



Integer Wealth Advisors Group, LLC

Advise, Guide and Protect

Fourth Quarter 2010 Market Commentary

In our Third Quarter 2010 commentary we made the following observations:

Having already seen a nice advance by stocks, investors may place a bit more caution before November elections just to make sure the apparent Republican advances somehow dissipate just before voters enter the booths. Without clear signals about the state of the Bush tax cuts, uncertain healthcare costs, businesses continue to hold back capital as evidenced by the nearly \$2 trillion sitting in corporate cash accounts. If clarity becomes reality, regardless of which way the Bush tax cuts may fall, businesses can at least get back to planning for new investments and hiring of employees. Until then, it's a waiting game.

As we move into 2011 we now have clarity on tax rates for individuals. Moving forward we hope the 112th Congress can “do the right things” for the economy and that businesses are encouraged to hire. Having said that let us be among the first to welcome you to the new decade which we are sure Wall Street will probably dub “the teens.” The first decade of the 21st century was dubbed the “naughts” for having so many zeros in the years not because the return on the markets for the past decade was close to zero. We’ve already looked at the data and it confirms that the markets did turn in a spectacularly bad performance thanks to 2008; however, any investor that maintained a diversified portfolio of bonds, international stocks and a dollop of precious metals and real estate didn’t fair all that badly. Let’s hope the maturation of the market into “the teen” years doesn’t mirror what it is like to raise a real life teenager!

The year of 2010, and an investor’s approach to investing in it, could have been compared to seeing a play. “Act One” of the play was completed on November 2nd as the Republicans won a majority in the House and narrowed the gap in the Senate. Investors now await “Act Two” with the seating of the 112th Congress in January. We’ll forego any debate on if the Republicans won or the Democrats lost seeing that voters have low regards for both parties. It is now up to both parties to work together, with the Republicans using the short-term confidence that voters just gave them, to try and make substantial changes to spending and taxes. Used correctly and both parties can help get the economy started again; dissolve into political “witch hunts” and get ready for another two years of economic malaise.

In May of 2010 we penned a piece regarding unemployment and concluded that the economy needed to create somewhere in the neighborhood of 400,000 jobs every month for a solid **year** in order to move unemployment close to 7%. Note that 7% is not even close to the 4-5% unemployment levels that drove the economy in the middle part of the last decade. We truly need a “moon shot” approach to restore confidence in the economy that will get businesses hiring and consumers more confident to buy houses, invest and spend.

We will leave it to the politicians to figure out what that “moon shot” needs to be, but if they focus on the Bill Clinton-era “it’s the economy, stupid” mantra, then they can start to get the economy moving at a more brisk clip, because it really is about the economy.

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OCTOBER

October has traditionally been a “scary” month for investors, but undeservedly so. A few years ago we did a study of equity performance for the month of October and found that if you take out a couple of the worst months (i.e. October 1987), the volatility served up a slightly negative bias. That was not the case for this particular October. The markets for the month of October posted very good results as the Dow Jones rose 330 points, or 3.06%, to close at 11118. That was the best October since 2006 and the first close above 11000 since May 2010. The best news event of the month, obviously, was the rescue in Chile of the 33 miners trapped over one-half mile below the earth. Truly a miracle rescue! Dominating the news, however, were the pending November elections that pointed to the Republicans being granted another “kick at the can” of fiscal responsibility. In the business arena there were some notable highlights: Delta and U.S. Airways turned in third-quarter profits, Microsoft posted a 51% profit jump, Google posted a 32% jump in third-quarter profits; while Apple announced it would start selling the iPad through Verizon Wireless stores toward the end of October. Also, despite the best efforts of Washington to reign-in big banker compensation, Wall Street firms were expected to pay a record \$144 billion in compensation and benefits this year. The estimated 2010 Wall Street profit of \$61.3 billion still falls 20% below the 2006 peak.

NOVEMBER

The Republicans did win control of the House as voters dealt a historic rebuke to the Democratic Party. The GOP’s net gain of 60 seats dwarfed previous Republican high-water marks of 1946 and 1994. At the state level the GOP flipped 12 states that had been governed by Democrats, racking up wins in key states such as Ohio, Michigan and Pennsylvania. The Dow Jones Industrial Average rose nearly 3% in the first week making the index’s return from the March 2009 lows at +75%. November also kicked off the holiday shopping season and from initial reports, shoppers were out in force on black Friday. Gold topped \$1,400 for the first time while the Fed announced it would buy \$600 billion of U.S. government bonds over the next eight months in a bid to rev up the economic recovery. Over in Europe, Ireland sealed a \$90 billion bailout as the financial “contagion” that plagued Greece was beginning to touch other parts of the European Union. The Dow closed November with a 1% loss to settle at 11092.

DECEMBER

Stocks started December on a strong note based on positive data out of the U.S. and China, despite reports that the U.S. economy added fewer jobs than expected in November. Auto makers were the bright spot as all manufacturers reported a solid rise in new-vehicle sales in November. Gold continued its march higher as it hit a record \$1,415 per troy ounce while silver hit a new 30-year high of \$29.70 an ounce. As the holiday day shopping season swung into high gear retailers were reporting strong sales both in traditional “brick and mortar” outlets and with on-line sales. The Dow Jones average hit its highest level since September 2008 by closing the week of December 17th with an 81 point gain to close at 11491, its third



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consecutive weekly gain. As the month was drawing to a close Congress finally approved far-reaching tax legislation by retaining Bush-era tax rates for an additional two years. The Dow finishes the year by falling 7.87 points shy of closing at a year's high, rising 11% to 11577.51. For the record, the Dow and the S&P 500 posted some of the best one-month increases in nearly 20 years. That is an impressive record when you consider that during that 20-year period, there were years such as 1995-1999, when the Dow posted double-digit returns of no less than 20% per year.

DOMESTIC EQUITIES

Index	Returns for the Quarter	YTD
S&P 600 Small Cap	16.42%	26.5%
NASDAQ Composite	12.0%	16.9%
Dow Jones Industrial Average	7.32%	11.0%
S&P 500 Index	10.20%	12.8%

(Returns are without dividends. Period Ending 12/31/2010)

<u>Company</u>	<u>Percentage Weight</u>	<u>4Q2010</u>
S&P 500		10.2%
Energy	12.0%	20.9%
Materials	3.7%	18.5%
Industrials	10.9%	11.2%
Consumer Discretionary	10.6%	12.2%
Consumer Staples	10.6%	5.3%
Health Care	10.9%	3.1%
Financials	16.1%	11.2%
Technology	18.7%	10.0%
Telecommunications	3.1%	5.9%
Utilities	3.3%	-0.02%

Source: S&P Global (www.spglobal.com)

Style Return Box for the Fourth Quarter 2010

	VALUE	CORE	GROWTH
LARGE	10.43%	10.71%	10.95%
MID	12.14%	13.44%	14.48%
SMALL	15.89%	16.19%	16.46%

Information provided in the above chart represents the quarterly returns of the S&P and I-shares for each class. Returns include reinvestment of dividends.



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INTERNATIONAL

Global stock markets followed the lead of U.S. markets with their own gains as developed and emerging economies continue to sow the seeds for an international recovery. Dominating the international markets has been the value of the dollar and the announcement by the Fed that it would begin flooding more dollars onto the markets via their \$600 billion dollar purchase of fixed income securities. In October the dollar hit fresh lows against several currencies. Yet another country, this time Ireland, buckled to the pressure to accept a historic bailout which led to speculation that other countries would soon be following that path. That crisis was soon overshadowed by North Korea when they fired on a South Korean island near the maritime border, killing several island residents. In mid-October China indicated that GDP growth slowed to 9.6% in the third quarter from a year earlier. Even in the face of that news they raised interest-rates sparking a world-wide sell-off in stocks, commodities and emerging-market currencies. Meanwhile Britain unveiled \$127 billion in spending cuts over the next four years choosing austerity over stimulus. In France, labor unions protested President Sarkozy's plan to increase the retirement age by two years. The wave of financial reform swept to Spain where the new labor minister said he would also push for a higher retirement age.

IN SUMMARY

Market Theme – Improvement Continues

Investors have begun to embrace the notion that the worst is behind us and that better days lie ahead. In previous market commentaries we noted that Washington was in a “command and control” mode on the economy. Businesses were taking their marching order from Washington in the form of new regulations that made investing in new plants, equipment and personnel difficult to execute. This made consumers, who are the employees of small businesses and corporations, reluctant to spend as the uncertainty of their job, home values and 401(k) balances hung in the balance. Over two years after the epic financial meltdown of September 2008, investors have slowly moved back into equities where prices provide compelling future returns. At this writing the Dow is approximately 2,900 points from the all-time high mark set in October 2007 and it makes sense that it should take awhile to repair the damage. Investors recall too vividly the 2000-02 equity bubble burst, and having now lived through a credit freeze, a slow, cautious embrace of the markets is a prudent approach. Putting the market theme in a sports vernacular, investing is a “marathon” not a “sprint.” Investors will continue to be cautious but as the markets improve so too does the confidence. In the end what will return the investor to full-blown confidence is when hiring begins to look sustained, banks begin lending with less onerous terms, home prices firm, and homebuilders begin building new homes. Providing this confidence will be the 112th Congress who can do much by delivering on the promises to return the country to fiscal responsibility.



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The Economy – It is the Economy!

Jobs, housing, spending and taxes all mix together to form the economy which moves the markets. At the end of 2010 the economy continued to repair the damage laid to it in the autumn of 2008. There's a lot of damage to be repaired but as we have said in the past, the farther we move from the epicenter of 2008, the better the economy will become. Not every part of the economy will recover at the same pace and the economic recovery will be rocky, "trees do not grow to the sky." We are encouraged by the recovery and the positive impact it is having on the markets and investors. Washington will continue to have a great deal of input on the soundness of the economy. We won't know the impact for a couple of months into the New Year, but if they are serious about reform their efforts could truly be the "moon shot" the economy needs to grow at north of 3.5% annual GDP.

To accomplish that we need a Congress that is willing to make tough choices on spending, tax reform and regulatory repeal. Businesses need certainty in order to make long-term plans for investment and capital formation. We hope this Congress can collectively deliver on their promises and return fiscal sanity with some semblance of regulatory reform that strikes the right balances.

Portfolio Monitoring: Portfolio monitoring, as always, focuses on a number of factors such as the quality of the investments in your portfolio, asset allocation and levels of cash. Over the past 24 months the focus has been on "keeping some powder dry" as the market turmoil continued to provide uncertainty for investors. With the Federal Reserve continuing to spend \$600 billion to inflate assets, the concern is in the bond market. We have been continually shortening portfolio durations in anticipation of rising yields while maintaining a high credit quality. No bonds, regardless of how short in duration, are totally immune from drops in prices due to inflation or a shift in investor sentiment. We will continue to monitor the overall fixed income duration and credit quality in portfolios. We continue to monitor both the tax-free and taxable bond markets. As we closed out 2010 we saw a noticeable increase in yields in the marketplace.

Manager Monitoring: We continue to monitor the managers running the mutual funds in your portfolio. On a quarterly basis we review the funds for style consistency, manager turnover and performance relative to their peer universe. It is during these times that we pay special attention to a manager's holdings, relative performance and the amount of cash in the portfolio. During the quarter we had one mutual fund report that the manager of the fund was taking a sabbatical of two months starting in January 2011. We reported this to all clients holding that fund and noted that we will continue to hold that fund in our list of approved mutual funds. We have also had some funds that we have been able to convert to the institutional share class in many client accounts. This change has resulted in certain fund fees being reduced by as much as 20%.

Fixed Income: In the fourth quarter 2010, bond yields moved noticeably higher. In our last commentary we noted that investors should maintain an overall short duration within



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their fixed income allocation. Even that advice did not provide a complete shelter against the onslaught of selling pressures by bond investors that was driven by two concurrent issues. First was the implementation by the Fed of “quantitative easing number two” in which the Fed pledged to spend \$600 billion over the next eight months to buy mortgages and treasuries. Bond investors understanding that more money in circulation causes inflation sold their holdings which pushed prices down...despite the Fed’s best efforts to prop up prices and hold down yields. The second issue was the expiration of the “Build America Bond” program whereby the U.S. government covered some of the interest costs of municipal bonds. In a rush to grab the final monies available in the program, municipalities flooded the market with municipal bonds causing prices to fall and yields to rise. For bondholders with long-dated maturities, the price drop was very noticeable. While this was also true for holders of bonds with short maturities, the price decline was nowhere near the decline seen in the longer end of the yield curve. The bright side of this market is that higher yields brought some money in from the sidelines which eventually restored some price stability to what is usually a very stable asset class.

Cash: We continue the same observations as last quarter regarding cash. There are virtually no yields available in cash. Alternatives include high quality, short-term investment grade bonds via mutual funds. However, these are not substitutes for cash investments where investors must be assured of the value of their cash as bond funds can lose money. The best approach to managing cash is managing the amount of cash you need to hold in your portfolio for living expenses and other short term obligations. By doing so this may allow for strategic reallocation to increase your yield with short-term high quality bond funds.

Equities: After a very nice run in December, stocks started to compete with bonds after having been trounced by them over the past three years. Given the run in the bond market it makes sense that investors, whose confidence continues to improve, would be looking to move out on the risk curve by shifting their allocations to stocks. Dividend yields in stocks continue to look attractive, and the price/earnings multiples based upon forward 2011 earnings suggest that stocks are not necessarily overpriced. Corporate balance sheets are flush with cash that has been on the sidelines for a couple of years. Combine a clearing picture in Washington with a rising consumer confidence and you get a good opportunity for equities to take back their leadership position in 2011.

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