INVESTMENT
UPDATE

ROMANO
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WEALTH MANAGEMENT
Protecting Your Prosperity. Securing Your Future. Since 1962.

Winter 2013

TAPER TALK IS FRONT & CENTER CONVERSATION

It's been a period of tremendous strength for the markets, with the Dow hitting 16,000 for the first time and the S&P hitting all-time highs. Through mid-November, stocks have been on a six week period of consecutive weekly gains. Earnings season is almost over, and of the 463 companies in the S&P 500 that have reported quarterly results thus far, 75% have topped analyst projections and profit growth of 4.7% for the period, according to Bloomberg. However, revenues have been less robust with only 54% besting consensus estimates and top-line growth of 2.8% year-over-year.

This recent market action stands in stark contrast to the preceding May to August period when concern over a sooner than anticipated end to Federal Reserve's accommodative policy of bond buying might begin at the June Fed meeting. This roiled markets, particularly fixed income markets, sending the yield on treasuries up sharply over a short period and tumbling bond prices.

To date this reduction of bond buying has not occurred, though "taper talk" continues to rule the day. Speculation of Fed tapering has market watchers continuing to move the mark on the timing of a wind down in bond purchases, first from June, then to September, and now the current consensus being pushed off to March of 2014. On a recent day when an increase in third quarter GDP was announced, the market counterintuitively sold off as good news on the economy is now viewed as bad news for Fed stimulus and therefore, bad for the markets.

According to research from Deutsche Bank, 75% of the S&P's YTD return has come from its trailing price to earnings ratio (PE) expanding from 13.7x earnings at the end of 2012 to 16.5x earnings now. Excluding 2009, this is the largest PE contribution to market return since 1998. In the midst of a strong market rally with rising stock valuations, speculation of an end to Fed stimulus, and a good news is bad news market psychology, we are looking to harvest gains for our investors in our year end portfolio reviews. With most stocks at 52 week and all-time highs, this not only limits the potential to offset these gains with losses on other positions, but also creates a conundrum as to where to invest the proceeds. As we've discussed before, bonds aren't as compelling with rates near historical lows and rates eventually but inevitably set to rise (see Doug Geisser's piece on how higher rates will affect your bond portfolio).

In sum, while we are enjoying the party like everyone else, rather than making another trip to the punchbowl we find ourselves searching for a preemptive aspirin and a tall glass of water. We find the best remedy in our targeted asset allocations, not looking to add more risk but to trim equity levels that have become outsized in this bull market back to intended levels. While this shouldn't be construed as in any way throwing in the towel on equities, we believe that the risk/return equation currently favors risk over return. We aren't uncomfortable with some cash in the bank, as we view its low return as akin to an insurance premium and firepower for a rainy day.

So while the last five years have seen some of the worst markets on record and more recently some of the best, they have been some of the most difficult to navigate in my 18 years as a professional manager. But I take great comfort in our now 51 year successful record of always emphasizing capital preservation of your hard earned wealth over aggressive capital appreciation.

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TAPER TALK

Indeed, we have much to celebrate this year and hope you enjoy this holiday season with friends and family. We wish you and your families the best and thank you once again for your continued trust and confidence in us.

Sincerely,

Joe Romano, PRESIDENT

HOW RISKY IS YOUR BOND PORTFOLIO?

In past newsletters we have discussed certain risks associated with owning bonds, mainly credit and call risk. With longer term interest rates rising this past year, I would like to examine another element and that is interest rate risk. The definition of interest rate risk is the change in an investment's value due to a change in the absolute level of interest rates. Essentially, as interest rates rise the value of existing bonds will fall. For example, thirty year treasury bonds had a yield of 3% back in May, while today the same bond has a yield of 3.85%. Since the coupon rate is fixed, the only way for this bond to offer a higher yield would be to purchase it at a lower price. Therefore, we have seen the price of this bond drop by over 12% since May from 95.00 to 83.00 today.

When we invest in bonds for client accounts, it is our intention to hold the issue until its final maturity date. By doing this we can somewhat disregard price fluctuation because we know what our return will be the day we invest in the bond. A typical bond portfolio might have 20 or more individual issues purchased over various interest rate cycles. The average yield of this portfolio is what you are earning regardless if the bonds price moves up or down. We have tools in place that can measure your portfolios average yield along with its sensitivity to changes in interest rates which is known as bond duration. Arriving at a portfolio's duration is a complicated calculation involving present value, yield, coupon, final maturity and call features, however, it is a very useful tool.

TEN YEAR TREASURY YIELD (SINCE 1953)

SINCE 1995 THE AVERAGE YIELD ON THE 10 YEAR TREASURY IS 4.39%. *Date Source: Bloomberg*

The longer a bond's maturity, the more sensitive it will be to changes in rates and the higher duration it will have. Let's examine the change in value of a bond's price if rates moved 1% higher overnight for various maturities:

- A two year bond's price would fall 1.93%
- A five year bond's price would fall 4.61%
- A ten year bond's price would fall 8.60%
- A thirty year bond's price would fall 19.70%

As you can see there is more interest rate risk associated with longer maturities. This is typically why longer dated issues carry higher returns to help offset these risks. Our typical client bond portfolio has numerous issues maturing over a number of years. By looking at the portfolio's duration we can see what effect rate changes would have on the its value. In essence, a duration of 4 would mean a portfolio would fall in value by 4% if rates increased by 1% across the entire yield curve.

If your portfolio has a longer duration you have likely seen a drop in your bond values as rates have moved higher this year. However, this isn't all bad as reinvestments today and hopefully in the future can be made at more attractive levels. This will increase the average yield on your portfolio which is what you are earning in the first place regardless of the price fluctuation. Please talk to your investment manager should you have any questions regarding your portfolio.

Doug Geisser
VP FIXED INCOME PRINCIPAL

PORTFOLIO MANAGERS ATTEND FIRST CLEARING CONFERENCE

In early September three Romano Wealth Management portfolio managers, Chris Knorr, Brett Larson and Scott Miller, attended a 3-day seminar hosted by First Clearing at their corporate headquarters in St. Louis. First Clearing, a division of Wells Fargo, is Romano Wealth Management's clearing partner, handling many back office functions including settlement of trades, dividend and interest payments and the preparation of statements and tax reporting documents.

Presentations covered a wide range of topics, with the goal of helping advisors to think differently and to make better, more well-informed decisions for their clients. The conference was also an opportunity to meet advisors from firms similar to Romano Wealth Management in size and client base. Brett Larson observed that, "For me, hearing about how a lot of the other firms operate really reinforced the 'Romano difference.'"

RWM PORTFOLIO MANAGERS BRETT LARSON, CHRIS KNORR AND SCOTT MILLER.

According to Chris Knorr, one of the key topics was the importance of recognizing how different clients' perspectives, goals and investment objectives can be, and how important ensuring that recommendations and advice are appropriate and tailored to each client. "This is something that I think we already do very well," he noted, "but we all picked up a few new ideas to consider for our clients."

Scott Miller noted that market decisions in the future will require innovation and new ways to better serve clients, methods that they expect will be implemented by cutting-edge firms like Romano. "The conference really drove home the importance of offering clients a consistent approach to growing and managing their wealth," he observed.

The three portfolio managers, despite combined experience of over 29 years, agreed that they came away with a better understanding of the many ways First Clearing can aid the company, all with the stated goal of improving the lives and fortunes of clients of Romano Wealth Management.

NEW LOOK FOR RECEPTION AREA

ROMANO WEALTH MANAGEMENT OFFICE

We pride ourselves on always offering a warm welcome to our clients and guests from the moment they arrive at our office. We've recently enhanced the experience by installing two smart TVs in our lobby, normally displaying market news and quotations via CNBC.

Those of you who come to the office know that there is never an extended wait before you visit with your portfolio manager, but now even those brief delays are informative. Guests waiting in the lobby can enjoy other programs and built-in apps on the second TV, including other daytime programming, cartoons for the kids and even golf or other sporting events. We hope you enjoy our technological updates when you next visit and don't forget to take a chocolate or two!

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WE SALUTE OUR CLIENTS!

FORMER CONGRESSMAN JOHN PORTER HONORED BY NATIONAL INSTITUTES OF HEALTH

Long time Romano Wealth Management client and former North Shore Congressman John Porter, was honored in October with the naming of the John Edward Porter Neuroscience Research Center on the campus of the National Institutes of Health (NIH) in Bethesda, Maryland.

Porter, a 21-year Member of the United States Congress, served for 20 years on the House Appropriations subcommittee. He protected medical research funding from deep budgets cuts in 1995 then went on to double funding for NIH over a five year period. The new building will be among the largest of 68 buildings on the NIH campus, housing most of its 27 institutes and centers.

LEARNING THE BASICS OF SMART INVESTING

Several Romano Wealth Management clients went back to school in October. Twenty clients took advantage of a special invitation to enroll in *Investment Fundamentals,* a course that has been taught by the Romanos for 47 years.

Offered through the New Trier High School Adult Education Program, this 4-week course, currently taught by Joe Romano, helps prospective and current investors understand the valuation of stocks, bonds, and mutual funds. Students gained a better perspective of their investments and learned how to structure them in their own portfolio.