MACMILLAN FINANCIAL
JOHN MACMILLAN, CHFC

P.O. BOX 66
ANNANDALE, NJ, 08801

T: (908) 236-7500
F: (908) 236-7511

WWW.MACMILLANFINANCIAL.COM

SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

June/July 2013

> **"It's not whether you're right or wrong that's important…but how much money you make when you're right and how much you lose when you're wrong"** George Soros

(The June newsletter didn't get out on time because of some significant computer issues and time constraints. In view of that and seeing as we're getting close to the July edition, I decided to combine them both to create a 'double feature'. There's a lot to chew on this month.)

Like the caption above points out, it's very important to keep stock market losses to a minimum. Similar to the IRS axiom, it's not what you make that counts…it's what you get to keep!

This month will look at some strategies to maximize profits and keep losses low enough so that you'll have the resource s available to fight another day.

For example, if you lose 15% on your investments you only need 17.5% to get back to even. If you lose 30% however, you'll need a gain of 43% to get back to where you started. This kind of summarizes the importance of stop-loss investing.

There are other components that also need to be taken into account when reviewing your investments. Like what is the macro picture on the economy and what is the momentum telling us about the market itself?

Everyone has an opinion on what' s going to happen next. Just about everyone falls into one of two camps. We're cruising for a major correction. Or, this market still has a lot of legs and will continue to go up.

According to the American Institute of Economic Research, __**every**__ indicator…leading, coincident and lagging are expanding at 100%. That's very impressive. Housing is telling us that its recovery is real, and of course the Federal Reserve has told us to expect low interest rates (like close to zero) for the foreseeable future.

We c an have faith in maintaining these low interest rates for a couple for reasons. First, higher rates would mean ***much*** higher expenditures for the Federal government. Right now we're spending around $300 billion per year on interest payments. If rates went up to say, 3% or 4% we'd be spending almost $1 trillion to finance those same debts. Or said another way: Which is better? A strong dollar or a weak dollar.

So, the second part of the equation has to do with a strong dollar vs. weak dollar. If we look at the chart below, we se e a pattern of weakness in our dollar starting in 2006. (it really started in 2003).

The effect of a cheap dollar means several things:

1st our exports are more competitive in the global marketplace.

2nd more exports lead to more infrastr ucture investments in the United States (think factories)

3rd strong exports create more domestic jobs.

4th a weak dollar helps US companies with their bottom line as they repatriate foreign earnings.

5th better earnings are good for the stock market.

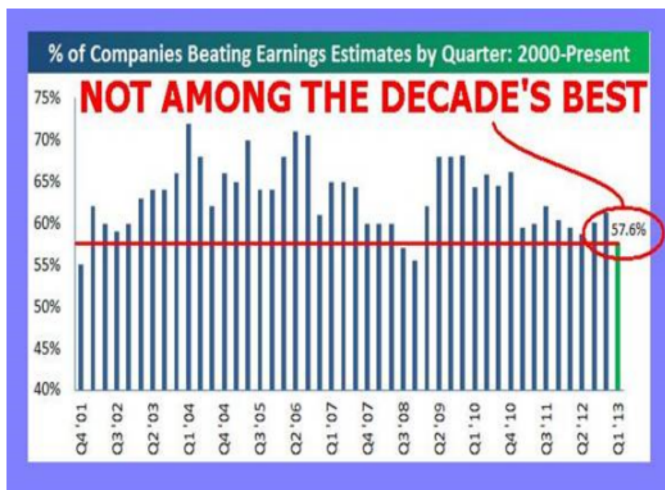
6th a good stock market is good for investors who gain confidence.

7th a confident consumer spends money.

So on and so on and so on. You get the point. My bet is that the powers that be like the weak dollar.

Next, let's take a look at the market. Many analysts say that the market is currently cheap based on a forward earnings ratio of 15 times. The key here is 'forward'. The profit forecast however, looks to be quite optimistic. The trailing P/E is actually at 18 times…which is not particularly cheap.

The chart below paints a less than bullish picture.



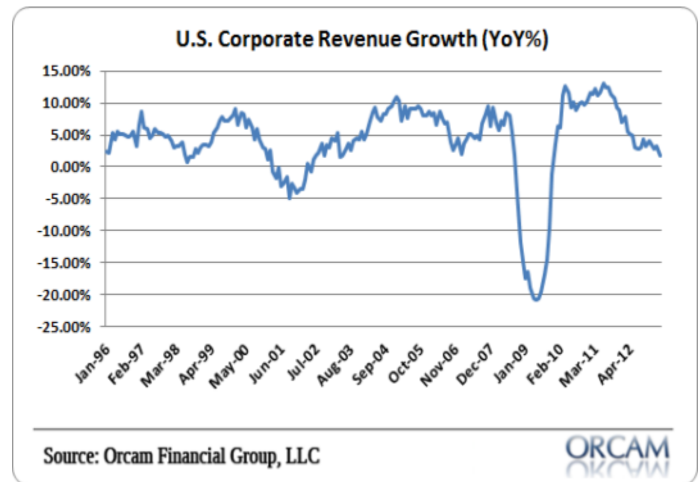
As we see, earnings are up, albeit not at a level consistent with the kind of bull-run we've had since the 4th quarter last year. There are 3 fundamental components that every investor needs to take away from a company's earnings report:

1. The bottom line which is the earnings/share.
2. The top line which is revenue.
3. Forward guidance.

So the bulls will argue that earnings are still growing…but to keep this in context we have to look at revenue growth. There are a lot of ways creative accountants can make earnings look better than they are; but you're either growing sales or you're not!

The next chart takes a closer look of what the S&P 500 companies are actually doing about revenue.

We had one peak in February 2010 and another in March 2011, but it's been downhill ever since. There are only so many cost cuts a firm can make before they need revenue to grow their business.



This is a big concern for me and other advisors who rely on fundamental-side analysis for whether or not we should recommend buying shares in a company. In the 1st quarter this year, S&P 500 revenue came in 0.6% lower than in the year ago period which was already down significantly from the projected growth of 0.9%. Additionally, for the quarter, more than half the companies missed their revenue projections altogether.

The saying is that a rising tide will lift all boats. This can be seen in several sectors. For instance, the Materials sector had a negative earnings growth of….. -15%, yet its ETF is up +10%. Consumer staples had a negative EPS of -4% but is up +20%.

Then looking at Telecom, we see a similar story. Earnings were down -14% but the sector was up +13%. Finally, Energy had a -4% earnings contraction, but is up +15% YTD.

I am not trying to paint a bearish picture here, but instead I'd like to lay out the reasons to exercise caution. On the whole I'm still optimistic on the economy long-term, but need to keep the short-term correction possibilities in plain sight.

Where has your money gone and where is it going…what the Federal Reserve is doing to steer your retirement savings???

As fixed income investors look for places to 'make a buck', it has become more and more obvious that, a) you can't make money parking your savings in the bank; b) you can't make money buying Treasuries; c) heck, you can't even make money in investment grade bonds anymore. So, what does that leave? Equities, of course.

Having near zero interest rates hurts savers and those on fixed incomes. It has forced many conservative folks – better known as moms and pops- into risky assets.

Now there's the rub. These people are not generally strong holders of stocks. At the first sign of a downdraft in the market, we'll no doubt see a cavalcade of selling…which leads to more selling.

I'm sure everyone has heard of contrarian investing. This is actually where the money is made. It's the 'buy when there's blood in the street'. 'Fish where they (investors) aint'. 'If investing is fun you're probably not making any money – good investing is boring'. A weak dollar may be good for the market, but is not that good for the savers.

The chart below is another way of looking at the value of the dollar. Since 1999, the dollar has fallen in

value from about 123 mg of gold to less than 21 mg today – a drop of more than 80%.

Against other currencies we have lost 30% of our purchasing power in the past 10 years. All this current Fed stimulus will bring on inflation eventually, and it's the fixed income retirees who will suffer most. Right now, savers are being crucified with artificially low interest rates and rising prices. It is increasingly more difficult for investors to find relatively safe products with reasonable yields.

I continue to hear reports from some of our biggest companies warning on earnings and lowering growth expectations. This comes at a time when just about every baby-boomer has their eye on the retirement 'finish line'. According to the Employee Benefit Research Institute only 22% of retirees have saved $250,000 or more for their golden years. It gets worse. Nearly one-third of Americans age 55 and older have saved less than $10,000. (Yes, you read that right).

The best advice for now is twofold. If you still have years before you retire, save, save, and save some more. Second, don't settle for the invisible yields you get on Treasuries or in CD's. You'll need to look farther afield. Below, I'll highlight areas for you to investigate…as well as the caution flags you need to pay attention to:

First, let's take a quick look at

CD's:

New Issue CD Offerings*

Term	Expected Yield
3 months	0.25%
6 months	0.30%
9 months	0.35%
1 year	0.50%
2 years	0.60%
3 years	0.80%
5 years	1.35%

I suspect that you're like me when looking at these rates. **I'm not very impressed.**

Now, how are Treasuries looking?

TREASURIES:

United States Government Bonds

Tenor	Coupon	Price	Rate
3 Month	0.0000	0.0450	0.05%
6 Month	0.0000	0.0750	0.08%
12 Month	0.0000	0.1200	0.12%
2 Year	0.2500	99-27½	0.32%
5 Year	1.0000	99-11½	1.13%
10 Year	1.7500	95-30¼	2.21%
30 Year	2.8750	90-31	3.35%

Again, I don't think you're overly impressed with these kinds of numbers. Let's look in other places.

DIVIDEND PAYING STOCKS:

As you well know, I am one of the biggest proponents of buying into companies paying out healthy dividends. The catch right now is, so is everyone else. What this has effectively done is drive down yields as stock prices go up.

What we've seen over the past 12 months is stodgy old blue chips that have gone up in price the equivalent of many years' worth of capital growth and appreciation. For example:

Johnson & Johnson	P/E 23	Price Gain +46%
Proctor & Gamble	P/E 17	Price Gain +40%
Colgate Palmolive	P/E 24	Price Gain +27%
Clorox	P/E 20	Price Gain +29%
General Mills	P/E 18	Price Gain +39%
Campbell Soup	P/E 19	Price Gain +56%

These are all great companies but frankly, looking at their P/E ratios and their fundamentals, they are getting quite 'pricy'. Not only are they 'pricy against their long-term historical growth…they are also much pricier than the S&P500 itself; and they have outgained the overall market by a wide margin!

P/E ratios in the 20 range are generally reserved for high-growth high-flying stocks. These stocks don't fit that bill. Finally, because their prices have gone up so much, their dividend yields have come done proportionately.

Next up,

PREFERRED SHARES:

Looking for yield has resulted in our going after high quality, investment grade preferred shares. Preferred stock are hybrids… part equity and part bond-like. If a company were to go bankrupt, preferred shareholders would be paid out before common stock holders, but after bondholders.

The thing with preferred shares is that they are very interest rate sensitive. As rates rise, their value **goes down!** You also have maturity risk, meaning that the longer duration before maturing, the more sensitive they are to rising interest rates. Finally, you also have a CALL risk. They can generally be called by the issuer after a certain amount of time as lapsed since they first came to market. So if you paid greater than par to get the high payout (usually about 6% or so), and if the issue were called, you could incur a capital loss.

Courtesy of Mr. Bernanke, we have been in an ultra-low interest rate environment for quite some time. Looking ahead, and based on minutes from the FOMC meetings, we can surmise that this will be the case for at least another 6-12 months. But, it's very important to be aware that at the first sniff of rising rates, the market will sell these and the value will drop.

MASTER LIMITED PARTNERSHIPS:

These are your oil & gas pipelines. By law, they are obligated to pay out most of their cash flows to their investors in order to avoid paying tax at the partnership level. They pay very attractive yields of between 4 – 10% however, again, there are some warning flags that you need to be aware of.

First, in order to grow, they must either borrow money or issue new shares. Borrowing money in a near "0" interest rate environment is nice and easy. If rates rise however, that becomes a game changer.

The 2nd way they can raise cash is through the issuance of additional shares in the partnership. As you will readily understand, the more shares in a company, the less their value. This is dilutive. The importance of continually growing their pipeline business cannot be overstated. It's their life blood.

At some point, if they do not have adequate funds to cover their Capital Expenditures…ergo cannot cover their growth requirements, the shares prices will fall hard! Remember, they **must** distribute almost all

of their cash flow and are not allowed to accumulate capital.

So, here, you want to keep a close eye on their Balance Sheet. Personally, I'm a big fan of MLP's but there are no 'free lunches'. Do your due diligence and continue to do so every month.

REAL ESTATE REITS:

Like MLP's, Real Estate REITS must pay out at least 90% of their funds from operations, or said another way, their cash flows. REITS are a great way to become a landlord without the hassle of dealing with tenants.

These entities purchase raw land, commercial and residential real estate. Their goal is to make money by collecting rents, which are then passed onto their unit holders.

It was quite common years ago to see yields in the 6-7% range, however; as more and more income starved investors piled into this asset class, their price went up and consequently, their yield went down.

Nonetheless, you can still find decent REITS paying around 4% to their investors. Not bad! What you need to be careful of here are two things:

1. Many REITS have outgained the overall market over the past two years by a margin of 23% to 19%. Valuations are looking pretty rich. So it will pay to be choosy.
2. As interest rates rise, all REITS will be obligated to raise their distributions in order to remain competitive in the income market. This could, and will affect their Balance Sheet adversely.

MORTGAGE REITS:

Mortgage REITS have a fairly simple business structure. They borrow money on a short term basis and then invest that money in long term mortgages. When rates are low, they win. When rates are high…not so much.

They pay out phenomenal yields: many times you can find 10% plus payouts. But, once again, there are no free lunches. They have to constantly go back to the market to roll over their short term debt. You, therefore have to constantly check their Balance Sheets.

The simplest, and quickest way to do this is to go to Yahoo Finance and look at their Balance Sheet to see what their ratio of debt to equity is…or said another way, what are their assets vs. their shareholder equity.

Let's say a company shows $50 billion of assets on their Balance Sheet and $5 billion of shareholder equity. That could be a problem!?!

What this tells you is that they borrow $4 for every $1 of their own money that they invest. This kind of leverage is probably not a sustainable business model…especially if interest rates rise.

CORPORATE INVESTMENT GRADE BONDS:

These are the cream of the crop. These are bonds issued by corporations with an AAA to BBB credit rating. Their default rate over the past 31 years has been a miniscule 1.1%, but, you generally have to pay for this kind of safety.

Yields have come down dramatically since the Federal Reserve started on Quantitative Easing. It wasn't that long ago that you'd get 4-6% yields on investment grades. Today, they're a fraction of that.

A few examples will illustrate this:

APPLE just issued $17 billion in a debt offering. Their 5 year note yields a microscopic 0.40 percentage points over a 5 year Treasury. Ten year notes are priced at 0.70% over the comparable Treasury. And, get this, their 30 year bond is paying just 1% over the 30 year Treasury.

MICROSOFT issued debt a couple of years ago with their 5 year note paying 0.875% and their 30 year at 3.5%

Finally, IBM issued 7 year bonds which pay 1.625%.

These kinds of yields on corporate bonds are ridiculous. These blue-chip companies issue debt because they are basically getting 'free money'. In fact, in the case of APPLE, they have even more cash than this sitting in offshore accounts. None of these firms need the cash, but what's not to like about this setup.

So, if you're looking for safety, these are almost as good as Treasuries. If you're looking for yield, they're not much better than Treasuries!

HIGH YIELD BONDS:

These bonds are known as 'junk bonds'. Their ratings are BB down to single C or D. Traditionally, they have paid anywhere between 7 -12% (and sometimes higher). The reason they pay so much is because investors are taking on a lot of risk.

The default rate on investment grade bonds was mentioned a few paragraphs back. It is miniscule. Default rates on junk bonds however, run a little higher…like between 4.5% up to 26.8%, depending on how low down the junk scale you wish to go.

With overall interest rates being so low today, believe it or not, junk bond yields have fallen through the floor. In many cases they are now yielding less than 5%. This is the first time in market history. Investors going after yield in this sandbox are literally walking into a dynamite factory with a lit blow torch.

For your reference, below is a bond rating scale to help you understand what to look for.

	BOND	RATING	
Moody's	Standard & Poor's	Grade	Risk
Aaa	AAA	Investment	Lowest Risk
Aa	AA	Investment	Low Risk
A	A	Investment	Low Risk
Baa	BBB	Investment	Medium Risk
Ba, B	BB, B	Junk	High Risk
Caa/Ca/C	CCC/CC/C	Junk	Highest Risk
C	D	Junk	In Default

Another place to look for yield is in the world of

MUNICIPAL BONDS:

I realize there been a lot of press devoted to some of the most recent municipal bankruptcies; Stockton, CA. San Bernardino, CA. Harrisburg, PA. and so on. The truth however is that less than one -third of 1% have defaulted on their debt in the past 3 years.

I certainly would not suggest that you throw caution to the wind and jump in buying willy -nilly. You must do your due diligence. Make sure that what you're buying is backed by an income generating project. You know, something folks can't live without. Sewers. Utilities. Water. Also check to be sure that the three ratings agencies show the bond to be investment grade.

Remember, with munis you generally don't pay tax. That means a yield of say 2.5% is closer to 3.0% when you're in the 15% tax bracket. The equivalent yield will be even higher, the higher your tax bracket is.

Finally, I know many advisors are telling clients that there are an unlimited number of stocks still worth buying. I disagree. I find it more and more difficult to find the kind of value I need to see before recommending new purchases.

There are some bargains there, but you'll need to do a lot of digging and excavation work to unearth them. What you don't want to do is over pay for your stocks. This will affect your total return. Buy as prices come to you. Do not chase stocks as they move away from your 'buy price'.

Also, very important. Make sure that you keep an eye on your stop-loss provisions. Don't let profits turn into losses. You can't afford them!

MISCELLANY

☺ If you're looking for information and maps on 1000's of national parks, historic sites, forests, etc. go to www.recreation.gov

☺ If you are travelling and have a disability, check out www.DisabledTravellers.com

☺ Looking for pet friendly accommodations when on vacation? Try http://DogVacay.com

☺ Do you like/love fishing? Try
☺ www.SaltWaterSportsman.com
☺ www.LandBigFish.com
☺ www.AmericanFishingContests.com

☺ Everyone wants to eat something *edible* when motoring around the country. Now you're got a guide at www.RoadFood.com

☺ Some folks like to find offbeat, and sometimes bizarre, things to look at or visit while on vacation. Go to www.RoadsideAmerica.com

HAVE A HAPPY & SAFE SUMMER