The ACM Journal

Nyla Fairy

A number of people have commented lately that I look tired. That seems to be a general state of being for Nipa and me.

Our oldest, now 13, didn't sleep through the night for the first 4 and a half years of his life. By then, his younger brother was waking us up, followed soon after by their younger sister. At this point, our youngest, Nyla, is 6, and the kids have all been pretty good sleepers for the past couple years.

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Lately though, Nyla has regressed and wakes up most nights with some pressing issue.

The other day it was 4:00 am when she came in and whispered "mommy" over and over again until Nipa acknowledged her. Under normal circumstances this might have been cute, but at 4:00 am, by the third "mommy," I was close to a homicidal rage. Nipa finally woke up and found that the reason for the interruption was simply that "I can't sleep." Nipa suggested Nyla listen to music in her own room. Nyla complied, but also graced us by singing along to the CD for the next hour.

Again, what might have been cute during the daylight hours was enough to send me to the boiling point. I was able to control my emotions more out of exhaustion than self-restraint. When it was time for Nyla to get up for school, she was sleeping soundly. Nipa and

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Portfolio Review

Investment returns in the third quarter were strong and rewarded risk taking. Looking at the U.S. stock market, smaller-cap stocks outperformed large-cap stocks, and value stocks generally outperformed growth stocks. Most often, this sort of risk taking occurs during periods of market certainty. If investors feel good about the market, they are more likely to shift money to risky sectors of the market in order to earn higher returns.

It is somewhat surprising that riskier market sectors would outperform now, given the uncertainty around the timing of an interest rate hike by the Fed, the upcoming election, and generally poor corporate earnings results. However, inflation is tame, interest rates are low, and the economy is still growing.

Our stock portfolios tend to be risk-seeking, so such an environment is good for our investment approach. While diversification and risk control are obviously important, we tilt our stock portfolios toward market segments that should earn higher returns over time. It doesn't always work out, but the environment this year has been constructive.

Increased risk taking could be seen within industry sectors as well. Technology stocks earned over 12% in the quarter, while more staid industries like utilities and real estate lost money. This is a change, as the higher-yielding utility and real estate industries had been star stock market performers earlier this year. Investors have been yield hungry the past several years, driving up the shares of any investment with a significant yield. Low bond yields have driven even risk-averse investors toward stocks offering high yields. In my view, this just drives up risk and tax liability, but many investors do not seem to care.

With valuations on higher-yielding investments reaching historic levels, I would not be surprised if the shift we saw in the third quarter is the start of a trend rather than a short-term blip. Particularly if the Fed decides to raise interest rates later this year, higher-yielding investments could experience significant losses.

International Rebound

As risk appetites increased, international stocks have performed well recently. Developed markets generally outperformed U.S. stocks in the quarter, and made up some of the lost ground from earlier in the year. Continuing uncertainty over Brexit and sluggish economic growth in much of Europe are still concerns for the foreseeable future.

The emerging markets continued to be the best performing part of the capital markets both for the third quarter and the year-to-date period. Emerging market stocks have performed awfully the past few years, so they are overdue for a rebound. Very low stock market valuations have been enough to entice investors back despite some notable headwinds. Rising interest rates in the U.S. are typically bad for emerging markets, and continued strength in the U.S. dollar is also problematic. Nevertheless, the promise of stronger economic growth offered up at relatively cheap valuations has been

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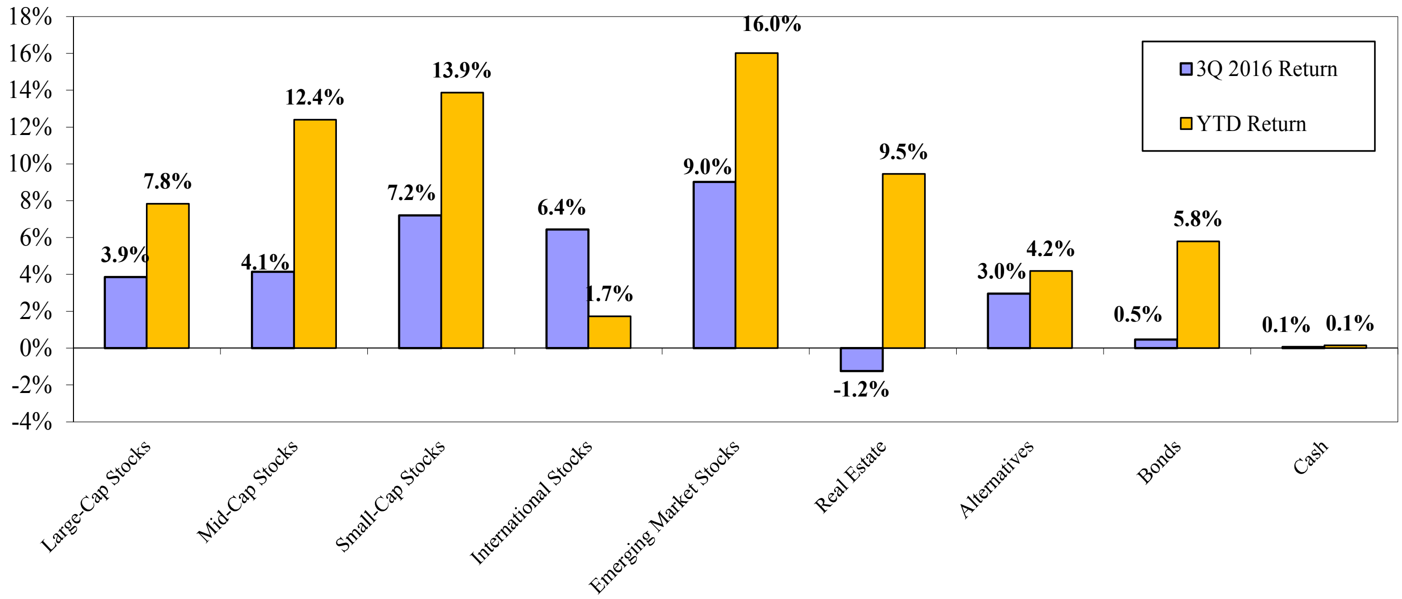
Third Quarter 2016 Asset Class Returns



Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indices. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Alternatives are 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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too much for many investors to pass up.

Alternative Investments

While stocks have been strong, returns for our alternative portfolio have been fairly anemic this year. That is not too surprising since alternatives tend to move inversely to stocks. It is because of the risk control they offer that we use them in our portfolios. However, there have been some notable successes in this part of the portfolio. The reinsurance fund we use is up around 5.5% so far this year. We also added a new fund in the third quarter.

The new fund is the Stone Ridge Alternative Lending fund. It invests in peer-to-peer loans offered on new lending platforms like Social Finance and Lending Club. These are loans that are usually too small for banks to consider, but the borrowers still have strong credit profiles. The Stone Ridge fund invests in personal loans, business loans, and student loans. Historically, the default rate on these types of loans has been quite low and the interest rate quite high. We expect this fund to offer returns that are in-line with the stock market over time, but with a very different risk profile, thus helping diversify our portfolios.

Bonds Moderate

While investors seek out risk, bond returns have stalled. For the full year, bonds have still earned a respectable 5.8%, however, returns in the third quarter were flat. Interest rates fell early in the year as the stock market was volatile and concerns overseas caused investors to direct money toward safe Treasury bonds. However, interest rates have started to rise, probably in anticipation of a Fed rate hike later this year. Rising interest rates means bond prices fall. We have positioned our portfolio conservatively in anticipation of this.

That said, bond market returns will likely be modest for the foreseeable future. Research shows that current bond market yields are a strong predictor of returns over the coming 7 to 10 years. That implies that annualized returns on bonds will likely be between 1% and 3%, roughly in line with what inflation has been historically. So, it is probable that real returns will be zero going forward. Bonds still provide an important source of risk mitigation, but for investors needing higher returns, the traditional approach of investing in only stocks and bonds seems unlikely to meet return targets.

So far, 2016 has been good to investors. Election years have historically provided strong returns, and this year, we're on track for the pattern to repeat. Certainly that could change as we get closer to the election, but the market undercurrents of increased risk taking and moderate volatility are positive signs for a strong finish to the year.

Don't Be Misled by Market "Data"

Now that we're in October, and close to a record high stock market, should we be worried? Is a crash imminent? After all, October has historically been one of the worst months for stock market returns. The crash of 1929, Black Monday in 1987, and the bear market precipitated by the housing bust in 2007 all occurred in October.

Among statisticians, there is an aphorism that correlation does not imply causality. That is, just because two events occur at the same time, it is not necessarily true that they are related. Maybe it has rained on Monday for the past four weeks, but Monday did not cause the rain. It is merely coincidence.

So it is with the stock market, where participants look for possible indicators of stock market performance to gain a trading advantage. Many of these historic relationships turn out to be more coincidence than substance. However, that doesn't prevent Wall Street from coming up with fun relationships it can use to entice clients.

"Sell in May and go away" is one. The logic is that the summer months generally aren't that lucrative, so you should close out all of your stock positions and enjoy your summer in the Hamptons. This year the stock market rose 4.8% between Memorial Day and Labor Day. Had you missed out on that, your returns would still be positive for the year, but far less than what they would be if you held on all year. Never mind that Wall Street brokerage firms have a vested interest in getting their clients to generate more commissions by trading frequently.

The Super Bowl indicator is another example of "experts" finding a pattern in data and proclaiming it as gospel. In this case, the correlation is found between the rise and fall of the Dow Jones Industrial Average and the team that won the Super Bowl. Historically, the data shows that if the team representing the old NFL won the Super Bowl, the Dow would rise, but if the AFL team won, the Dow would decline. For many years, the statistics showed close to an 85% correlation between these two data series. However, there is no economic link between football and investing, so it has to be dismissed as coincidence. In recent years, the Super Bowl indicator has not been quite so prescient, showing the danger of jumping on the bandwagon even when relationships persist for many years.

My personal favorite was an academic study published over twenty years ago that looked for the single best indicator of stock market returns. The authors found a data series that explained 99% of the movements of the S&P 500. Interestingly, it wasn't interest rates, corporate earnings, or economic growth. The indicator was butter production in Bangladesh. While there clearly is no reason why stock returns should follow third world dairy markets, I'm sure many day traders subscribe to the Dhaka Daily Star for the important insights it can bring them.

So, just because it is October and the stock market is at fairly high nominal levels, it by no means indicates a crash is imminent. Market levels have not historically been predictive of future returns. Valuation levels matter far more than the market's price, but even valuation has been unreliable as a market timing tool. Now is not the time to run for the hills, but rather to stick with proven investment fundamentals.

Perhaps we need to coin our own catchy phrases with actual helpful advice. Something like "invest for the long-term, and your future will be firm." Or "buy and hold until you grow old." Or "keep an eye on your costs and your returns won't get lost." I guess none of these are as catchy as the Wall Street saws, but the advice is better.

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 minimizes conflicts of interest. Acting as a fiduciary, the firm creates truly customized investment portfolios tailored to each client's unique objectives.

Firm News

I am very proud to announce that our portfolio analyst, Nick Russo, has passed the level three exam of the CFA program. With a couple more years of work experience, Nick will be a full CFA charter holder. CFA stands for Chartered Financial Analyst. It is a designation you can earn after three years of rigorous exams and several years of industry work experience.

There are a host of designations you can earn in the financial industry. Perhaps I'm biased because I am also a CFA charter holder, or maybe I'm just being snobby, but I think most would agree the CFA designation stands head and shoulders above the rest.

As proof, you need only look at the pass rates for the exams. It is not unusual for only 35% to 45% of those signed up for the CFA exams to pass. So, the odds of making it through all three exams is less than 10%. The fact that Nick passed all three in concurrent years is even more impressive.

I have been an active participant in the CFA Institute over the past fifteen years. I have been President of the local CFA society, given speeches at CFA events around the U.S. and Canada, and written articles for their educational web sites. However, I have a poor track record as far as employees passing the CFA exams.

There have been a couple notable success at Armbruster Capital, but over the past fifteen years, mostly at my prior firm, the vast majority of my investment team has been unsuccessful with CFA exams. It is therefore quite meaningful to me that Nick has achieved this level of investment competence.

We continually strive to build the best team we can to provide innovative investment solutions and exceptional client service. I'm humbled that I've been able to convince a couple CPAs, an attorney, and now an aspiring CFA to work with me. Pound for pound, I would argue our firm has the most intellectual horsepower of any around.

Also notable recently, Chris Cebula (a CPA) was recognized as one of the most promising young professionals in the Rochester area. He is included this year on the Rochester Business Journal's Forty Under 40 list. In a typical year, there are well over 300 nominations submitted for this honor, so Chris's accomplishment is impressive. We'll be celebrating at the awards luncheon in November, and Chris and the other honorees will be featured in an upcoming issue of the Rochester Business Journal. Keep an eye out for it.

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I had been up for hours.

Most nights we don't have midnight karaoke, but the interruptions persist. It is not unusual for me to wake up hanging on to the edge of the bed with Nipa smooshed in next to me. When I look over to her side of the bed, Nyla and her stuffed animals are luxuriating with plenty of space. Perhaps it is time to spring for a king-sized bed.

We now joke that the Nyla Fairy pays us a visit most nights. The bed is empty when we go to bed, but we wake up to find that a little something extra has been left for us, even if we don't leave anything under the pillow.

I suppose I just have to resign myself to a constant state of exhaustion. Even if Nyla ultimately stays in her own bed, our oldest is a teenager now, and I'm sure he will come up with new and interesting ways to keep us up at night.

Still, I take solace in the fact that my partner Chris Cebula has a six-month old and a two-and-a-half-year-old at home. He's REALLY not getting any sleep.

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