# INVESTMENT UPDATE

ROMANO BROTHERS & CO. WEALTH MANAGEMENT

Protecting Your Prosperity. Securing Your Future. Since 1962.

December 2014


## INVESTOR'S PARADISE OR INVESTING PARADOX?

As of this writing, the S&P stands 12.28% higher year to date, and recently reached its 45th record high this year. The quarter ending September 30th was the 7th straight positive quarterly return in a row, the longest streak since 1998.

But the market gains also came with a short-lived dose of volatility in the last week of September and the beginning of October, which saw a market decline of about 7% from its peak and at one intra-day point as high as a 9% drop. This was gut wrenching for many investors with some heading for the exits but was also a healthy reminder about risk, volatility, and that markets don't always move up in a straight line.

This time at least, it was over almost as quickly as the selloff began. So even with stocks hitting new highs on what seems like a routine basis, it was also a reminder as to what Warren Buffet once said about market risk: "The risks of being out of the game are huge compared to the risks of being in it." This is a phenomenon that Doug Geisser explores in greater detail inside this publication.

Given this market volatility it seems timely to examine our strategy because with stocks at all-time highs it is logical reasoning that there are less bargains out in the marketplace than when at lower levels. Still, this is not a reason to shun equities altogether, especially when one considers that investors and professionals alike have continually demonstrated that they are not very good at market timing. As our wise founder and a student of the market for over 50 years, Dick Romano continually reminds each employee here, "We manage risk, not return—the upside takes care of itself."

So let's examine precisely just how we strive to mitigate risk. First, it comes down to stock selection. We have a process in place to identify what we believe are reasonably priced, high quality companies that we can own for the long haul. Note that this doesn't mean these companies are immune to business or market cycles, but rather due to competitive advantages we think they will continue to earn healthy profits for the time to come and hold up better in down markets.

Second, we pay close attention to the asset allocation of a client's portfolio, not only with respect to that client's risk tolerance but also with respect to our view of the market. Again, Doug explores the relationship between asset allocation and return more extensively, but I want to highlight that we are continually evaluating expected returns for stocks, bonds, and cash relative to one another.

As an example, with rates still at historic lows and a 10 year treasury yield of 2.33%, it has been one reason we have favored dividend paying equities over bonds as we have explored in previous commentaries. Contrary to the earnings of many global banks and Wall Street firms which report record profits from their bond desks, we aren't excited about tying up yours (and our own) money at 2.75% for 10 years. No doubt you have noticed a slowdown of bond purchase confirmations in your mailbox…

This tilt to equities has helped us capture excess return from the stock market but has also poised a conundrum of sorts. While stocks may be more attractive relative to bonds they are also riskier as bonds offer a return of principal at maturity. So while our equity allocations are already stretched at top end targets, we can't continue to pursue this strategy indefinitely. Thus, this brings our focus back to fixed income. Amidst paltry yields, Doug Geisser and Holly Nanos have done a great job at our bond desk of exploiting inefficiencies in fixed income trading markets and finding higher yielding investments when possible.

This also has its limitations as you can't make a 6% yield environment against a 2.5% rate backdrop. Realizing this, they have both kept us focused on not reaching out too far along the yield curve or too far down the credit ladder to obtain a higher yield.

So where does this dichotomy leave us? Even when viewing cash as an insurance premium and firepower for an eventual pullback, being fully invested in equities while constantly striving for bonds leaves us higher in cash than we would prefer. Consider that as a firm we manage $1 billion of your assets and currently have $130 million in FDIC insured money funds. That means that our average client portfolio has a 13% cash holding at the moment, an all-time

*continued on next page*

## PARADISE/PARADOX (con't)

high during my nearly 20 year tenure with the firm.

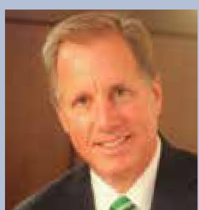
We share this statistic with you because we think it offers a good basis to which to compare your own portfolio. Moreover, we share our reasoning as it is meant to assure you that we aren't sitting idly nor unaware of this fact. Rather, taking into account all considerations especially from a risk perspective, this is the best parking place for the moment.

As the holidays rapidly approach, let us once again say thank you for choosing to invest alongside us. We wish the best to you and your family now and in 2015!

Sincerely,

Joe Romano, PRESIDENT

# HOW WILL YOU REACT WHEN MARKETS BEGIN TO FALL?

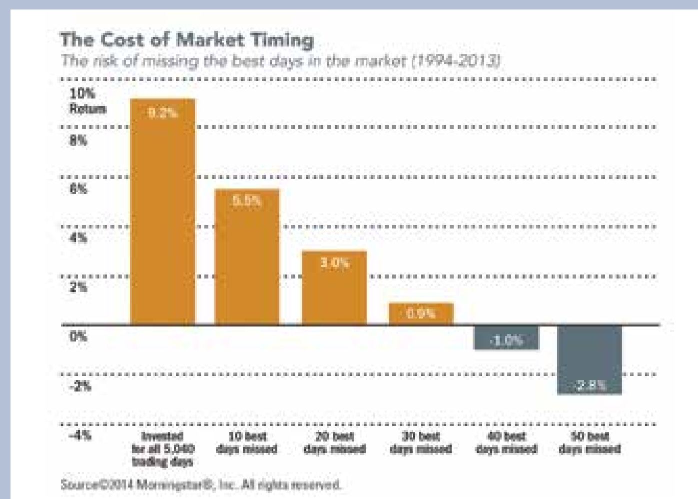


With interest rates still hovering near historical lows, many investors have looked to or increased their holdings in equity investments. This has likely been one of the major catalysts behind the stock market's recent run to record highs. While taking on greater risks gives one the potential for higher returns, it also increases the possibility for principal losses.

It has been a few years since we have experienced a 10% decline in equity prices. However, the sudden 6% drop in equity indexes that occurred in October, created some anxiety amongst clients. One needs to remember that stock prices do not go up in a straight line and pullbacks and market corrections should be expected (on average, since 1900, equity market declines of 5% or more occur three times per year). Success in investing is measured in years, not days. Investors need to be cognizant that volatility exists, and construct their investment portfolios to satisfy their goals, needs and most importantly risk tolerances.

It all starts with your needs and goals. What is your current financial status and where do you need to get to? Are you retired and in need of cash flow, saving for retirement that is 15 years away, or planning for college education expenses? Having a clearer picture of your goals is important because they help determine your investment time horizon. Knowing your time horizon will help determine your asset allocation. Longer time horizons will allow for more aggressive strategies because you should be able to ride out the short term price volatilities. Shorter time horizons will likely require more conservative allocations. Staying focused on your goals and investment allocations instead of the daily fluctuations and "noise" of the markets increase the potential for long term investment success.

Buying stocks when they are priced low and selling them when they are high would lead to profitable returns. Unfortunately, no one can successfully time the ups and downs of the markets. I see many investors waiting to buy stocks after they have performed well for a while and not wanting to sell until after they have gone down. The following chart




shows the effect on someone who invested in the S&P 500 index on January 1, 1994, and missed the greatest 10, 20, 30, 40, or 50 percentage gain market days of the ensuing 20 year period. The highest returns were enjoyed by being invested ALL days, while investors who missed the best 40 or more days, lost money. It's not market timing, but time in the market that can bring the potential for long term success.

How you have your money divided amongst the major asset classes; stocks, bonds and cash is called your asset allocation. Studies have shown that your allocation will determine nearly 79% of your overall returns while actual security selection, market timing and other factors account for only 21%. Changing your allocation based on a particular asset class's current performance is seldom a good idea. There's no telling which investments will perform better or worse from one year to the next. One year's leader can be next year's laggard. During times of volatility, it's often important to stick with your asset allocation to avoid making decisions based on emotion. Your asset allocation should be designed to help you reach your desired return with a risk level you are comfortable with. It defines what asset classes belong in your portfolio, and in what proportion based on where you are today, where you want to go, and how long you have to get there.

Doug Geisser
VP FIXED INCOME PRINCIPAL

# SPOTLIGHT ON OUR CLIENTS

**Sarah Fritz** started racing in 2006 when a friend who had joined the Porsche club received a magazine which outlined regional Porsche club events. He asked Sarah if she'd like to try racing; then it was on to a Novice Day training session and she has never looked back!

With encouragement from friends, Sarah bought a car of her own and started racing. She now drives a 1987 944 Turbo with race modifications. She recalls doing rallies in her mom's old Peugeot 404 as a teen. Sarah races mainly in the Midwest where there are several race tracks. Using a combo/street track tire, she drives herself to the various racing locations. So if you are on the road and notice a beautiful Porsche being driven by an energetic woman, pull over. She has the wheels and determination to leave you in the dust!

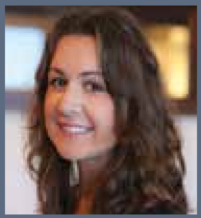
**Ruthann Haigh**, a longtime Romano Wealth Management client, was honored earlier this year by Northwestern Lake Forest Hospital for her dedicated service to the hospital and its patients. As of April, 2014, Ruthann has dedicated 3,184 hours of service since she began volunteering. She acts as a liaison between the surgeon and families on the day of surgery, providing updates on the health of the patient as well as general information on the hospital. Serving as an ambassador to the community, Ruthann provides firsthand information from the physicians and nursing staff as a member of the "What's the Buzz?". Ruthann began her volunteer career at Lake Forest in 1993 but technically started volunteering in high school when she rode the 'el' from Evanston to a Chicago hospital.

# ROMANO PROMOTIONS AND ADDITIONS

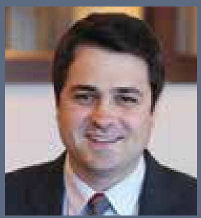
As Romano Wealth Management continues to grow, we are pleased to announce new responsibilities for current staff members and the addition of a new Portfolio Manager.

**Joe Romano** was named Chairman of the Financial Industry Regulatory Authority (FINRA) Small Firm Advisory Board, effective January 1, 2015. The SFAB ensures that regulatory issues and their impact on Broker-Dealers with less than 150 employees and their clients are effectively communicated to and considered by the FINRA Board of Governors and FINRA Executive staff.

**Laura Daly,** who has been assisting Dick and Joe Romano as well as Scott Miller for the past two years has been named Director of Client Relations. Laura is our go-to person for those really hard-to-solve client issues.



You met **Holly Nanos** in our spring newsletter. She joined Romano in 2013 and has recently been promoted to the position of Portfolio Manager. Along with her current responsibilities, she will be managing her own client accounts.



**Peter Hemwall** has joined our firm as a Portfolio Manager and will be working alongside firm President, Joe Romano. A graduate of Miami University where he majored in Finance, Peter comes to us with 3 years of experience at Merrill Lynch as a Financial Advisor. Peter is a native of Evanston. He is the son of Rick Hemwall, a Romano Portfolio Manager who came to the firm from Merrill Lynch 18 years earlier.

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1560 SHERMAN AVENUE
SUITE 1300
EVANSTON, IL 60201

**OFFICE** 847 866 7700
**FAX** 847 866 7054

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## HAPPY HOLIDAYS TO ALL OUR CLIENTS AND A HAPPY, HEALTHY, AND PROSPEROUS NEW YEAR!

TOP ROW: Richard C. Romano, Joseph R.V. Romano, Douglas N. Geisser. Grace Garby, William J. Reilly
MIDDLE: Richard A. Hemwall, Deborah L. Cross, Brett Larson, Scott Miller, Holly C. Nanos , Peter M. Hemwall
BOTTOM: Laura Daly, Caryn Okubo, Michael Appleby, Wendy Ek, Veda Sidney