Integer Wealth Advisors Group, LLC

Advise, Guide and Protect

Third Quarter 2014 Market Commentary

Here is an excerpt from our last quarter commentary:

The unevenness of returns, the instability of regions and the complexity of business laws across regions makes international investing tricky. We have been underweight international positions in client portfolios for the past couple of years, preferring to over-weight the United States relative to the rest of the world. It has worked as the U.S. markets have staged an impressive recovery. We will continue to evaluate the international markets and suggest opportunities in the emerging and developed markets to increase weighting in portfolios. We are still, however, partial to the U.S. economy and the revolutions taking place in technology, healthcare and energy.

It has been a difficult year to generate a positive return than in the United States and the S&P 500 index. Despite the powerful returns posted in 2013, the S&P 500 continued its march higher through the end of the third quarter. The United States continued to lead the world markets as 77% of the companies in the S&P 500 beat analysts' expectations for the quarter. The S&P 500 broke the 2,000 point mark on August 26th, and reached as high as 2,010 on September 19th. While the quarter, especially September, was not without volatility, the record of the U.S. markets versus the world suggests investors like what they see in the way of earnings..

The Most Disrespected Rally

When you listen to most financial news programs you are likely to hear the refrain that this stock market is the most disrespected ever. The common refrain is that stocks are making their earnings thanks to the largesse of the Federal Reserve. Clearly, the Fed's actions stemmed a psychological "break" in the financial markets that could have plunged the world into economic chaos. Over the past year the Fed has been reversing course and slowly "draining" the liquidity pool (or not adding to it); other bankers around the world have not yet done so (witness the Euro's drop relative to the dollar). Regardless of Fed actions, the stock of Apple, IBM, GE and countless others must be agnostic to the Fed's workings. They must answer to stockholders who buy the stock for management's ability to produce earnings. We doubt that Warren Buffett runs Berkshire based upon the Fed's next move.

As of June 30th, the forward Price Earnings ratio of the S&P 500 stood at 15.6 versus the 20-year average of 16.2. Not wildly over-priced by any stretch. The table below compares the current P/E ratio of the S&P 500 broken down by their sector category. With a couple of exceptions, the markets look reasonable on a price and earnings valuation.

Equities

2Q 2014

	Value	Blend	Growth
Large	5.1%	5.2%	5.1%
Mid	5.6%	5.0%	4.4%
Small	2.4%	2.0%	1.7%

Year to Date

	Value	Blend	Growth
Large	8.3%	7.1%	6.3%
Mid	11.1%	8.7%	6.5%
Small	4.2%	3.2%	2.2%

Since Market Peak (October 2007)

	Value	Blend	Growth
Large	35.7%	45.2%	59.9%
Mid	63.2%	63.2%	61.4%
Small	48.1%	55.0%	61.3%

Since Market Low (March 2009)

	Value	Blend	Growth
Large	238.2%	224.4%	226.2%
Mid	316.6%	293.9%	273.1%
Small	266.2%	273.8%	280.7%

Current P/E vs. 20-year avg. P/E

	Value	Blend	Growth
Large	15.0 / 14.0	15.6 / 16.2	18.3 / 21.0
Mid	17.0 / 14.1	18.4 / 16.4	19.8 / 21.8
Small	16.7 / 14.4	18.5 / 17.2	20.7 / 21.4

Current P/E as % of 20-year avg. P/E

E.g.: Large Cap Blend stocks are 3.4% cheaper than their historical average.

	Value	Blend	Growth
Large	107.4%	96.6%	87.1%
Mid	120.1%	111.7%	90.7%
Small	116.1%	107.6%	96.5%

Source: Russell Investment Group, Standard & Poor's, FactSet, J.P. Morgan Asset Management.
All calculations are cumulative total return, including dividends reinvested for the stated period. Since Market Peak represents period 10/9/07 – 6/30/14, illustrating market returns since the S&P 500 Index high on 10/9/07. Since Market Low represents period 3/9/09 – 6/30/14, illustrating market returns since the S&P 500 Index low on 3/9/09. Returns are cumulative returns, not annualized. For all time periods, total return is based on Russell-style indexes with the exception of the large blend category, which is reflected by the S&P 500 Index. Past performance is not indicative of future returns.
Guide to the Markets – U.S.

Data are as of 6/30/14.

Taken another way the table above is the current price earning multiple as a percentage of the 20 year average P/E. Note that Growth is well below the 20-year average P/E ratio for that sector. The small and mid caps are clearly elevated.

So the question continues to be asked is why investors are not embracing a market that has rallied 190% from the bottom. The answer seems simple enough to us…too much volatility and not enough diversification wiped a lot of enthusiasm off the map. Starting in 2000 the forward P/E of the S&P 500 was 25.6 on March 24, 2000 which precipitated a 49% decline over the next three years to October 9, 2002 when the S&P sank to 777. That decline was followed by a 101% rally to the top of 2008 where the S&P 500 P/E stood at 15.2 on October 9th, 2007. A decline of 57% over the next 18 months sealed the fate of many an investor who simply gave up and swore off the stock market for good. On March 9, 2009 the S&P 500 hit 677 and sported a forward P/E ratio of 10.3…190% and five years later we are in the third quarter of 2014. That type of ride is not for the feint-of-heart, but those with patience and proper asset allocation got through it in fine shape and have been richly rewarded.

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DOMESTIC EQUITY STATISTICS

Index	Returns for the Quarter	YTD
S&P 600 Small Cap	-7.01%	-4.6%
NASDAQ Composite	5.45%	7.6%
Dow Jones Industrial Average	1.83%	2.8%
S&P 500 Index	0.61%	6.7%

(Returns are without dividends. Period Ending 09/30/2014. Source: Morningstar and spindices.com)

Company	Percentage Weight	Year to Date 2014
S&P 500		6.70%
Energy	9.7%	1.44%
Materials	3.5%	-0.23 %
Industrials	10.3%	1.25%
Consumer Discretionary	11.7%	-0.23%
Consumer Staples	9.5%	5.07%
Health Care	13.9%	15.21%
Financials	16.3%	5.96%
Technology	19.7%	12.71%
Telecommunications	2.4%	3.61%
Utilities	3.0 %	10.76%

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

Style Return Box for the Third Quarter 2014

	VALUE	CORE	GROWTH
LARGE	**0.20%**	**1.12%**	**1.88%**
MID	**-4.7%**	**-4.1%**	**-3.3%**
SMALL	**-6.8%**	**-6.7%**	**-6.7%**

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

INTERNATIONAL

The quarter for the international market was nothing short of a disaster as the broad international index, the MSCI EAFE, posted a negative 6.22% return for the quarter. For the year it was down 2.09% through September 30th. Europe continues to struggle, China is experiencing some economic slowdown and the emergence of the Ebola virus put the world on edge. Toss that on top of the continuing ISIS crisis in the Middle East and the only great news is that the United States has a lot of energy coming out of the ground. Prices at the pump continued to fall during the quarter despite the conflicts raging in Iraq and Syria.

Was there anything good on the international front? It is simply hard to pinpoint any economic news that was bright for the sector. South America? Forget it. Brazil was down 9.06% for the quarter, down 19% for the month of September. Japan? Nope. Down 2.53% for the quarter and down 3.88% year-to-date. Israel? Sorry. Down 2.6% for the quarter, although for the year it is up 6.02%. Australia? Sorry mate, toss some shrimp on the "barbie" and have a quaff of beer, for the quarter Australia was down 12.05% and down 2.74% for the year.

The fact remains that the United States has been the best investment market since it bottomed in March of 2009. Does this mean that an allocation to the international market should be abandoned? No. However, it requires a strong constitution to watch those markets struggle with high debt, devaluation of their currencies, and poor economic policies. Therefore, as we have suggested in the past, have an underweight in the portfolio (which we have done for our clients). The time is not right to plow money into the international markets.

FIXED INCOME

The biggest news in the bond market was not the chart below (which we have shown many times), but the news that Bill Gross left PIMCO. While the chart below could be a representation of the slide PIMCO will experience in assets due to Mr. Gross' departure, the fact remains that yields continue to be held low as Central Banks around the world try to pump up economic growth.

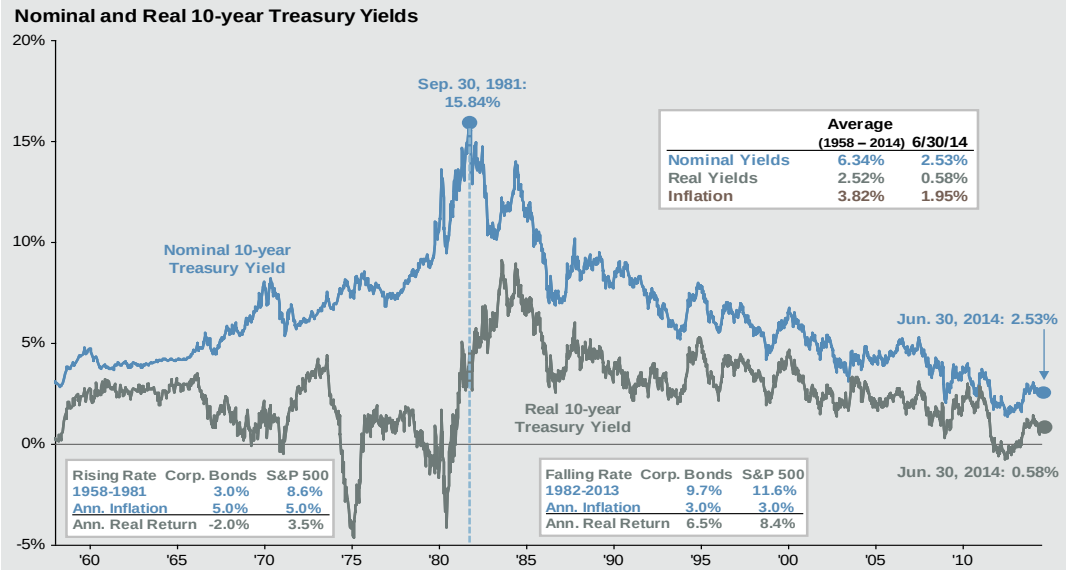
Yields continue to stay low and will be low for the foreseeable future. Our recommendation is if you have not yet bought a house…go buy one! With 30-year mortgage rates now at 4%, or lower, you are essentially buying a "put" to the bank that loans you money on rising interest rates.

If interest rates, as measured by the 10-year Treasury, continue to move lower, then the risk in a portfolio shifts from equities to fixed income. Remember, rates and values move inversely to one another, so the value of a bond portfolio will be high. Investors should review their fixed income mix and if the duration is long in nature (say greater than 7) it would provide an opportunity to swap long dated debt for something shorter in anticipation of rates moving back up.

The chart below reminds us that we've been in a very prolonged bull market in fixed income which started back in 1981. Note that 10 year rates hit the high of 16.84%. Who can remember

those days! With inflation nowhere in sight, bond investors can at least rest easy that their purchasing power is still intact.

Fixed Income



Source: Federal Reserve, BLS, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for June 2014, where real yields are calculated by subtracting out May 2014 year-over-year core inflation. All returns above reflect annualized total returns, which include reinvestment of dividends. Corporate bond returns are based on a composite index of investment grade bond performance.
Guide to the Markets – U.S.
Data are as of 6/30/14.

EQUITIES

We spent a few paragraphs on the issue of fixed income and the 10-year Treasury as a set-up to this section on equities. It's important to watch the 10-year because it's a good benchmark for determining the value of owning equities. Referencing the graph above, bonds gave equities a real challenge back in 1981 when an investor could buy a 16.84% yield in bonds. By the end of the third quarter this year, the 10-year was down around 2.5%. That yield is nominal, meaning before inflation, so if you take that into account, the "real" yield is around 0.5%.

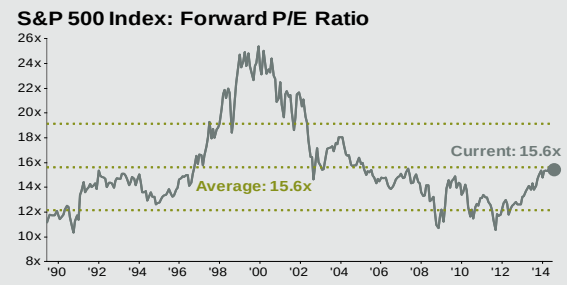
Now let's consider the equities market, which for the quarter was "challenged", especially with the hiccup of September. For the year, the major U.S. averages were all positive by the end of the third quarter, well ahead of their international counterparts. But what really stands out is the price earnings multiples of a lot of popular stocks held by investors either outright or in mutual funds.

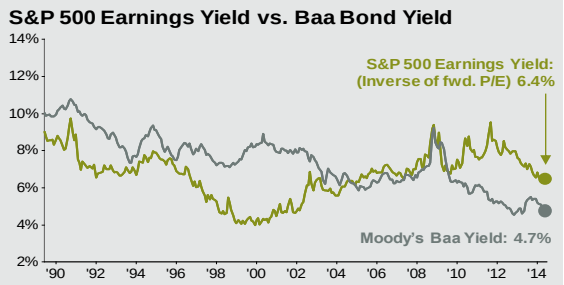
The charts below begin to clear up the issue of the markets being too expensive, too cheap or somewhere in-between. The S&P 500 has a price-to-earnings multiple of 15.6x, slightly above the 25-year average of 15.5x. The forward looking P/E ratio is 16.8x which is right on the long-term average. But what really catches our eye is the S&P 500 dividend yield of 1.9%, below the 10-year Treasury but still a very attractive yield.
So an investor looking to put cash to work has an interesting decision. Buy a 10-year Treasury and get a 2.5% yield over the next 10 years, or buy a broad based stock index like the S&P 500

index, and get 1.9% yield, plus the ability for appreciation? Equities will have to be a part of the asset allocation decision, and despite the value of the broad market indexes, entering the market today will be a smart decision 5 or 10 years down the road.

Equities

U.S. Equity: Valuation Measures			Historical Averages			
Valuation Measure	Description	Latest	1-year ago	5-year avg.	10-year avg.	25-year avg.*
P/E	Price to Earnings	15.6x	13.8x	13.4x	13.8x	15.5x
CAPE	Shiller's P/E	25.6	24.4	21.7	22.9	25.1
Div. Yield	Dividend Yield	1.9%	2.0%	2.0%	2.0%	2.1%
PEG	Price/Earnings to Growth	1.5	0.8	1.1	1.7	1.4
P/B	Price to Book	2.8	2.6	2.2	2.4	2.9
P/CF	Price to Cash Flow	11.0	10.3	8.9	9.5	10.6
EY Spread	EY Minus Baa Yield	1.7%	1.5%	2.0%	1.2%	-0.7%





Source: Standard & Poor's, FactSet, Robert Shiller Data, FRB, J.P. Morgan Asset Management. Price to Earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months. Shiller's P/E uses trailing 10-years of inflation adjusted earnings as reported by companies. Dividend Yield is calculated as the trailing 12-month average dividend divided by price. Price/Earnings to Growth Ratio is calculated as NTM P/E divided by NTM earnings growth. Price to Book Ratio is the price divided by book value per share. Price to Cash Flow is price divided by NTM cash flow. EY Minus Baa Yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. *P/CF is a 20-year avg. due to cash flow data availability.
Latest reflects data as of 6/30/14.
Guide to the Markets – U.S. Data are as of 6/30/14.

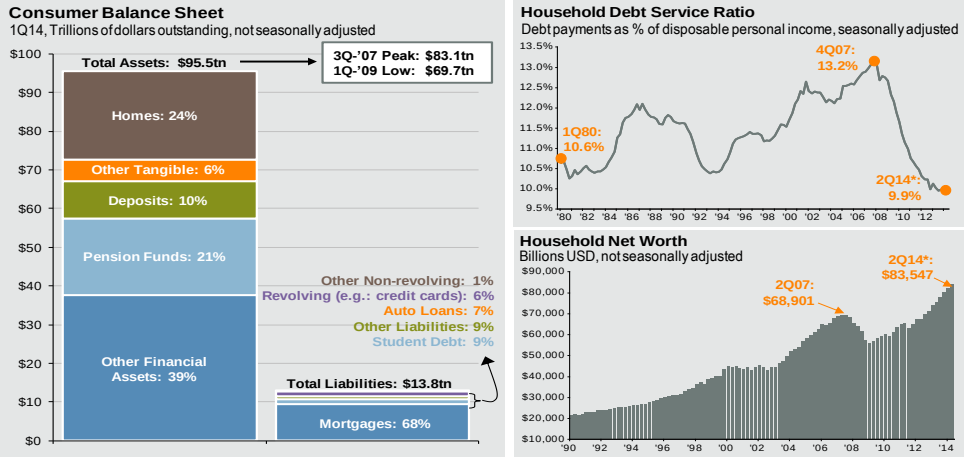
Manager Monitoring: The earthquake in the bond market was the resignation of Bill Gross from PIMCO. While we have a few clients invested in the PIMCO family of funds, we believe that clients should not react and stay with the PIMCO line-up. In his resignation speech Mr. Gross indicated that he wanted to return to managing money and away from running a company. So even though his name was "on the door" of many mutual funds, the fact is that Mr. Gross had a talented team of managers helping to run the vast bond pool. Good management companies groom a lot of talent for just

IN SUMMARY – It's the Economy, Stupid.

Election Day is Tuesday, November 4th and it reminds us of the slogan James Carville developed for Bill Clinton's 1992 Presidential campaign….It's the Economy, Stupid. And it really is about the economy, both in the election booth and on Wall Street. While unemployment has dropped, wages have stagnated as inflationary fears have been extinguished by exceedingly low interest rates. Businesses are not expanding as quickly as they might like due to continuing tight credit (despite low rates) and the unfolding unknown of the Affordable Care Act (referred to as Obamacare). Despite these negatives in the economy, there are bright spots as highlighted in the graphs below. Consumer balance sheets have been repaired with the help of rising home

prices and a robust stock market. Household debt has dropped to 1980 levels as consumers pay-off debt (or have walked away from underwater houses and started anew), save more or generally see their investments increase due to the rebound in the markets. Inflation, or lack thereof, continues to trend below historical averages. Further the "raise" due to declining prices at the pump should provide a lift to the economy in the 4th quarter. In short, this is very good news.

Economy

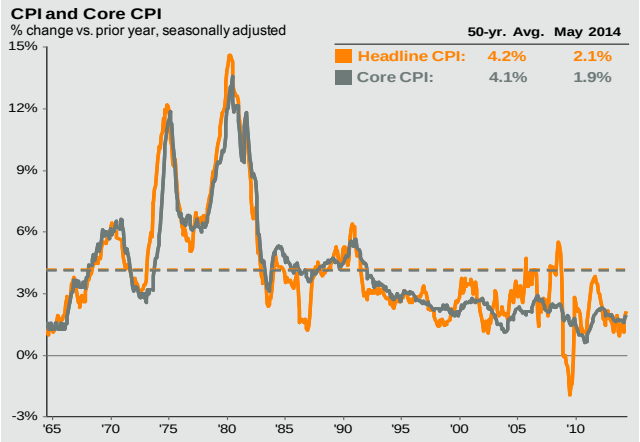


Source: (Left) FRB, J.P. Morgan Asset Management. Data includes households and nonprofit organizations. (Right) BEA, FRB, J.P. Morgan Asset Management. *2Q14 household debt service ratio and household net worth are J.P. Morgan Asset Management estimates. Values may not sum to 100% due to rounding.

Guide to the Markets – U.S.

Data are as of 6/30/14.

Economy



CPI Components	Weight in CPI	12-month change (sa)
Food & Bev.	14.9%	2.4%
Housing	41.4%	2.6%
Apparel	3.4%	0.7%
Transportation	16.4%	1.8%
Medical Care	7.6%	2.8%
Recreation	5.8%	0.4%
Educ. & Comm.	7.1%	1.5%
Other	3.4%	1.8%
Headline CPI	**100.0%**	**2.1%**
Less:		
Energy	9.0%	3.4%
Food	13.9%	2.5%
Core CPI	**77.1%**	**1.9%**

Source: BLS, FactSet, J.P. Morgan Asset Management.

CPI used is CPI-U and values shown are % change vs. 1 year ago and reflect May 2014 CPI data. CPI component weights are as of December 2013. Core CPI is defined as CPI excluding food and energy prices.

Guide to the Markets – U.S.

Data are as of 6/30/14.

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.

Integer Wealth Advisors Group, LLC

Atlanta Office:
3440 Blue Springs Road, Suite 403
Kennesaw, GA., 30144
(o) 770.974.2787

Philadelphia Office:
790 Penllyn Blue Bell Pike, Suite 203
Blue Bell, PA., 19422
(o) 215.643.6490