The ACM Journal

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One of my least favorite things is getting my hair cut. I think it stems from when I was a kid and I would come out of the barber with my bangs uneven, my cowlick sticking up, and looking like a cross between The Beaver and Alfalfa.

Even now as an adult, I'm not thrilled with the whole haircut experience. These days, everyone wants you to make an appointment. I don't know when I'm going to have time, and when I do, more important things almost certainly come up. So, I generally put off my haircuts for a very long time. Thus was the case recently, when my wife grew fed up with my increasingly ragged locks, and told me that she and my kids were going to the salon, and that she had made an appointment for me as well.

I remember a conversation with my colleague Bill from several years ago, when he summed up his expectations of the barber experience as such: he wants to sit down, get a brush cut, not have to talk to anyone, and leave. Such has been my experience in mostly smaller and inexpensive barber shops, but this is not what I found at the salon. Indeed, I had to talk with everyone. The entire staff

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What to do if the Stock Market Corrects

Lately, volatility seems to have returned to the stock market. It is impossible to tell if this is just normal, short-term jitters over world events, or if we are on the verge of a more significant downturn. There are certainly those arguing that stocks are overdue for a fall, but I'm not sure I agree with those sentiments. However, even if the stock market does take a turn for the worse, there are strategies we employ to ease the pain somewhat. Below is an excerpt of a recent article we wrote for the Rochester Business Journal that addresses what we do if and when stocks turn down.

First off, don't panic. Selling at the bottom may cause damage that your portfolio will never be able to recoup. It can be painful to watch your portfolio decline in value, particularly if you are relying on it to meet living expenses. However, ask yourself what has changed as a result of the market's decline. Are people still going to work? Are companies still trying to earn profits? Is the economy still functioning? If so, there probably is no reason to expect Armageddon. During times of market extremes it may seem like stocks are never going to rebound, but in over 200 years of history, they always have.

Selling to stop the pain may feel good at the time, but in order to be successful at timing market peaks and troughs, you not only have to get out of the market at the right time, but you also have to get back in before it rebounds. There isn't much evidence that investors, or investment advisors, have employed this strategy profitably over time.

As stocks fall, it is likely that your portfolio will need to be rebalanced, since severe market swings will probably skew your portfolio away from its allocation targets. For example, a portfolio that targets 60% in stocks and 40% in bonds would be roughly only 45% in stocks and 55% in bonds after a 40% decline in stocks and a 5% rise in bonds, similar to what happened in 2008. Clearly, this is a different, and more conservative risk profile than you started with.

It may seem that being more conservative during periods of market extremes is a good thing, but really the opposite is true. When stocks trade at low valuations, that is the time to have a full allocation to stocks, as future returns often prove lucrative. Indeed, Warren Buffett aggressively invested in financial company stocks back in 2008. He invested $5 billion in Goldman Sachs shortly after the collapse of Lehman Brothers, when the

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outlook for financial companies was at its worst. The Wall Street Journal estimated last year that Buffett likely earned profits of more than $10 billion from the investments he made during the depths of the stock market crash in 2008.

So, while it may seem counterintuitive to buy stocks when the world appears on the verge of collapse, that is exactly what you should do in order to maximize long-term earnings. In the asset allocation example above, your stock portfolio would sink from a 60% target to an allocation of 45%. To get back to the target allocation, you would need to sell bonds, which in this example have outperformed, and reinvest the proceeds in stocks, which have underperformed and are likely relatively cheap. You would buy stocks "on sale", and set your portfolio up for significant gains when the subsequent rebound arrives.

Next, we will be tax-loss harvesting. When the stock market really falls, there are usually plenty of losses in your portfolio, if only on paper. "Realized" capital losses, meaning losses on investments that have been sold in the current tax year, can result in a tax benefit. Capital losses may be used to offset capital gains in the current year, may be used to offset a modest amount of ordinary income in the current year, or may be carried forward indefinitely to offset capital gains and income in future years. So, aggressively realizing losses during a bear market could offset capital gains for years to come, thus making your portfolio very tax efficient. This helps ensure you keep as much of your return as possible, rather than surrendering gains to Uncle Sam.

Just because we sell stocks for tax purposes, it doesn't mean we have to be out of the market. In fact, it is best to marry a tax-loss harvesting program with the rebalancing strategy discussed above. For example, assume you have a large-cap stock mutual fund that declines in value by 20%. You could sell this fund, realize the loss for tax purposes, and then immediately reinvest the proceeds in another large-cap stock fund. This would allow you to realize the tax benefits of the loss, but also remain fully invested. The one caveat is that you can't sell an investment for a loss and then repurchase it within 30 days, or the loss will be disqualified by the IRS. But, you could buy another investment with very similar characteristics, allowing you to keep the integrity of your portfolio intact, but still optimizing your tax situation.

While stock market downturns can be downright scary, they also represent significant opportunity. Rational steps to improve your portfolio when stock market valuations are low allow you not only to rebalance without paying taxes, but also may help "bank" enough losses that you won't have to pay capital gains taxes for years into the future. With intelligent decisions, a little patience, and a focus on the long term, you could end up turning a bad situation into a profitable opportunity for the future.

Portfolio Review

It has generally been a good run for stocks since early 2009, but the third quarter of 2014 did not continue that trend. The stock market was up marginally, as measured by the S&P 500, but that masks the weakness in every other segment of the global stock market.

Mid-cap and small-cap stocks were down fairly significantly in the third quarter, and small-cap stocks are even showing losses for the full-year period. As stocks continued to climb this year, investors became nervous that the cycle may be getting long in the tooth. Since small-cap stocks tend not to weather bear market storms as well as large-cap stocks, investors have pulled out of smaller stocks as a way to position their portfolios more conservatively. Geopolitical concerns in Europe and the Middle East have not helped build confidence, but fears that the Fed will raise interest rates have likely been the biggest damper on smaller stocks. Smaller companies have a harder time getting financing, which can be particularly onerous when interest rates are rising, which can weigh on future growth prospects.

The bright side is that as small-cap stocks have fallen, their valuations have become more attractive, particularly for small-cap value stocks. While the S&P 500 trades at a price/earnings ratio of around

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Portfolio Review

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17 times its past twelve months of earnings, small-cap value stocks trade at a P/E ratio of 16. Valuation is not a great market timing tool, and there could be more volatility for smaller stocks, particularly if the overall market starts to turn down. However, the more reasonable valuations auger well for long-run returns.

Real estate investment trusts (REITs) also posted losses in the third quarter. We have been of the mind that REITs have been overvalued for some time, and the strong performance early in the year didn't help. Despite their poor performance during the quarter, REITs are still the best performing asset class year-to-date. We expect more near-term turmoil for REITs, but we like them for their long-term growth prospects, and the diversification benefits they bring. We've generally been underweight in REITs, but will be watching for opportunities to get back in.

International stocks lost almost as much as small-cap stock over the past three months. However, all of that is attributable to strength in the U.S. dollar. Measuring returns in local currencies, international stocks actually posted a gain of almost 1.0%. Troubles in Russia/Ukraine and Israel/Palestine have injected a lot of uncertainty into the growth prospects for already fragile European economies. Accordingly, positive, if anemic, economic growth in the U.S. looks good by comparison, driving up the U.S. dollar relative to foreign currencies. This dampens the returns U.S. investors earn in foreign stocks. Foreign stocks continue to trade at reasonable valuations, especially in the emerging markets, but fear may trump greed for some time as investors focus on the possibility of escalating tensions.

While returns for alternative investments are still preliminary (not all data was available as of this writing), they appear to be positive for the quarter. This is a good sign, as alternative investments are meant to offer protection during times of stock market volatility. We have been using alternative investments for roughly the past five years. During this time, the stock market has staged a historically strong rally, and alternative investments have consequently lagged behind. However, we may be at a turning point if stock market volatility increases.

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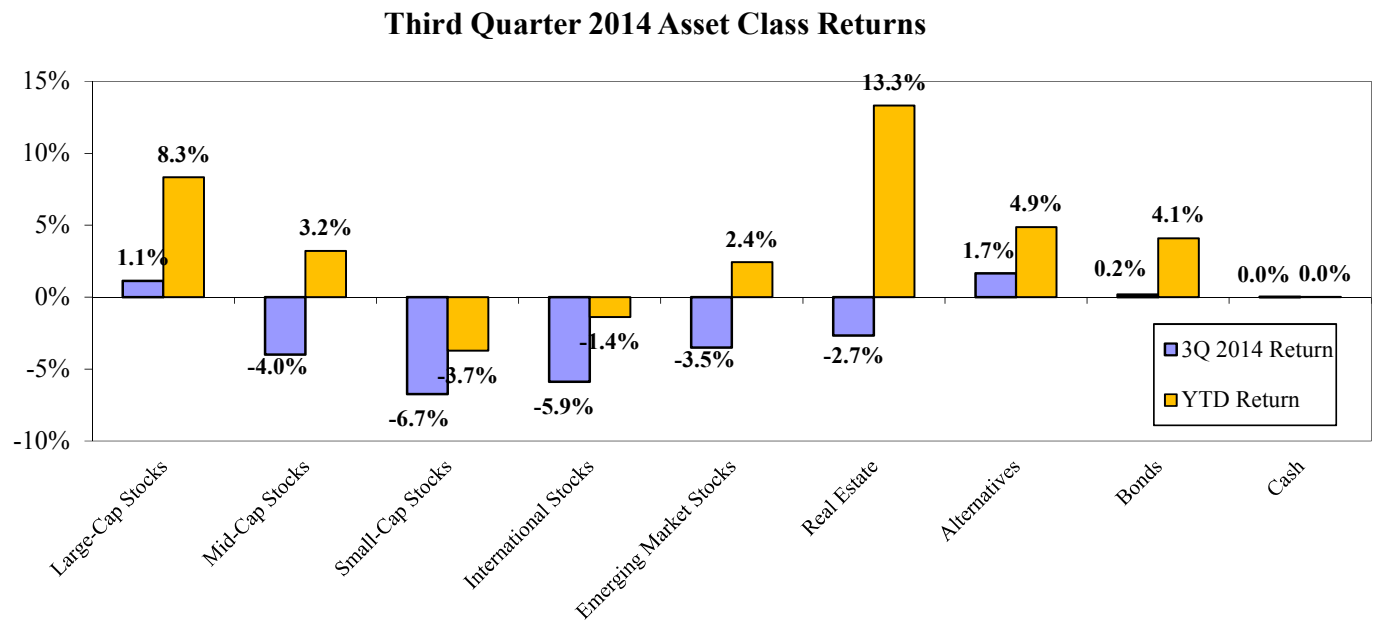

Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indcies. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Alternatives are represented by the HFRI Fund Weighted Composite Index. Bonds are the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

Portfolio Review

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Given how low interest rates have been, bonds have actually posted respectable returns so far this year. Uncertainty in the stock market usually makes for a robust bond market, and indeed that is what has happened recently. Already low interest rates fell even further, which increases the price of bonds, as investors fret over bad news in the headlines. The Fed is signaling that it will raise interest rates sometime next year, however, the Fed only controls ultra-short-term rates. The market sets prices for intermediate and longer-term interest rates, which may rise sooner or later than when the Fed decides. In any case, there is heightened risk in the bond market these days because of the low interest rates. Accordingly, we've taken a more conservative stance by keeping credit quality high and duration low. When rates do inevitably rise, we should be well positioned.

Overall, the global capital markets were shaky in the third quarter. However, year-to-date returns are still decent in most asset classes. Short-term volatility is part of investing, even if we have been fortunate enough not to experience it for the past five years. Despite troubles overseas and continued political squabbling at home, there are positive tailwinds as well. Unemployment is falling, the economy is growing, interest rates are quite low for now, corporate profits are still growing, and housing prices have been recovering. There is still room for positive returns for stocks and bonds in the years to come.

Firm News

In Memoriam: Joseph A. Komma

Our clients in Jamestown will be interested, and saddened, to hear that Joe Komma passed away on August 9th. Joe was one of the founders of Fulreader & Komma Management, a predecessor firm to Armbruster Capital.

Joe was the epitome of a Renaissance man. He was interested in many different areas, and excelled at them all. He spent most of his career at Lincoln First Bank, where he was a portfolio manager. However, he was more than just a practitioner. Joe continued to study the markets, and even taught classes to other investment professionals at the New York School of Finance. Upon retirement from Lincoln First (then Chase), Joe co-founded Fulreader & Komma Management with Tim Fulreader. Joe worked here from 1991 until his retirement in 2011. Joe's investment career spanned over fifty years.

Joe was also interested in art, antiques, and oriental rugs. He was a local authority on, and collector of these items throughout his life. His collection was truly amazing, but the level of knowledge he had on each of these items was beyond impressive. Joe knew every detail about the artists' lives, the history of the subject matter, and how the political events of the time influenced the art. While he learned these details over the course of many years, he could recall them right up until the end. Joe also spoke several languages, including French, German, and Latin. To say he was intelligent is a huge understatement.

Joe was 85 when he passed away, at home in his sleep. He was with his wife of 60 years, and surrounded by all the art objects that he loved. A fitting end to an inspiring life.

New Team Member

In September, we hired Jian Wong to help us with investment research and trading. Jian obtained his master's degree in Business Research in Economics from Stanford University. He also holds a bachelor's degree in Economics and master's and bachelor's degrees in Chemical Engineering from the University of Rochester.

Jian brings experience in quantitative analysis that far exceeds what we had previously. We have a fairly robust quantitative approach to analyzing investments and building portfolios, but Jian can take us to a whole new level. He will also work with Mark to conduct primary research and hopefully publish a few articles in academic journals.

The addition of Jian really rounds out our team and gives us a tremendous platform on which to service our existing clients, continue to seek out innovative investment solutions, and grow our firm.

Financial Planning

We work with a lot of clients on financial planning and estate planning issues. We've seen a lot of unique situations, and have been able to help come up with some pretty interesting solutions. Unfortunately, we have also worked on estate administration for some of our clients who have passed away. Having seen both sides of the estate process, we have learned a few things over the years.

Clearly, the basics are important; everyone should have a will or living trust, most people should at least consider life insurance, and long-term care insurance is increasingly important for many. However, here are a few other items that are less common to consider:

1. We think executors and trustees should be family members or close friends, if possible. Some attorneys believe a corporate trustee, such as a bank, makes more sense. However, we have seen too many banks take advantage of clients over the years. Try to keep things simple, and in the family if you can.

2. Having a smaller number of executors is much easier than having several. The old saying about too many cooks in the kitchen certainly pertains. If possible, pick one person you trust, and who has good sense to be your executor. Of course, a backup executor is also important, but ideally only one would serve at a time.

3. Make sure your living will and health care proxy are up to date. When you are unable to make decisions about your own health care, it is nice if those left with the responsibility have some direction about your wishes.

4. Avoid holding physical stock and bond certificates. Dealing with these after death can be very cumbersome, often requiring a lot of backup documentation, research, and trips to the bank to get Medallion Guarantee stamps. Putting securities into an investment account is easy while you are alive, but not so much after you pass.

5. Consider buying an umbrella liability policy if you don't have one. These policies protect you against lawsuits and such above and beyond your automotive and homeowners policies. They are relatively inexpensive, but can offer a lot of protection.

6. You can use a living trust, rather than a will, to avoid probate after your death. However, you can also use a "transfer on death" designation on your taxable investment accounts to accomplish much the same. This is sort of like naming a beneficiary to your retirement account. It will avoid probate on those assets, and should result in your heirs getting their inheritance in a more expedient fashion.

7. Keep a detailed list of assets and accounts so your executor doesn't have to search too hard. The same is true for passwords to on-line accounts, and maybe even social media accounts that you want closed after you pass.

8. Prepaid funerals can help alleviate the burden on your spouse or kids, and guarantee that your service is in line with your wishes.

These are a few considerations as you think about your financial plan. However, individual circumstances can differ, so we'd be happy to talk with you in greater depth if you have questions or concerns. It is also often good to get a formal legal opinion on these matters, and we can help coordinate with your attorney. Let us know if we can help.

What is ACM?

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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was overly happy and supportive, more than should have been allowed on a Saturday morning when I was still not quite happy to be awake. I was also handed a chai latte, which I have never seen in any barber shop before. In fact, I think you get beat up if you use the word "latte" in the barber shops I'm used to.

When I sat down in the chair, I was asked if I usually "style" my hair. I replied that I sometimes comb my hair. Then, throughout the haircutting process, I was asked several more times about styling. Still sort of fuzzy on what was being implied, I said that she should just do whatever she thought would look best. That set off a wave of washing, shampooing, massaging, buzzing, snipping, and blow drying.

When it was all done, I looked like I had been out in a gale too long. My hair oddly felt stiff and gooey all at the same time, and was reeking of coconut. I was a bit nervous I might attract a flock of tropical birds on my way out to the car. Everyone commented on how terrific I looked, but I think that is just standard practice in the salon world. However, even if I did concur, which is still a dubious prospect, trying to replicate what was done would require far more technical skill than I could possibly muster on the average workday morning as I get ready for work. I don't possess the requisite tools, patience, nor the graduate degree in chemical engineering that seemed required to figure out which chemicals to apply.

My wife took care of the bill for this family experience, and never would let on as to how much it all cost. I'm sure it was far in excess of what I would have normally paid, or would be willing to pay, but she tells me to consider it as an investment in my professional appearance. Knowing that my hair likely won't be the driving factor in my future success, I think next time I'll try to sneak off to Super Cuts and skip the fanfare and coconut, even though that means I'll have to buy my own chai latte.

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