAN HOPE ENGEL

Those of you who viewed Susan Hope Engel's film on the 50 year journey of Romano Brothers from a two- man office to a company with close to a billion dollars in assets, have seen how this talented woman brings photos, the written word and solid work ethic to life. Her most recent films have ranged from the 60th Anniversary film for SHORE Community Services to a documentary *(Unforgettable)* on the legacy of the Emerson Street (Evanston) YMCA. The Shore film won a 2011 Bronze Telly award and *Unforgettable* won 5 awards including a 2010 Silver Telly. *Unforgettable* also was featured in a New York Times story for its unique perspective on what was once Evanston's "Black YMCA". Susan's unique style of collective storytelling and outstanding work on many subjects makes her a frequent contributor to several film festivals.

MILESTONES

Doug Geisser Named Five Star Wealth Manager

Doug Geisser, Vice President of Romano Wealth Management, was recently named a Five Star Wealth Manager in the November issue of *Chicago Magazine.* The 2012 Five Star Managers are a select group, representing less than 3 percent of wealth managers in the Chicago area. Those selected are identified through internal and external research and a survey of over 11,800 registered financial services professionals as well as registration with FINRA or the SEC. Doug has served as Vice President of Romano Wealth Management for 22 years. He oversees the fixed income department and manages $250 million in client assets.

Grace Garby Receives FINRA Series 99 Certification

Romano Chief Administrative Officer, **Grace Garby,** recently received FINRA Operations Professional Series 99 certification. This new registration requirement for individuals responsible for operational functions was established to increase their awareness and knowledge of regulations protecting investors' interests and the integrity of the firm. Grace joined Romano Wealth Management in 2005 and has over 28 years of investment management experience in the industry. She oversees all Administrative and Human Resource functions of the firm.

Congratulations to Doug and Grace!

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