



Integer Wealth Advisors Group, LLC

Advise, Guide and Protect

First Quarter 2013 Market Commentary

Here is an excerpt from our last quarter commentary:

“Looking forward investors have to weigh the impact of taxes on their investments and become more adept at managing on an after-tax basis. We do not believe that investors will shun equities because of taxes. Remember not everyone pays taxes on their investment income and gains. Retirement accounts, foundations, endowments, pension funds and trusts will always own equities and do not have to be so concerned with taxes paid on gains, dividends, and interest.”

Confidence

Markets reached all time highs in the first quarter of 2013 despite fears of sequestrations and fiscal cliffs. As we observed in our fourth quarter 2012 commentary not everyone is driven by taxes or has a short-term view on the markets. It is ironic that almost four years to the day (March 9th, 2009 to be exact which marked the low) the markets would be approaching all-time highs. So we are back where we started in October 2007, a round trip of epic proportions to be sure. It is only natural that we should survey the investment landscape as we sit atop the mountain once again. Will we face another fall from the peak and experience another 2008 fiscal crisis? We think not.

With the S&P 500 up 10.6% in the first quarter, and reaching its all time new high, investors who stayed the course have been amply rewarded. The question previously asked is where do the markets go from here? With fourth quarter 2012 GDP coming in at 0.4%, the economy has to grow faster here and across the globe. The really bright spot is in housing. While new home sales slowed from January's pace, financing is still cheap and the 4.4-month supply of new homes remains at historical lows. The median new-home price rose by 2.9% year-over-year to \$246,800. As consumers realize that buying a home does not lock them into a potential loss, and the threat of cheap credit slowly rises, the economy could be at the “perfect storm” point for a stronger growth pattern.

In late March we circulated an e-mail with the title “Green Shoots” to help answer the question of “where can we go from here”? We had survived the “fiscal cliff” (which turned out to be more of a “Scottish crag”), and managed through the perceived horrors of a sequestration. The economy was improving gradually and consumer confidence was improving. We decided to ask a simple question: “What if?” What would happen to the equity markets if housing continued to recover; Congress was able to pass some combination of tax reform and entitlement spending or a major energy policy like the Keystone XL Pipeline was approved? Any one of those, we suggested, would increase consumer confidence which, in turn, would improve business confidence thus igniting a virtuous circle of economic improvement.

Let's not forget that the markets are global and that growth continues in the emerging markets of the world despite some of them not always being friendly to our interests. Capital goes where it is well treated, and if that capital produces goods and services that are desired by consumers, an exchange will take place....that is commerce. With low interest rates and an improving confidence the virtuous circle of an improving economy could be close at hand.

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January:

The Dow started the new quarter with a gain of 77 points to reach 13515. The economy seemed to gain a steady footing as the Institute for Supply Management purchasing index rose to 51.50 from 49.60. Anything above 50 suggests expansion and with gold setting a 7-month high settling at \$1780.50 an ounce, investors may have picked up on some up-beat news. Real estate continued to climb higher as evidenced by shopping malls in the United States reporting an average vacancy rate of 8.7%, down from 8.9% in the second quarter, and rents climbing 0.3%, the fifth consecutive quarterly increase.

February:

February continued the equity streak with the Dow Jones finishing the first week in up 113 points to close above 14000. Nonfarm payrolls rose by 157,000 in January but that was tempered by a fourth-quarter GDP that contracted 0.1%, its first such move in more than three years. The Fed said it would hold steady on its purchases of bonds to stimulate the economy which contributed to the joyous feeling about equities. That feeling contributed to the 10-year Treasury bond yield jumping to 2.01% as investors decided that loaning the government money for too long might be a losing proposition over the longer run. The Dow continued to hover around the 14000 mark as news of concerns in Europe again resurfaced. If the zigzag of the markets wasn't enough, mother-nature took its fury out on the Northeast again with a blizzard that dumped up to three feet of snow in the area. Perhaps it was the weather, or the Fed minutes that showed some schism between officials over the easy-money policy, or Italian elections, whatever the cause, the S&P 500 index sustained its worst two-day drop since November 2012. The S&P 500 dropped to 1515.60 while gold dropped 2.26% to a 2013 low of \$1,572.40 per ounce.

March:

A good thing about the markets is that they don't necessarily dwell on bad news for too long. Perhaps the Italian elections were over-stated a bit, and the snow eventually melts, but the stock market started a climb in March with a quick trip over the 14,000 threshold without seeming to break a sweat. The Dow finished the first week of March at a five-year high. All this, despite the continuing fear of sequester which was supposed to have extreme dire consequences for everyone. The Dow certainly did not care about sequester as it promptly tacked on 307 points in the second week to finish at 14397, topping the previous record set in October 2007. Underlying this grind higher was the fact that bonds did not necessarily crater in price. If "the great rotation" out of bonds was occurring, then bond yields should have sky-rocketed as equities climbed and bonds were sold. What appeared to be happening was a rotation out of cash to stocks. Confidence, as previously noted, was back in the markets with the Dow rising to 14512 by the last full trading week in the month.



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DOMESTIC EQUITIES

Index	Returns for the Quarter	YTD
S&P 600 Small Cap	12.1%	12.1%
NASDAQ Composite	8.2%	8.2%
Dow Jones Industrial Average	11.3%	11.3%
S&P 500 Index	10.0%	10.0%

(Returns are without dividends. Period Ending 3/31/2013)

<u>Company</u>	<u>Percentage Weight</u>	<u>Year to Date 2013</u>
S&P 500		10.6%
Energy	10.9%	9.6%
Materials	3.4%	4.2%
Industrials	10.1%	10.1%
Consumer Discretionary	11.6%	11.8%
Consumer Staples	10.9%	13.8%
Health Care	12.5%	15.2%
Financials	15.9%	10.9%
Technology	18.0%	4.2%
Telecommunications	3.0%	8.2%
Utilities	3.4%	11.8%

Source: Standard and Poor's (www.standardandpoors.com)

Style Return Box for the First Quarter 2013

	VALUE	CORE	GROWTH
LARGE	11.91%	10.59%	9.28%
MID	14.77%	13.43%	12.06%
SMALL	11.58%	11.81%	11.93%

Information provided in the above chart represents the quarterly returns of the S&P indexes of iShares Class of funds with dividends reinvested.

INTERNATIONAL

In a word..."Cyprus". The quarter was once again dominated by the off-again, on-again concerns about Europe. This time the tiny nation of Cyprus was front-and-center with a crisis that saw creditors, and some depositors, get an unexpected "hair-cut" from regulators. To date,



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European politicians have prevented a “contagion” through bailouts, bail-ins (meaning unsuspecting creditors and depositors who lose money) and stimulus to buy time to make tougher long-term decisions. Growth in Europe will be difficult to achieve if leaders don’t come up with solid plans to address these problems. What is curious is how the issue in Cyprus took the markets on a short roller-coaster ride due to the expectations of a collapse of their banking system. Clearly, the Russian’s that use Cyprus as their banking center, due to the lax oversight of their banking laws, were the ones to be more concerned.

Over on the other side of the world, China and Japan took center-stage (along with North Korea, but for different reasons), as the world’s second and third largest economies seem to be stabilizing and poised for some growth. Japan’s new government, under the leadership of Prime Minister Abe, has declared the strongest attack yet against a stagnant economy, vowing to hit explicit inflation targets of 2% in 2013. China’s year-on-year GDP growth is expected to be at 8.1% in the first quarter of 2013 according to Reuters. While the super-hot housing market in China is cooling off, there are signs that the domestic market continues on a path of recovery from previous slowdowns.

The Domestic Economy Continues Slow Progress

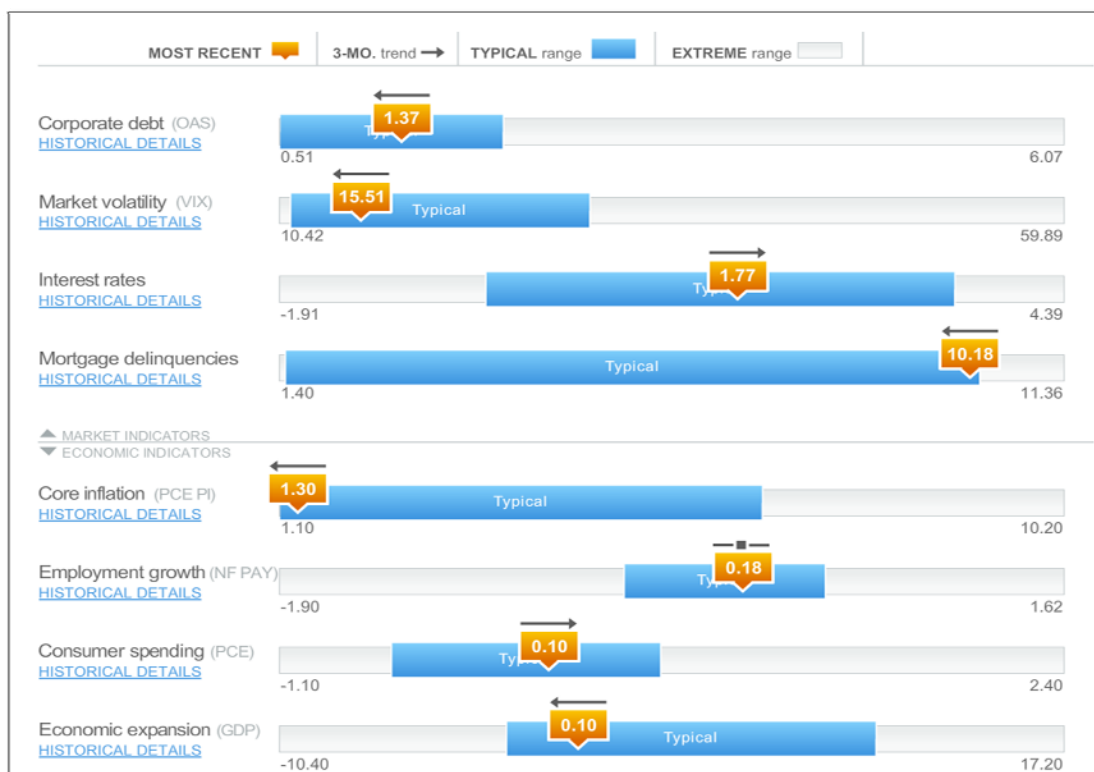
This theme is continued from our last quarter’s commentary as the economy continues to move forward, albeit at a slow pace. Economists are predicting GDP growth for 2013 to be in the 2.5% to 3.0% range, not fast enough to achieve a “break out” to improve unemployment. On that score, while the unemployment number continues to fall, as recently reported by the Department of Labor, it is only because the number of people actively looking for work is shrinking, thus the number is artificially reduced. Most economists believe the number is higher, and it is much higher for teenagers and minorities.

To put the domestic economy into perspective we found an interesting chart at Russell Investments (below) which highlights some interesting trends. The chart highlights several areas that should be of interest to investors: market volatility, interest rates, mortgage delinquencies, core inflation and employment. Of note is that all indicators moved with the “typical range”, meaning the extreme “tails”. In short, the chart gives us an indication as to whether or not the economy is returning to a more typical behavior.

While the chart is not a predictive tool, it does provide a very good context for evaluating the current state of the economy. Mortgage delinquencies are down which is a good sign, inflation is low and interest rates remain in check. Employment growth and economic expansion are the two indicators that remain weak. Consumer spending, while not robust, suggest that consumers may be “de-leveraging” their balance sheets, meaning they are paying down debt and saving a bit more.



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As we indicated in our last commentary the bright spot is housing that continues a very steady improvement as bargain hunters continue to pick through the housing inventory. Areas such as Phoenix, Las Vegas and Florida continue to see housing prices moving higher, still far from the peak prices where some homeowners had purchased their homes.

FIXED INCOME

Fixed income is on everyone's radar as the prices in this security class have risen nicely over the past few years. This quarter, fixed income returns came back to earth with some taxable fixed indexes actually producing a negative quarterly return for the first time in several years. So the question that is on many an investor's mind "is there a great rotation going on from bonds to stocks?"

To that we say "no". We wrote in our last commentary that fixed income is a great diversifier in a portfolio and that the best way to approach fixed income in the current market environment is to manage duration (the measure of volatility). Accordingly, our view has been for several years to manage overall duration of a mixture of bond funds in the range of 3 to 5 years depending on each of our clients risk profiles and cash flow needs.. Relevance of duration: A one-percent rise in interest rates means a bond fund with a duration of five would lose approximately 5% of its value (this is not hard and fast, but a good rule of thumb). What is interesting is that many bond fund managers understand that analysis and have been shortening their duration as a result of the run-up in prices.



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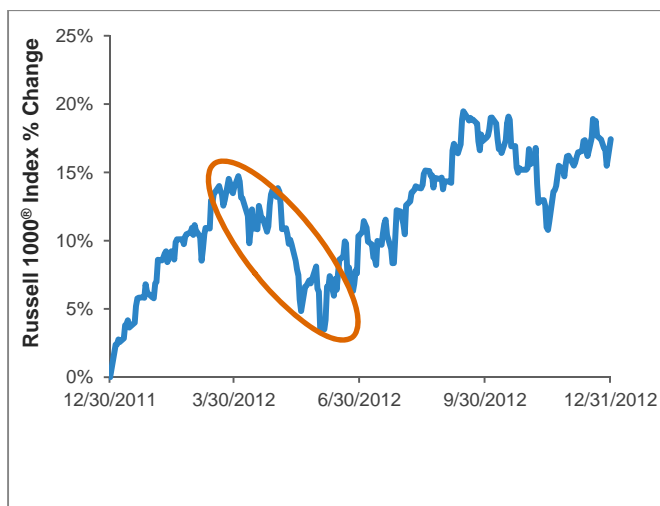
If there was a great rotation occurring yields on bonds would be rising more quickly. That has not been the case. Yields, and bond prices in general, are still stable and we have not seen a massive outflow of cash from bond mutual funds to equities. Therefore, in our opinion investors are maintaining their strategic allocation and putting idle cash to work in the equities markets. We have remained consistent on this point of duration, and of managing portfolio credit quality. Investors who want higher yields can achieve this by going out longer on the duration curve and/or buying lesser quality credits. They should do so at their own peril as the yields they receive will not adequately compensate them for what will surely be a quick turn in the bond market when it comes. When that day is, no one knows, but when “Uncle Sugar” (aka The Fed), takes away the punch-bowl of stimulus, the exit doors will be very crowded for the bond holders of long-dated, low quality credits.

Equities:

Here’s what we said last quarter in this space:

As investors survey the landscape of opportunity, equities continue to be an area that can provide a longer-term total return opportunity, at this time, especially when compared to long-dated fixed income.

First, it was not our intention to suggest that one abandons all fixed income and go to equities. In our last commentary we simply acknowledged that stocks represent a good long-term value to the patient investor. And we know that what goes up must come down, but it doesn’t always stay down. The chart below is a perfect example of the fluctuations that occur in the market place. There will be stretches when indexes pull back after a period of gains, what we call a “consolidation”. March 2009 was the extreme of consolidation but for investors who stayed put with their allocations, or even put money to work, it was a great time to buy equities on the cheap.



Stocks continue to provide a reasonable opportunity for investments. The price earnings multiple of the U.S. equity market as of December 31, 2012 was 16.4. The historical range for



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the past 10-years has been 15.8 to 18.7, so stocks on that measure are fairly, if not still cheaply, priced. Investors should also be reminded that part of the run-up in U.S. equities has been the turmoil in Europe, especially Cyprus. The U.S. equity market began its rapid climb above 14500 when the Cyprus banking crisis broke and investors around the world realized that they could take an unwitting “hair-cut” should one of their European banks flounder. So, part of the run-up of the U.S. equity market can be attributed to international investors seeking a safe haven in the United States. That has, and will be for the future, a theme that will not go away.

Portfolio Monitoring:

In our last commentary we mentioned that portfolio monitoring would take on added complexity with the new tax code. That being said, investors should also be reminded that portfolio monitoring includes assessing their “risk and return” perspective. With the impressive run-up in equity markets in the first quarter of 2013 the natural inclination is to “chase the hot dot” and consider changing an asset allocation to capture more return. This is particularly on display with the portfolio returns experienced in the first quarter of 2013.

Anyone reviewing a balanced portfolio of say 50/50 bonds and stocks will be hard-pressed to see a return coming anywhere near the 10% return of the S&P 500, or the 11% return of the Dow. Bonds simply did not produce any significant return to speak of, cash has been idle for years, and the international market produced only one-half of the return of the S&P 500 for the quarter.

The important question when reviewing the portfolio is risk and return. Change the strategic allocation (stocks/bonds/cash), only when there is a compelling reason to do so; or a change in the original thesis of your investment philosophy.

Manager Monitoring:

We did not have any manager issues in the first quarter of 2013.

IN SUMMARY

It Bears Repeating

Sometimes the best advice is that which has been previously offered. What we said in our previous commentary is about as good as we have seen and cannot be improved upon:

The best thing that investors can do is to focus on three simple steps for their investments. First, have reasonable return expectations for the foreseeable future. What we mean is calibrate the risk you are willing to take to the return generated. Balanced portfolios have been running in the high single digit to low double-digit area over the past few years. With fixed income becoming stretched, do not expect fixed income returns going forward to match previous years. (Update: This came true in the first quarter of 2013)



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Second, expect volatility and do not let it drive “knee jerk” investment decisions. We have been in this business for many years and have managed client portfolios through many cycles, some of the worst ever seen in modern times. One thing we know is that investors tend to make the worst decisions under panic conditions.

Finally, when things are not going well investors should have their “shopping list” prepared for investments in areas that are beaten down. Following suggestion number two, if you can maintain calm and rationally pick through some investment opportunities chances are that you’ll find some great bargains to add to your portfolio and enhance the longer term prospects of your investments. Remember, investing is a marathon, not a sprint!

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