The ACM Journal

"Fowl Play"

Spring is here, and it is almost time to pick up chicks. I mean this not in the vernacular sense, but in the wife-sanctioned, literal sense: acquiring baby chickens, turkeys, and pheasants.

I placed my order for 50 pheasants recently and expect them to arrive later this month. The state actually gives them to you (thank you, New York tax payers) to raise and then release on your property. I have been doing this with my neighbor the past few years, and it is a lot of fun.

The chickens will arrive in May. A group of us will order over 100 this year. The process is interesting because they get shipped from Pennsylvania via U.S. mail. I have to pick them up at the post office. The postal workers are usually happy to see them go because they make a surprisingly loud racket with all their peeping. Besides, I get to tell my wife, Nipa, I'm going out to "pick up chicks." After several years of this, she groans and rolls her eyes at my tired pun.

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In This Issue

Capital Markets Review

Despite overhyped fears that the Fiscal Cliff and subsequent budget sequester would derail economic growth, send us headlong into another recession, and plummet the capital markets into a financial darkness so complete that we might never see the light of day again, the capital markets actually did pretty darn well in the first quarter of 2013. In fact, despite all the negativity, the S&P 500 reached a new all-time high.

I'm not saying that politicians and financial journalists lack all credibility, but, well, okay that's exactly what I'm saying. The point is, you can never trust "the experts". There are no crystal balls in this world (at least not ones that predict the future), so the best bet is to pick an investment strategy, stick with it through thick and thin, and tune out all of the noise from the media and talking heads.

Stocks Hit Record High

The stock market defied all odds and rose 10.6% in the first quarter of 2013. Mid-cap and small-cap stock performed even better, showing that investors, rather than being risk averse, are again willing to accept risk in order to realize stronger returns. Indeed, much talk has turned these days to being left out of the rally, which is a dramatic turn from all the talk of preservation of principal the past few years.

To be sure, there are still problems in the economy both domestically (huge federal debt) and abroad. The recent implosion in Cyprus is a reminder that we're not totally out of the woods. The troubles in Cyprus, in fact, weighed on international stock market returns so far this year. However, valuations are still quite low and the odds of another financial catastrophe in Europe appear more remote. Accordingly, we're expecting the international stock rally that started in 2012 to continue for some time.

Bonds Flat

Bonds stalled in the first quarter as interest rates rose modestly. We're still a long way from "normal" interest rates, but the yield on the

ten-year Treasury bond rose above 2.0% at one point during the first quarter.

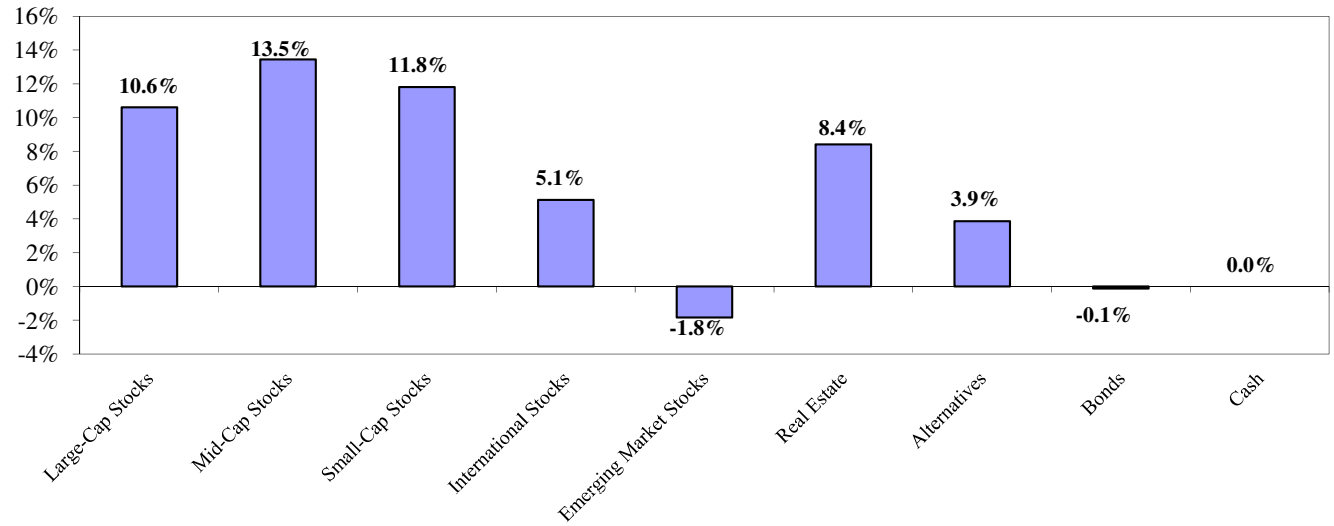
The Fed continues to be the primary driver of the bond market. A Fed Funds target rate of 0.00% to 0.25% has kept short-term interest rates low, while government purchases of Treasury and mortgage bonds have kept longer-term interest rates well below their historical average rate.

After a decade of very solid returns, bonds may prove lackluster for the foreseeable future. That said, they still have a place in most portfolios as a means of dampening volatility and hedging against declines in the stock market.

As a result of the low interest rate environment, we've taken some steps to reduce the risks we perceive in the future. For example, we have shortened the duration of the bond portfolios we manage to reduce the risk of rising interest rates. We have also reduced exposure to Treasury bonds since they seem to have the most egregious valuations currently. Broad diversification and high credit quality are still a primary focus of our bond portfolios.

Outlook Still Optimistic

Despite the flat performance in the bond market, the first quarter was largely good for investors. Many are worried that we've come too far too fast, but valuations are still reasonable, interest rates are accommodative, corporations are financially healthy, and there could still be more room for stocks to run.



Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indcies. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Alternatives are represented by the HFRI Fund Weighted Composite Index. Bonds are the Barclays Aggregate Bond Index. Cash is the yield on the 30-day T-Bill.

CORE ELEMENTS OF INVESTING

The investment management industry is based on the premise that smart, hard-working managers with cutting-edge technology can outperform "the market". These "active managers" strive to outperform by trading stocks or other securities in order to capture the best investment opportunities at any point in time. While it seems intuitive that this approach would produce positive results, the evidence has not been supportive.

The problem is that all of the required ingredients for outperformance are expensive. Smart portfolio managers and analysts don't come cheap. Cutting-edge technology is also expensive. Thus, the hurdle for active managers to achieve outperformance rises substantially. Just to break even after costs, they have to outperform significantly on a gross-of-fees basis. A high level of trading activity, which is characteristic of most actively managed funds, can also result in significant tax expense. Combined, investment-related costs and taxes can consume half of your return if not managed properly.

The evidence of these "frictions" is pervasive. Standard & Poor's recently updated its biannual study of actively-managed mutual fund performance. The table at the end of this page shows the results. Over shorter periods, the odds of a mutual fund outperforming its benchmark index are reasonable, though less than 50% in most asset classes. However, over longer periods there are very few mutual funds that provide returns in excess of what you could earn with index mutual funds (which generally charge very low fees and are quite tax efficient). While there are always some active funds that outperform, past winners are statistically unlikely to repeat in the future, making the job of finding truly stellar fund managers exceedingly difficult. This also renders past performance all but useless when looking for fund managers that will outperform in the future. Studies showing similar results can be found with data going back to 1927.

Where does that leave us? Well, there are some factors that have proven to work in the investment world. They are all very basic, common sense strategies, but interestingly, many are largely ignored by the professional fund managers.

Asset Allocation

The first is finding the right mix of risk and return for your unique investment objectives. You have to get the right asset allocation, or mix of risky and more stable investments. A portfolio that is too aggressive can cause great anxiety, but one that is too conservative may not meet your long-term goals. A balanced approach is necessary, and both financial and psychological factors should be considered.

Long-Term Approach

Staying in the market is also important. Trading in and out of

Mutual Funds That Trail Benchmark Index

Fund Category	1-Year	3-Year	5-Year
Large-Cap	63.25%	86.49%	75.37%
Mid-Cap	80.45%	90.22%	90.03%
Small-Cap	66.50%	83.05%	82.76%
International	44.25%	56.27%	73.73%
Emerging Markets	46.23%	57.62%	75.51%
Bonds	68.89%	97.65%	93.75%
Muni Bonds	21.88%	52.94%	86.11%

Source: Standard & Poor's, data through December 31, 2012

the market can result in higher costs (in the form of commissions and bid/ask spreads), higher taxes (for realized capital gains), and the opportunity for emotional decisions that could impair long-term wealth creation. For example, selling out of the market during bear markets and buying in during bull rallies is a comfortable approach, but opposite of what is likely to be financially rewarding. A study by finance professors Terrance Odean and Brad Barber showed that less frequent trading can have a meaningful impact on performance. They found that low frequency traders can outperform high frequency traders by up to 6.8% annually.

Diversification

Spreading your risk across a number of different asset classes (such as stocks, bonds, cash, real estate, or commodities), subclasses (such as domestic stocks, international stocks, large-cap stocks, or small-cap stocks), and securities is essential to reducing risk and building an efficient portfolio. It also helps protect against a downturn in any one asset class, and allows you to stay the course during difficult market cycles.

Low Costs

Keeping investment costs to a bare minimum helps you keep more of your return. This includes investment management fees, trading costs, commissions, mutual fund expense ratios, and potentially others. In his paper "The Arithmetic of Active Management", and a recent follow-up piece, "The Arithmetic of Investment Expenses", Nobel Prize winner William Sharpe showed that added costs all but guarantee that investors will trail the market.

Manage Taxes

Taxes can be the single largest expense if left unchecked. Fortunately, strategies exist to manage the tax bite. For example, you can put investments that pay income taxed at ordinary income rates, such as bonds and REITs, into retirement accounts. You can also use low turnover strategies so that realized capital gains are kept to a minimum. Finally, you can harvest tax losses, when available, to use against current or future realized capital gains.

While there is no "silver bullet" in the investment world that guarantees a successful investment experience, these common-sense strategies go a long way toward helping regular investors meet their objectives. While it is possible for some actively managed funds to incorporate these strategies, and provide solid returns, it is rare to find them in the real world. However, index funds offer a convenient wrapper for many of the strategies discussed above, which is why we tend to use them when building out portfolios.

A version of this article previously appeared on the CFA Institute's Inside Investing blog: www.blogs.cfainstitute.org/insideinvesting

COMPLIANCE CORNER

The nature of our business requires us to obtain sensitive personal and financial information from our clients. As a registered investment adviser with the United States Securities and Exchange Commission (SEC), we must adopt policies and procedures to protect this nonpublic, personal information. Our policy mandates that ACM employees are prohibited from disclosing nonpublic, personal information to any person or entity outside of our firm, except as authorized by our clients or an appropriate regulatory institution. We also take all reasonable measures to ensure secure transfer and/or disposal of documents containing sensitive information about our clients.

Registered investment advisors are required to file Form ADV with the SEC on an annual basis. A copy of our updated Form ADV is available at any time upon request. Please let us know if you would like us to send you a copy. Our Form ADV may also be viewed at the SEC's website (www.adviserinfo.sec.gov). The second part, our Form ADV Part 2 brochure, is available on our website.

FIRM NEWS

It was another busy quarter at Armbruster Capital. We signed a lease for new office space. It is located at 1250 Pittsford Victor Road, just a couple miles from where we are now. However, proximity is the only thing the two offices have in common. Our new space will be much more accessible, with ample parking, an elevator to the second floor, and a convenient location just off Interstate 490.

The new space is much larger, to accommodate our growth, and much more amenable to private meetings with clients. We are moving on April 26th. The new address is 1250 Pittsford Victor Road, Building 100, Suite 180, Pittsford, NY 14534. Our phone number will remain the same. We hope you'll stop by to see us soon.

New Team Member: Rudy Warren

More importantly, we further expanded our team with the addition of Rudy Warren in February. Rudy's primary role will be business development and client service. However, he is a multi-decade veteran in the business community, having owned several of his own businesses, and he will be an invaluable advisor to us. Rudy has served on several large non-profit boards and investment committees over the years, so he brings a client's perspective to our firm that will help us improve our service offering. We are honored to welcome Rudy to our team.

Good PR

We had some good PR during the first quarter. Mark Armbruster was again quoted in the Wall Street Journal. This was particularly flattering because the journalist, Jason Zweig, is someone we hold in high regard. Jason has a common sense investment approach that we find refreshing and unique in the financial media. If you missed the article and would like a copy, please let us know. You can also find a link to the article at our website.

App Launched

We also launch an app for the iPhone and iPad recently. It is a calculator that lets you know how much money you will need to withdraw from your IRA or 401K retirement plan after you turn age 70 ½. Clearly this is not applicable to everyone, but it should be useful for retirees, those helping elderly parents manage their finances, accountants, and other financial advisors. The app is free and can be downloaded from the iTunes store on your iPhone or iPad. Just search for "IRA RMD". Let us know if you find it useful.

WHAT IS ARMBRUSTER CAPITAL MANAGEMENT?

Armbruster Capital Management, Inc. (ACM) is a boutique wealth management firm serving high-net-worth individual and institutional clients. The firm's innovative "Passive Quant" investment approach incorporates cutting edge financial research to help control risk and pursue superior returns. ACM uses index funds, exchange-traded funds (ETFs), and other investment vehicles to build portfolios designed to reduce investment-related costs and taxes in order to maximize net returns.

Located in Pittsford, New York, ACM is employee owned, independent, and free of conflicts of interest. Acting as a fiduciary, the firm creates truly customized investment portfolios tailored to each client's unique objectives.

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The turkeys will also come via mail. They are probably my favorite of all the birds. Not only do I love to have my own turkey at Thanksgiving time, but they are neat animals to observe. They wander all over the place, annoying the neighbors and causing traffic incidents in front of our home. Nipa again rolls her eyes when she watches me call to them, believing I can commune with the turkeys. They do seem to respond, but I'm not really sure what I'm saying to them.

Raising all these birds takes a lot of time, and a fair bit of money. It is surely a loser from an investment standpoint when you can buy a chicken at the grocery store for $6. However, I expect dividends in the form of healthier kids who will hopefully grow up with a strong work ethic.

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