TAMMA CAPITAL

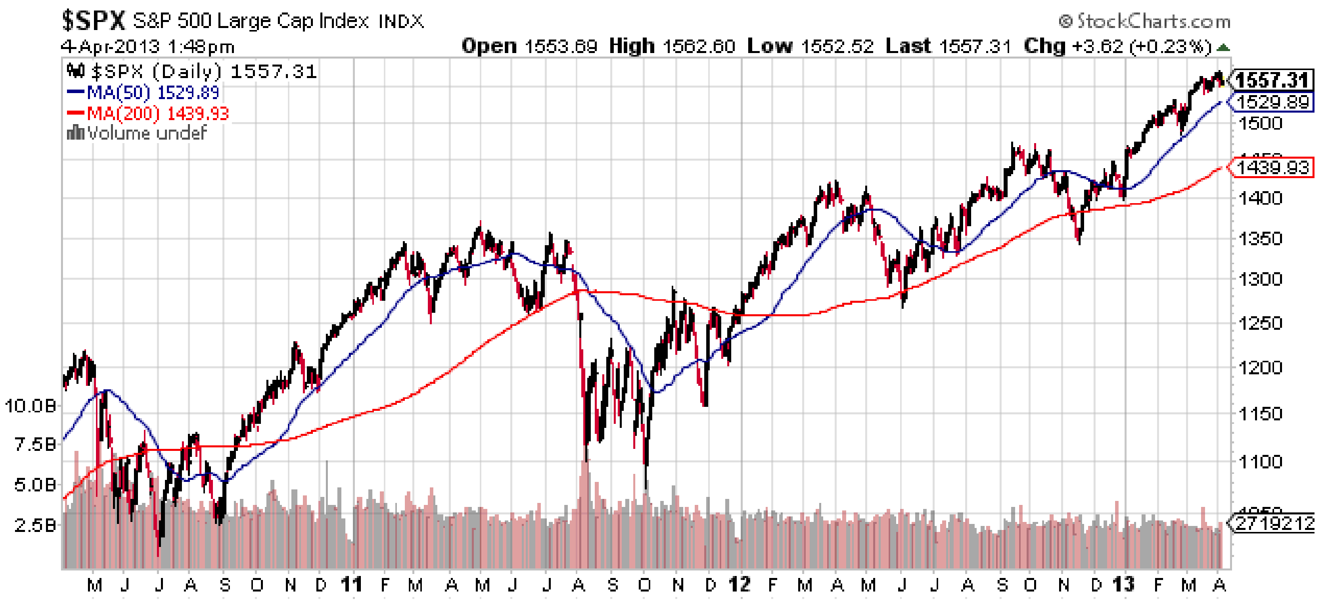
Personalized Investing for Your Future

Investment Perspectives
2013 O1

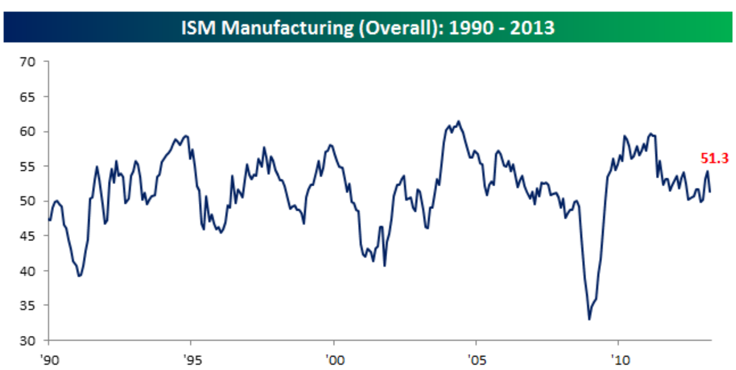
Records Are Meant to Be Broken

In sports they say that records are meant to be broken. In the first quarter of 2013 this phrase certainly rang true, as both the Dow Jones Industrial Average and S&P 500 each reached new record highs. It still seems that it was just yesterday when the market averages were at their lows but that was nearly four years ago. So why do the losses seem so fresh?

Although there have been hints of an economic rebound here within the US, there has been one crisis after another over the past four years. However, if you looked at the equity indexes you might not be able to tell. There was a gap down in the summer of 2011, but since then the trend line has been a very steady move up. So why is this the most hated rally in possibly all of stock market history?



There is still a disconnect between Wall Street and Main Street. Although the unemployment rate has come down it is still very high for where it should be at this stage in an economic recovery. This tells us that no matter how much economic stimulus the Fed has poured into the economy; there has been a structural change in the US labor market. Some jobs that have been lost are not coming back.



Some manufacturing has returned state side; the problem is that the jobs once performed by people have been replaced by high tech robots. The labor market now demands a certain type of worker with a skill that those who were replaced do not have. The ISM which measures manufacturing output may have rebounded as well, but that hasn't been the case for everyone in the US economy.

Fed Policy Still a Driver of Equity Market Returns

There has been a shift in investor expectations which also helps explain the returns in the equity markets. Equity returns are made up of two components; corporate profits and the multiple at which people are willing to pay for those earnings which is reflected in a stock's Price/Earnings ratio (P/E). While corporate earnings have been solid they have not been good enough in order to support the complete rise in the equity markets which means that a shift in investor expectations has occurred. Investors are willing to pay more for those corporate profits which leads to an expansion of the P/E.

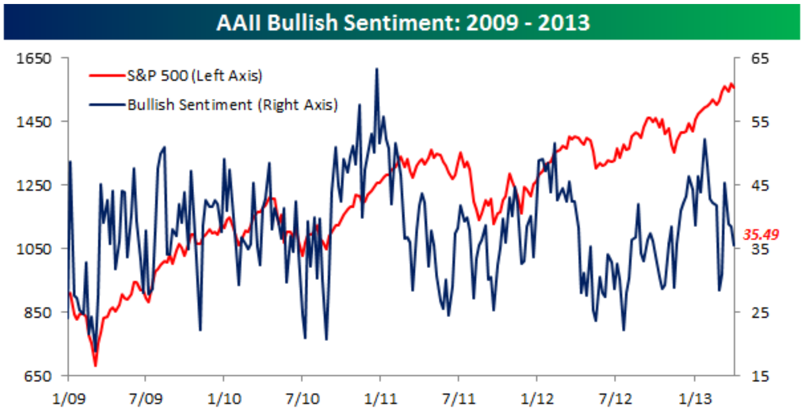
P/E expansion can occur for many reasons but the most likely cause is the continuation of the Fed's low interest monetary policy. By keeping rates artificially low, the Fed has forced investors and savers alike into riskier assets in an attempt to capture higher yields/returns.

The Fed is not looking to take their foot off of the stimulus pedal yet due to stubbornly high unemployment. The current unemployment rate stands at 7.6% vs. the Fed's target of 6.5%. Only the rapid increase of inflation which appears to be tame (depending on which metric you look at) would cause the Fed to change their course.

Although one month does not make a trend, inflows in equity funds spiked dramatically in January. The rotation out of bond funds and into equities could be a key factor that could help sustain this already long rally. As Barry Ritholtz of *The Big Picture* pointed out recently, "this is 6th best almost 5th best rally in market history."

The old adage of "don't fight the Fed" is definitely holding its own as an investment strategy.

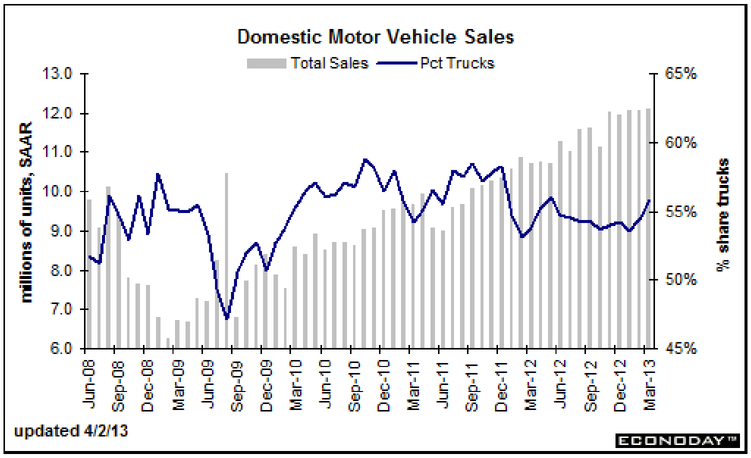
Indicators Still Point to Expansion



Overall, valuations are not sky high and investor sentiment remains on the mild side with more people being in the middle rather than leaning strongly to one side vs. another. Although we have had P/E expansion, the S&P 500 index is still trading at a P/E ratio well below the previous two highs set back in March 2000 and October 2007. This would lead one to believe that this rally still has time to move up.

Investor sentiment as measured by the *American Association of Individual Investors (AAII)* has shown a deep drop in bullishness since hitting a high in January of this year. Investor sentiment is more of a contrarian indicator which means when bullish sentiment is low it could represent a buying opportunity as opposed to a high reading when people are euphoric about stocks which could mean a market top. According to the chart, sentiment is just about in the middle, not too hot and not to cold.

Technical indicators such as advanced decline lines, moving averages, and relative strength indicators (RSI) all point to a market that is and has shown great stability no matter what crisis has been thrown its way. From a fundamental standpoint Americans are still spending money. There has has not been a strong impact from the payroll tax increase as we had anticipated. For the most part, Americans have continued to spend but that doesn't mean it will continue. Incomes levels have barely increased and jobless claims have been on the rise for the past four weeks.



On the contrary, the latest auto sales figures could give people confidence that the economy is getting back to a solid state. The trend has been a strong increase in sales since the middle of 2009. People will not invest in a large ticket item such as an automobile unless they have some indication of a stable financial environment.

A Shift in Strategy: Adapting to Market Conditions

Our defensive strategy that worked well in Q4 2012 leading up to the climax of the Fiscal Cliff situation in Washington lagged the market in Q1 2013. The temporary deal that was reached at the last minute which helped to spark this strong market rally was not expected in our viewpoint. We fully anticipated the sell off that began in October of 2012 would continue as neither political party had much hope of reaching a bipartisan compromise.

As the markets have climbed steadily higher, we have slowly become more aggressive but at a measured paced. We fully anticipate a pullback of some degree but like so many others, we do not know the time or severity of that impact.

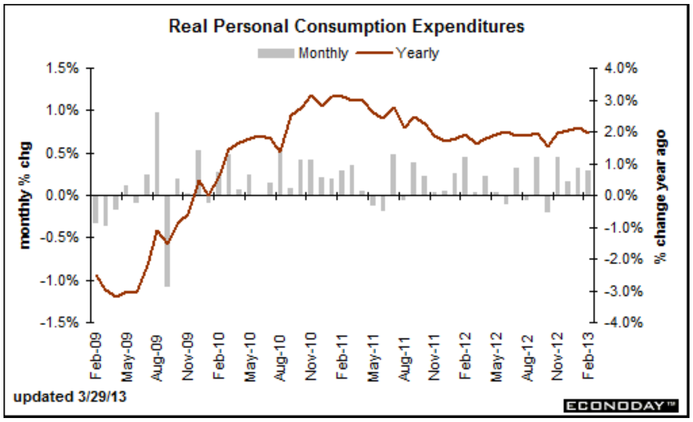
- Part of our diversified portfolio strategy is to invest in a basket of commodity names such as basic material, gold, silver, oil, steel, and the like. Commodities lagged the overall market returns in Q1. We would have thought that commodities would be a leader in this rally as economic data showed some signs of growth. If commodities continue to slide downward, this may be an indication that real growth is slowing at a faster rate than expected which could indicate a market pullback.
- Apple stock continued its slide down from its record high set back in mid September 2012. The stock was down another 16.8% in Q1 2013 and is down 39% from that all time high. So what is next for Apple? Headwinds include a compressing margin factor and the potential slow down of iPhone sales. On the flip side, Apple has turned into a cash generating value machine with solid growth albeit at a slower pace. From a valuation perspective, Apple is a bargain based upon P/E, cash flow yield, and an economic margin standpoint. Apple will remain a core holding in our portfolios.

- Companies with strong balance sheets paying a healthy dividend continued to perform well again this quarter. With the Fed maintaining its low interest rate policy, investors continue to seek investments with less risk and the potential for income and these types of companies are one way to achieve that strategy.
- Real Estate turned in another strong quarter as well. Again REIT's are another way to find higher yields in a low interest rate environment. The real estate market has been rebounding from its Great Recession lows and we see continued strength in this sector.

Market Outlook

There are always going to be headwinds and tailwinds facing the markets. As some concerns subside, likely new ones appear to give us caution in a different direction. Here are a few factors that we see which could affect the capital markets.

- Increased tensions between the US and North Korea are beginning to take center stage. Although the equity markets have not really reacted to the saber rattling between the two nations one can only hope that cooler and calmer heads prevail.
- The debt situation within the European Union (EU) never appears to resolve itself no matter what actions are taken. Recently the focus has been on the tiny country of Cyprus with an economy the size of New Hampshire. In an unprecedented move, insured depositors' at Cyprus banks are at risk of losing part of their savings partially due to a lack of EU support.
- Geopolitical risk within the Middle East region can always come to forefront and have a direct impact on oil prices which in turn can effect an already tepid global growth recovery
- The US has managed to get through the first leg of the Fiscal Cliff will little or no impact upon consumer spending which has not yet seen any ill effects of the increase in taxes. The second round which were mandatory spending cuts at the beginning of March, will take some time to measure what their impact could be. But overall, the markets have been able to look past these issues.



- Both home sales and prices continue to rise throughout most of the country giving a boost to consumer confidence which could keep the US consumer spending and helping corporate profits.

Overall we remain cautiously optimistic about the current rally and market conditions. The Fed remains strong when it comes to its monetary policy of providing liquidity at all costs. Given these conditions, it makes it nearly impossible not to have some of your assets within the equity markets.

As we approach one of the most volatile seasons of the year for stocks, we would tread lightly in regards to adding more risk at this point in time. It is better to miss some parts of the rally than to lose capital chasing returns.

A fairly valued market poses its own unique set of challenges because it does not send a clear investment signal either way. Investors need to be selective with their investment decisions because an overall fairly valued market does not mean that every stock is fairly valued. Patience is always a requirement when it comes to investing.

Retirement Planning: Are You Saving Enough?

This quarter, we review the second pillar within the "Five Pillars of the TAMMA Wealth Management Process", Retirement and address the question, "are you saving enough."

1. Emergency Fund
2. **Retirement**
3. Education
4. Investment
5. Philanthropy

According to a report released this month by the Employee Benefit Research Institute, 68% of workers in its annual Retirement Confidence Survey said they think they need to save at least 10% of their household income to live comfortably in retirement. Yet only 24% report that they have saved at least $100,000 and just 57% say they are saving for retirement.

These are troubling statistics but there are ways that people can address their retirement savings needs. First develop some type of automatic savings plan, and second put a plan together that helps you determine how much you need to save.

According to Aon Hewitt consultants, companies that automatically enroll employees into a company sponsored retirement plan report that 83% of employees stay in the plan and automatically contribute. By making saving automatic, you have done the "heavy lifting" as opposed to forcing yourself each pay period to set money aside. You can either allocated a fixed percentage of your income every month or set aside a fixed amount. Just be sure that either approach aligns to your retirement planning goal.

But saving automatically alone will not help you reach your goals. You must also plan on what you actually need to save in order to retire with the lifestyle that you so desire. This can be done in one of two ways:

1. Build a detailed plan from the ground up based upon your current spending and forecasting what you think that you will spend in the future adjusted for inflation. As some costs go down in retirement such as a mortgage and job related expenses, other costs go up such as medical and travel.
2. The income approach is simply to take a percentage of current income level adjusted for inflation and use that as an income replacement ratio. The key is determining what income

you need to replace which would again involve making some key assumptions about your future lifestyle.

When it comes to retirement planning there are numerous products that offer you a tax advantage by deferring taxes, making tax free withdrawals, and/or making tax free contributions. Below are some of the more popular products.

- Employer Sponsored plans – 401k, 403b
- IRA Plans – Traditional, Roth
- Self Employment Plans – SEP, Keogh, SIMPLE 401k or IRA

Please feel free to reach out to us with any questions you may have about these or any other investment vehicles.

To clients, we thank you for allowing us to personalize investing for your future. We hope that all readers find our insights to be both educational and helpful.

Paul Fenner, RIA, ChFC
President

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*Charts used courtesy of StocksCharts.com, Bespoke, and Econoday