INVESTMENT
UPDATE

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

Summer 2012

A NOTE FROM JOE ROMANO

A recent *Morningstar* article noted that 2011 "ended with a statistical oddity of historic proportions," with the S&P 500 index closing exactly at the same place it started the year. Well not exactly if you go out three decimal places, as with a start on January 1, 2011 at 1,257.64 and a close on December 31 at 1,257.60, that is a loss of just 0.003% for the year. After a year of such macroeconomic uncertainty and market volatility, who would have thought the index would finish where it started? Much ado about nothing.

The S&P 500 doesn't tell the full story, as large cap domestic stocks (not to mention U.S. Treasuries) were one of the few safe havens in 2011. Emerging market indices were down 18% and the EAFE (akin to the S&P 500 of foreign stocks) returned -12%. This made for a tough year for portfolio managers, with even veteran Warren Buffet's Berkshire Hathaway portfolio returning -4.5%.

Similar to 2011, the market rallied in the first quarter of 2012 and the S&P 500 had a strong 12% showing. Interestingly, Apple accounted for 15% of that return. But also similar to last year, the market had a steep selloff down 6.27% in the month of May alone. Granted, this is less severe than the late July thru September 2011 pullback, but of note nonetheless as yet again, Europe's woes took center stage and a dismal U.S. employment report was enough to send investors reeling. It seems like a broken record, though attention now shifts to Spain, the latest recipient of a bailout.

The market has recovered some of May's losses though you'd be surprised at the explanation. It seems that things are so bad and the economic recovery so unstable that the odds of Fed intervention and stimulus have gone up. As we've written before and more importantly as we've now seen recently, this isn't the foundation for lasting bull markets.

So where is an investor to turn amidst this uncertainty, particularly with bond opportunities screeching to a halt as the ten year Treasury note recently hit an all time low yield of 1.4%? (Doug Geisser has more inside on strategies he is using for Romano Wealth Management clients to wring blood from a stone and capture excess yield in this low rate environment for our clients.) With bonds at their priciest levels, buyers are accepting yields that are four percentage points lower than the earnings yield for the S&P 500 index of stocks. The S&P 500 earnings yields is the earnings per share for the most recent 12 month period divided by the current market price per share, and shows the percentage of each dollar invested in the stock that was earned back by the company. Currently, the earnings yield is 7.59% while the investment grade borrowing cost index fell to 3.33% in May. This is one of the largest gaps in history and may point to bonds being overvalued and stocks being undervalued.

From an equity perspective, we believe the best way to continue to play this gap is through a dividend return strategy. While this strategy is not for all investors because it introduces principal risk through market volatility, it has its advantages in today's uncertain environment. First, a basket of stocks that yield four to five percent start out with a two to three percentage point advantage over the rest of the market, and pay three times the rate of the 10 year Treasury! Second, dividends are cold, hard cash that can't be faked the way reported earnings sometimes are. Finally, most dividends today are paid from economically defensive companies like utilities, large healthcare and energy firms, pipelines, real estate investment trusts, etc. For investors concerned about eventual inflation as we are, this is a great hedge.

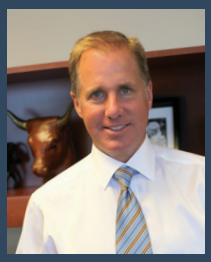
As further evidence, *Morningstar* notes that the total return of the market over the past 100 years was 9.5%. Dividends were the largest component of that return adding 4.4%. The second largest component was inflation at 3.4%, and the most volatile and least reliable was capital growth at 1.0%. Finally, dividend growth accounted for 0.7% of the 9.5% total return. If history repeats itself, it seems that dividend stocks are the best place to be in what we see as a low growth and looming inflationary environment.

On a side note, we hope that you can join us for our 50th anniversary celebration on Thursday, August 16 (details inside). We can't think of a better way to mark the occasion than to do so with all of you as we celebrate our mutual success. See you soon, but until then thank you once again for your continued trust and confidence in us.

Sincerely,

Joe Romano
PRESIDENT

WHERE CAN I EARN SOME INTEREST ON MY INVESTMENTS?



This is the number one question we have received from clients recently. The reality of the low interest rate environment is finally beginning to sink in with investors as yields continue to tumble across all sectors of the bond market. Ten year treasury yields declined to an all time low of 1.40% and the most recent 30 year bond auction resulted in another record low yield of 2.72%. Low longer-term rates coupled with short-term rates well below 1%, have left fixed income investors with very few options to conservatively earn a reasonable rate of return. This has accounted for the decreased activity in your accounts and is a far cry from the days when one was able to open a passbook savings account at a bank and earn 4.50%.

The real winners in all of this are the borrowers. Even though the U.S. government has added $5 trillion of debt over the last 3 years, the annual interest expense is nearly the same today as it was then. Mortgage rates are at all time lows while municipal and corporate bond borrowers have enjoyed record low borrowing costs. The losers are numerous retirees, pension funds and insurance companies who require a consistent cash flow to offset liabilities. However, there are a few strategies an investor can use to generate some cash flow and minimize principal risk and one involves the greater use of dividend paying stocks as Joe mentioned.

One strategy that can be deployed with bonds is the "kicker" bond strategy. A kicker bond is a callable, premium bond that is priced assuming it will be redeemed at its future call date in advance of its final maturity. However, should the call feature not be exercised by the issuer, the yield the investor will receive increases, or "kicks up," based on holding the high coupon bond to the later maturity date. Buyers often receive higher yields relative to non-callable bonds of similar maturities because they must be compensated for the uncertainty of the call. As an example, we recently had an A+ rated Marion County Florida School issue with a 5% coupon, due 06/01/27 and callable 06/01/17 at 100. The bond was priced at 109.12 which generated a 3% yield to the call and if not called the yield "kicked" to 4.17% to maturity. The yield to the call date was nearly 1.60% higher than similar rated new issues and 1% higher to maturity. The other advantage to this high coupon structure is a decrease in price sensitivity due to rising interest rates. Basically if 15 year bond yields rise 2% from today's levels (go from 3% to 5%) the Marion bond price would only fall nine percent to 100 whereas a 3% coupon bond would decline twenty percent if priced at the same 5% yield to maturity.

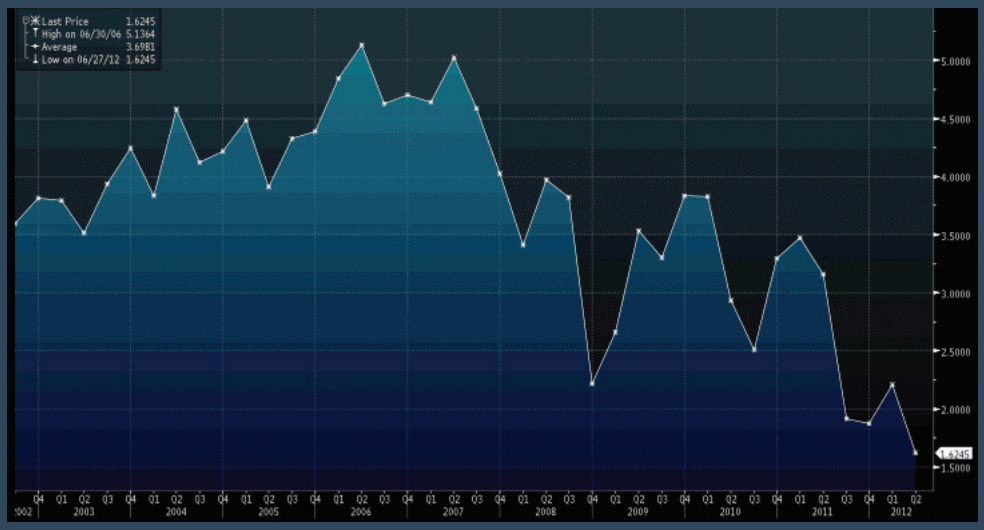
Another sector we have been utilizing more is the use of zero coupon issues. Zero coupon bonds are purchased at a discounted price and then the bondholder will receive full face value at maturity. A lot of income oriented investors tend to shy away from zeros since the interest earned is not paid out annually. Because of this, zero coupon issues typically have higher yields than regular coupon bonds.

We feel these issues are suitable for many of our clients even if they are looking for cash flow. For example, if you accrue $10,000 of interest annually in zero coupon interest you could withdraw $10,000 of principal and maintain the same account value. In addition zero coupon bonds offer semi annual compounding of interest at the yield you purchased the bond at, compared to no compounding in bonds that pay the interest in cash.

You can always be certain that markets will always change. Therefore, it is most important to be diversified in your investment portfolio and deploy a mix of different strategies to help reduce long term volatility and increase your performance.

Doug Geisser
VP FIXED INCOME PRINCIPAL

TEN YEAR TREASURY YIELDS FROM 2000 TO JUNE 2012



ROMANO JOINS THE RACE AGAINST HATE

On June 12, Romano employees joined 4,500 other participants in the Race Against Hate in Evanston. Proceeds from the Race Against Hate benefit the work of the YWCA Evanston which promotes violence prevention and racial equality. Romano Wealth Management and portfolio manager Deb Cross manage the YWCA Evanston Endowment.

JOE AND DICK ROMANO WITH KAREN SINGER OF THE YWCA

CLIENTS IN THE NEWS!

RICH DANIELS MEETS PRESIDENT CLINTON

Romano Wealth Management client Rich Daniels, the musical director of City Lights Orchestra, was recently featured in Bill Zwecker's *Chicago Sun Times* column in a piece called "Sax-y Stuff." Rich gave a concert with the 40-piece version of his orchestra at the opening of the National Restaurant Show, the group's 20th year of kicking off that major convention. Here is an excerpt from the column:

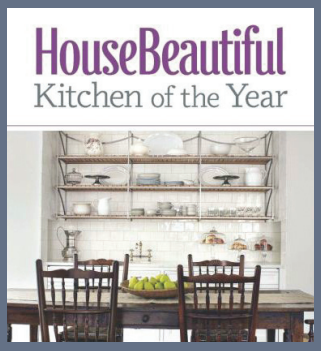
Bill Clinton, the show's keynoter, spent most of his speech talking about the election, NATO and various international and domestic issues, Daniels was thrilled the ex-president (and noted amateur saxophone player) spent 10 minutes afterward chatting with him about Daniels' rare 1923 curved soprano sax."Truly a fun and memorable encounter with the former leader of the free world," quipped Daniels.

It should be noted that this wasn't Rich's first brush with fame. Several years ago, Rich got an urgent phone call from an English woman needing an impromptu sax lesson in her suite at a prominent Chicago hotel. Turns out it was Heather Mills, ex-wife of Paul McCartney. Sir Paul was in town for a Wings performance and oversaw the lesson.

Congrats Rich! More information can be found about Rich and the City Lights Orchestra at www.citylightsorchestra.com.

MICK DEGIULIO DESIGNS KITCHEN OF THE YEAR

Mick DeGiulio, internationally acclaimed kitchen designer, is at it again. Fresh off of his 2010 tour promoting his book *Kitchen Centric*, Mick was named as the designer for the *House Beautiful* 2012 Kitchen of the Year. Newell Turner, Editor-in-Chief of the magazine, says "***Mick is not just any kitchen designer—he is THE kitchen designer with hundreds of projects completed around the globe. We've featured his work in House Beautiful and he is admired throughout the industry as one of the very best.***"



Named "America's dream kitchen," his breathtaking design will be built and on display in Rockefeller Center in New York City from July 16 through July 20.

Congrats Mick! Additional information about Mick and his design firm can be found at www.degiuliokitchens.com and also at www.housebeautiful.com/koty, which also features a video of Mick.

Note: We sincerely respect our clients' privacy and all information is printed solely with the advance consent of our client. Knowing this, if you've reached a professional milestone or had a significant newsworthy event you'd like to share we'd love to hear about it! Email us at info@romanowealth.com or inform your portfolio manager.

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YOU'RE INVITED

ROMANO BROTHERS CELEBRATES 50 YEARS!

This year marks a very special milestone for the firm as we celebrate 50 years in business. All clients are invited and by now we hope you received your invitation to our Anniversary Celebration on August 16 at the North Shore Center for the Performing Arts in neighboring Skokie, IL.

What better way to celebrate this remarkable achievement than to celebrate with you, because without you none of this success would be possible. We hope that you will be able to join us for an evening of hors d'oeuvres, cocktails and a private concert by 60s pop rock band The Buckinghams as they take us back in time to the era of our founding in 1962!

CARL AND NICK OF THE BUCKINGHAMS

A LITTLE BIT ABOUT THE BUCKINGHAMS...

For the past two and half decades, The Buckinghams have successfully toured the nation with their signature pop music featuring founding members Carl Giammarese (lead vocals) and Nick Fortuna (bass and vocals). Their show is filled with harmony, spontaneity, humor, and a musical strength that appeals to not only their loyal fans, but forges new links with younger generations as well. Hits include "Kind of a Drag", "Don't You Care", and "Hey Baby (They're Playing our Song)".

If you haven't done so already, please RSVP to Veda Sidney as seating is limited. Also, if there is a family member or friend that you feel might benefit from our services and should get to know us now is your chance! Let us know so we can add them to our guest list.

The attire for this event is business casual. If you have any other questions regarding the event or need information on the North Shore Center for the Performing Arts, please feel free to contact us.