Integer Wealth Advisors Group, LLC

Advise, Guide and Protect

Fourth Quarter 2014 Market Commentary

Here is an excerpt from our last quarter commentary:

The positives moving forward include an improving consumer balance sheet, sustained corporate earnings, slowing down of the federal balance sheet expansion, directionally positive employment numbers, and increasing consumer confidence. As we move forward, there will continue to be challenges which include a need to retool our workforce, increased regulations, burdensome corporate and individual tax rates, and a general consensus for defined actions to stimulate economic growth. We are hopeful with the recent message and mix inside Washington, that the government can begin take action and provide clearer direction. In summary, we remain positive and continue to believe in what we have been preaching for years…asset allocation, while boring, works.

In a few of our communications earlier in the year, we indicated that great years such as 2013 can be followed by good years, and 2014 can be considered as a good year. While a few weeks into the fourth quarter may have placed that theory in doubt, investors remained focused on corporate earnings, while inflation and a stabilization of the employment market kept 2014 in the positive. Heading into 2015, therefore, the annual renewable question is "what about next year"?

Imagine

In 1971, John Lennon released a song called "Imagine", a haunting solo that talks about people living life in peace. A great concept that got us to thinking and applying some imagination to the markets. Looking back over the past six years imagine what the economy would be like today had Congress been able to focus on tax reform, less regulation and job growth? Yet for the past six years Congress has not passed a budget, but they have increased taxes and imposed heavy regulations partly as a result of the 2008-09 financial crisis.

What do individuals and corporations do when faced with onerous taxes and regulations? Corporate America does not repatriate dollars from overseas entities in order to shield it from the highest corporate tax rate in the world. According to a report by The Washington Times, American corporations have a record $1.53 trillion in cash on the books. Three-quarters of that corporate cash pile was earned overseas and is being held outside the country to avoid U.S. corporate tax rates of 35 percent, according to a study by Standard and Poor's Corp (May 2014). Corporations can also engage in a practice called "inversions", where a U.S. company buys a company located outside of the United States and moves the headquarters overseas to a tax situation that is lower than that of the United States.

From the standpoint of the individual, productivity can be impacted by higher taxes at the margins. Why produce another marginal dollar of revenue if you are hitting the top income bracket that produces a combined state and federal rate of 45%, or higher? Or, individuals begin to engage in "under-the-table" work that the Federal government never sees and thus cannot be taxed. High taxes make payers engage in perverse behavior. Why does the U.S. Government feel that it should be up to a 50% partner in our economic activity?

Six Year Cure for a Two Year Flu

The whole financial structure of Wall Street seems to have fallen on the mere fact that the Federal Reserve Bank raised the amount of interest from 5 to 6 per cent. Any business that can't survive a 1 per cent raise must be skating on mighty thin ice... But let Wall Street have a nightmare and the whole country has to help get them back in bed again." Will Rogers, Aug. 12, 1929

One of the few upsides of having a terrible golf game is that you do not leave the office to try and improve your handicap. Place us in that category as most days we are seated in front of our screens watching the markets and listening to the talking heads on CNBC or Bloomberg. One of our favorites is Rick Santelli (CNBC) who reports from the floor of the Chicago Board of Trade. The title of this section is directly taken from Rick's comments regarding the Federal Reserve's policy. In short, Mr. Santelli believes the Fed has stayed too low for too long, in effect administering a "six year cure for a two year flu".

That is a good set-up for discussing the year ahead and how to position for changes to Fed policy, should they occur. The question today is the same as it has been for the past few years: "When will the Fed start raising rates", effectively removing the "cure" from a flu that has long past? The Fed has indicated in its last meeting of 2014 that it will be "patient" when raising rates. Our take is "the sooner the better" coupled with reforms that lower taxes and improve the regulatory environment, and continuing moderate energy prices. Unfortunately, as we will address later, it is more likely that the Fed will delay raising rates beyond 2015.

What is the basis for our view to encourage a modest rise in rates? It is like "ripping the band-aide" off. For years the Fed has avoided "ripping" the band-aide fearing the patient could not take the pain or the wound would be reopened. By starting to normalize interest rate policy from ZRIP (zero rate interest policy) to something positive, banks earn more money (albeit slowly over time) and investors can earn something on deposits. Banks earn a better rate on the "spread" between what they are paid for deposits by the Fed and what they charge to loan us money. Investors earn more because banks want to attract more deposits to earn the spread and competition for those deposits will begin. That's a win/win. The good news is that the economy will be able to withstand a modest rate hike.

An upside to a hike would be to send a message that the Fed is ready to "tamp down" any type of speculative desires that drove the 2008 financial crisis. A small 25-basis point hike won't have much impact on "speculative juices", but demonstrating that they have the will to do so would serve the Fed well. Regulations have already taken the teeth out of proprietary trading desks that traded "house money" with huge levered bets. Those days are past.

No document loans, liar-loans and the like that fueled the speculative housing market are history. Those individuals that filed for bankruptcy in the post-financial crisis are now approaching the time when the bankruptcy will be off of their credit records. That allows for these consumers to once again enter the housing market (assuming they have been renting or owning at much higher rates) and either buy a house using proper documentation or re-finance their existing lows at more favorable rates.

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DOMESTIC EQUITY STATISTICS

Index	Returns for the Quarter	YTD
S&P 600 Small Cap	9.5%	4.4%
NASDAQ Composite	5.4%	13.4%
Dow Jones Industrial Average	4.6%	7.5%
S&P 500 Index	4.4%	11.4%

(Returns are without dividends. Period Ending 12/31/2014. Source: Morningstar and spindices.com)

Company	Percentage Weight	Year to Date 2014
S&P 500		11.4%
Energy	8.4%	-10.0%
Materials	3.2%	4.68%
Industrials	10.4%	7.52%
Consumer Discretionary	12.1%	8.05%
Consumer Staples	9.8%	12.87%
Health Care	14.2%	23.30%
Financials	16.6%	13.10%
Technology	19.7%	18.18%
Telecommunications	2.3%	-1.91%
Utilities	3.2 %	24.29%

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

Style Return Box for the Fourth Quarter 2014

	VALUE	CORE	GROWTH
LARGE	13.2%	13.6%	14.7%
MID	11.9%	13.0%	7.4%
SMALL	7.3%	5.7%	3.7%

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

INTERNATIONAL

Is 2015 the year the increase international exposure in a portfolio? This question has been asked at the end of the past several years. Investors that have been heavily weighted to the international market have been disappointed by the uneven returns generated in this space. Sure, 2012 and 2013 were good years (up 17.2% and up 22.6% respectively), but the domestic U.S. markets gave a bit better return (up 15.9% and 32.3%). For the year ending 2014, the S&P 500 was up 13.6% (with dividends reinvested) while the MSCI EAFE index was down 5.04%.

As we said in our previous commentaries some international exposure is good for a diversified portfolio. Diversification comes in the form of attempting to combine asset classes that don't all move in tandem together, that way you spread out the distribution of returns. Unfortunately, the international market had a huge divergence to the U.S. domestic market and in 2014. Underperforming by nearly 18% relative to the U.S. market causes heartburn for investors. The international market is still a tough market to own.

Considering what has occurred in Europe, Russia, Japan and China and it is no wonder investors have been placing their bets with the best market on the planet (the United States). Certainly we want robust markets around the world so that more economic well-being is generated but at the moment it's not occurring in these markets. Don't abandon them all together just reevaluate how much exposure you want in the international space.

Europe is simply has too high a tax structure and archaic work rules to get the economies on a sustainable path. As we saw going into the last quarter of 2014, the Euro's decline versus the dollar sped up considerably as investors knew the ECB would have to stimulate (print money) to help the economy avoid falling prices.

China's slow down should not come as a surprise after breakneck gains in GDP over the past many years. A slowdown should be natural and we should not forget that China is a country where there are nearly 150 cities with a population of one million or more people. Structural changes continue in China and we have to remember it is a more centralized planned government. Their emergence of the middle-class continues to fuel demand for housing, cars and consumer products.

The balance of the planet should benefit from the recent slide in global energy prices, although it will take some time to work through the various economies. Places like Japan that are dependent on oil will receive the biggest boost, while commodity rich Australia will find the lower prices not to their liking.

In the end, economies work on cycles and the international markets are going through a tough stretch at the moment. Continued low energy prices coupled with economic reforms that can unleash the entrepreneurial spirit can quickly put an end to the recent downturns. We still think the United States is the lead economy for the next couple of years with an appropriate allocation of 5-10% to the international market.

FIXED INCOME

There is two things that can disrupt business in this country. One is war and the other is a meeting of the Federal Reserve (Board)." Will Rogers, April 2, 1929

Will bonds crater if the Fed starts raising rates? The second eternal question. We've been on ZIRP (Zero Interest Rate Policy) for nearly seven years and no one has suffered more than individuals who rely on fixed incomes. Money in the bank is dead money. Money in CD's barely breaks even. So over the past six years investors wanting higher cash flows in their portfolio have plowed into dividend paying stocks and longer dated bonds. We'll address stocks in the next section but for now bonds have rewarded investors with handsome total returns (income plus appreciation). Several bond funds even made capital gain distributions in 2014! It was a very good year for bonds.

So as we enter another year of zero rates investors mull over what a hike in interest rates would mean to their investments? First, there is no exact consensus that 2015 will be the year the Fed starts raising rates, but given the events of other world Central Bankers, it's hard to see that the Fed would raise rates this year. Everyone is lowering and we are raising rates? At best it would have to be a "push" as the Fed keeps interest rates where they are…they have no ability or rationale to go to negative rates.

If we are wrong and the Fed does move, rising rates do not necessarily portend disaster since you raise rates to keep an economy from overheating and to starve off speculation. It doesn't seem to us that the economy is overheating or speculation is of a concern; It also is not a bad thing for bonds since it is the duration (a measure of sensitivity of a bond price to interest rate changes) that really tells the tale.

Investors in really long dated bond funds will not like interest rate hikes, investors in shorter dated maturities will see a ripple in their portfolios. When rates move up, bond prices adjust and the yields move higher. Investors with cash to invest will eventually see an opportunity to "buy low" and invest at attractive yields. Eventually the market reaches an equilibrium as more investors buy and the yield comes down. This cycle is played out repeatedly.

So, we continue to recommend bonds for a portfolio in proportion to an investors need to balance volatility with income generation.

EQUITIES

What is driving the equity market? The volatility in equities has been driven by several issues including energy, Euros, interest rates, and earnings. On the latter, it's no surprise that earnings have a bearing on equity prices. Earnings for U.S. companies have been good over the past few years and that has moved prices higher. The underlying issue on earnings is if they are coming from real top-line growth, or are companies cutting costs to hit the bottom line? Many companies have engaged in "buy-backs" which has the effect of taking shares out of circulation

and "goosing" earnings per share. In many cases there are real increases in market share and consumers buying products they really want. Technology is a prime example.

Concern about the stability of the Euro, and the lackluster growth potential in Europe, have sent investors to the United States. During the final six months of 2014 the Euro has weakened against other currencies. The pledge to prop-up the European economy by the European Central Bank (ECB) has not materialized and the resulting lackluster growth prospects have moved investors to the U.S.

With Central Bankers around the world lowering rates (and printing money), raising rates here would only strengthen the dollar. The impact of the Fed raising rates would mean an increase in the strength of the dollar ultimately hurting exports and costing jobs.

Finally, we have energy. The spectacular fall of oil prices has scared investors because they have not been able to digest the impact on the economy. At first blush one would think lower energy prices would be a windfall to the economy. We believe it should be the case but the rapid decline in oil prices simply has investors scared. We are seeing oil at 5 year lows and with the recent build-up of oil production in the United States there is a general fear that it went too far too fast. When you look at energy as 8-10% of the S&P 500 index, you can understand why price declines can have a dramatic impact on the volatility of the stock market. Until the prices stabilize expect more of the type of market swings that we saw in December, to continue into the foreseeable future.

IN SUMMARY

2014 brings to a close one of the largest stimulus programs an economy has seen since The New Deal of the 1930's. Now the question to be faced is can the economy function without stimulus? Were the five years of gains in the marketplace artificially produced by the influx of stimulus? We are sure that whenever you increase assets by $4 trillion dollars or so, there has to be some impact to pricing and investor psychology, especially when the easing is designed to prevent an economic collapse (or perception of one occurring). The next few years will provide the opportunity to judge the stimulus programs, the impact on asset prices and the economy's ability to continue normal operations. We tend to be in the camp that the U.S. economy will function just fine.

So, how should you consider positioning your portfolio in 2015 and beyond given all that we have discussed? Let's break it down by category.

Fixed Income

First, recognize that rising rates will not obliterate a fixed income portfolio. You can still own fixed income in a rising rate environment. While we have recommended owning shorter dated bonds and bond funds rather than longer ones, that advice in 2014 back-fired as long dated bonds rallied hard. We still prefer to hold this line of thinking especially as the 10-year Treasury bond is at 2%. Not much more room to go before "zero", but a whole lot of upside to yields should things turn quickly. Keep the focus on high quality bonds while avoiding the temptation

to load up on the high yield variety. Whenever rates start rising the "junkiest" of the bonds will come under pressure since companies that issue these types of bonds have questionable economic viability. The higher interest costs they have to pay will eventually catch-up with their ability to pay interest.

Equities

We have often remarked that the stock market is a market of stocks. It's good advice to remember since companies such as General Electric, IBM, Coca-Cola, UPS, United Technologies, Proctor and Gamble, and others have been in existence for 80 to 100 years or more and have seen a lot of economic cycles. It bears repeating that investors own equities to participate in the growth of the company and to own a piece of the income stream. Companies with competent management teams, good balance sheets and products and services that are in demand will always have investors.

When you think about how to structure the equity portion of the portfolio you think about the main drivers of the economy: Energy, Healthcare and Technology. It goes without saying that the technology that has enabled the energy revolution is producing solid dividends. Low energy prices are like tax relief to the American consumer. Despite lower gasoline prices new technologies are increasing the miles per gallon of vehicles and new hybrid technologies will continue to evolve.

Low gas prices do not mean innovation will cease. The younger generation today, with their emphasis on a mobile lifestyle and earth-friendly products will continue to buy vehicles that are fuel efficient, ecologically sensitive and fun to drive. They do not want "your father's Oldsmobile".

As the original baby-boomers age consumption of health care related products and services continues to soar. This trend will continue for decades as each successive generation is replaced by the first. Scientific advances in biotechnology that fine-tunes drugs with a person's DNA continue to hold promise that many scourges of the modern world can be greatly reduced. Earlier detection protocols and the incorporation of "wearable" technologies that can monitor the functions of the body are all advances that will drive new products for companies.

Finally, in the overall space of technology there is still a lot to look forward to. Just think, less than 6 years ago we had never seen an iPad? Many of our children laugh at us when we tell them of the "dark ages" when we didn't have Internet access, cellphones or computers, and we had to get off the couch to change the television channel.

Cash

Have some "dry powder" because the volatility in the markets will never go away. Days of plenty cause us to forget the days of despair and vice-versa. The only problem with cash is that you do

not get paid for holding it in the portfolio. That is simply a new variable to incorporate into the overall portfolio management. With inflation non-existent it's not as big a problem as when inflation was running at 3-4% annually. The choice for cash will be an individual decision but it helps smooth out some volatility and gives an investor the opportunity to "buy the dips" when the ultimately occur.

And Finally

Let's imagine that Congress will enact some positive reforms, the Fed will retreat from the "command and control" dials of monetary policy and the global economy will stabilize. That's a nice scenario to imagine. Investor "utopia"? We think not, just common sense that could go a long way for our economy.

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