ASCENTIAL
WEALTH ADVISORS

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Equities Advance….Bonds Retreat

The bull market in US equities, which began in March of 2009, continued through the first six months of 2013. Reassured by stronger economic data and favorable monetary policy, investors pushed equity indices through new all-time highs.

Index:	June 2013	2012	2011	2010	2009
S&P 500	+13.8	+16.0	+2.1	+15.1	+26.5
DJIA	+15.2	+10.2	+8.4	+14.1	+22.7
EAFE (Int'l)	+4.0	+17.3	-12.1	+7.8	+31.8
BC Ttl Bond	-2.6	+4.4	+7.7	+6.5	+5.9
Dow Jones Relative Risk Benchmarks					
Conservative	-1.7	+5.4	+5.3	+8.5	+10.8
Moderate	+4.2	+11.2	+0.3	+14.0	+23.8
Aggressive	+9.2	+16.8	-5.1	+19.4	+39.0

Despite strong US equity gains, diversified investors' performance was hindered by disappointing results in both international equities and fixed income.

US investment grade bonds posted negative returns as interest rates rose. Bond prices began to reflect anticipated tapering of the US Federal Reserve's (Fed) historic bond buying program.

Developed international equities modestly advanced as global central banks furthered their easy money policies. Even with the stimulus, most international developed economies remain notably weaker than the US.

Emerging market returns were disappointing (MSCI EM Index down 11%) as economic growth in those countries slowed and a stronger US dollar magnified weak results.

Focus:

- ✓Reduce traditional US fixed income
- ✓Reduce high yield bonds
- ✓Modify US Equities:
  - Overweight financial services
  - Increase mid & small cap equity
- ✓Increase Alternative Investments

Focus

One of the greatest challenges investors face when selecting investments is balancing risk and return when valuations change over time. In 1982 the US Ten Year Treasury yielded 14.5%, 13 years ago 6.7%, and today a mere 2.6%. With traditional fixed income yields now struggling to keep pace with inflation, the prospect for decent returns from bonds over the next 5-10 years appears questionable. For this reason, we continue to recommend moving away from US traditional fixed income while adding to alternative investments as a substitute for bonds.

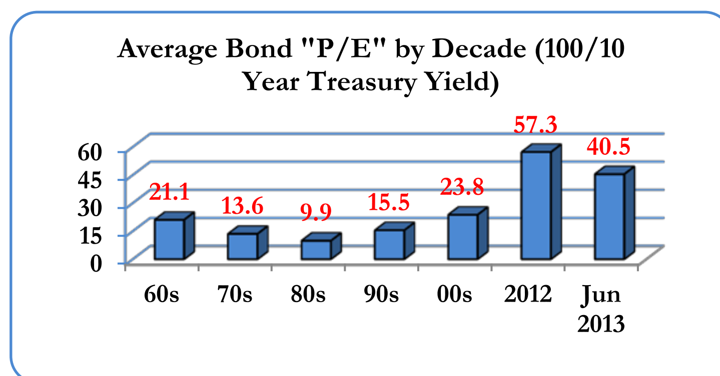
Specifically, we recommend reducing U.S corporate bonds (a portion of investment grade and all high yield).

For equities, our recommended allocations remain unchanged, overweight US and underweight international. Within the US markets we see opportunity in the financial services sector. Additionally, we favor greater exposure to small and mid-sized companies which derive a higher percentage of their revenue from inside the US.

"Our long term concern is that traditional US bonds will return significantly less than they have the past 10 years and continue to weigh down overall portfolio performance."

Fixed Income

Since the early 1980's, prices for high quality US bonds have climbed, pushing yields to historically low levels. The chart to the right depicts the average "bond P/E" by decade over the past 50 years. Bond P/Es are calculated by dividing 100 by the average yield; higher P/Es are indicative of higher bond prices and vice versa.



Source: Strategas Research Partners 1/2/2013.

In 2013, interest rates rose and high quality bond prices fell as investors began to worry about the "true" level of interest rates absent the artificial effects of the Fed's massive bond buying program.

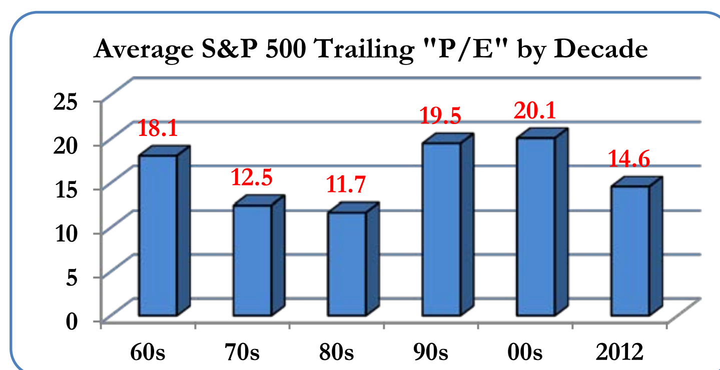
High yield bonds resisted the selloff as investors desperate for yield chose to accept additional credit risks. We believe that high yield bonds are approaching full value and recommend selling remaining positions.

As we have discussed, we are wary of traditional fixed income should interest rates continue to rise. Our long term concern is that traditional US bonds will return significantly less than they have the past 10 years and continue to weigh down overall portfolio performance. Consequently, we also recommend a reduction in our traditional US bond holdings.

"While many indices hit new highs, current equity valuations appear reasonable and within their historic norms in contrast to US bonds (see section above)."

US Equities

The table to the right illustrates the average price earnings (P/E) ratio of the S&P 500 by decade over the past 50 years. While many indices hit new highs this year, current equity valuations appear reasonable and within their historic norms in contrast to US bonds (see section above).



Source: Strategas Research Partners 1/2/2013.

We continue to favor growth over value stocks which is reflected in our overweight position in technology. Typically, growth companies increase earnings faster than average. However, they usually pay smaller or no dividends, as earnings are typically reinvested back into the company to support continued growth.

We are recommending additional exposure to financial services for the following reasons:

- Their valuations are below historical averages.
- Loan losses will likely be below expectations due to an improved housing market and tighter credit standards.
- Higher long term interest rates would likely boost net interest income.
- Improved capital markets should help investment banking results.

In addition, our recommendations include increased allocations to small and medium sized US equities. In general, these companies' profits are less reliant on European economies which we expect will remain weak.

International Equities

Emerging markets have had a difficult start this year, posting negative returns as economic growth slowed in a spillover from European woes. We maintain the view that emerging markets are attractively priced relative to their historical averages, and present more opportunity for return than their developed counterparts.

With inflation relatively low, and government debt at manageable levels, emerging market policymakers are cutting interest rates and providing fiscal stimulus in an effort to improve growth. Emerging countries are expected to have twice as many middle- and upper-income households as the developed world by 2025, and already account for 40 percent of global consumption, nearly double the United States' share. (McKinsey Global Institute). Although recent results have disappointed, we recommend maintaining our overweight allocation. We expect periods of greater volatility from emerging markets, as we have experienced this year. Long-term, however, we believe the rewards will be worth the risk.

While developed international markets have squeezed out positive results so far, we suggest maintaining an underweight allocation. Europe still has significant barriers to overcome with first quarter GDP showing a sixth consecutive quarter of economic contraction. Further, Europe is politically divided, and lacks an integrated fiscal policy. This coupled with a smaller and less aggressive European Central Bank stimulus program make us uncomfortable in rebuilding our positions.

"We maintain the view that emerging markets are attractively priced relative to their historical averages, and present more opportunity for return than their developed counterparts."

Other (Real Estate, Commodities, and Alternatives)

Historically, real estate and commodities have helped mitigate the risk of inflation. Since 2008, investors have bid up the prices of these investments and we suggest waiting for a more attractive entry point.

Over the past 3 years, we have recommended greater weightings in alternative strategies. We believe traditional bonds are overpriced, with yields below inflation, and are vulnerable to further weakness, especially as investors continue to anticipate a reduction in the Fed's bond purchases. We are concerned about an extended period of rising interest rates, and less convinced that traditional fixed income will provide reasonable returns.

The alternative strategies we have selected focus on preserving capital and delivering positive returns under most market conditions. We accept that alternative strategies will underperform when equity markets are strong. However, we expect lower price volatility when equity markets falter or interest rates rise.

As with any strategy, there are risks. Alternatives rely on the market savvy of managers to achieve results. We have conducted due diligence to identify managers that we expect to fulfill these objectives, and are comfortable taking the talent risk versus equity market or interest rate risks.

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Heads Up:

- Clients over the age of 70 ½ that hold IRA accounts are required to take a minimum distribution (RMD). You can find your calculation on the last page of your statement. We will contact you prior to the end of the year to arrange the distribution, or feel free to call Gayle or Lori anytime.
- IRA beneficiaries – your current designations are shown on the last page of your IRA statements. Please let us know if you would like to make changes.
- Should you reallocate your 401k? Please provide a recent statement and we can help you decide if and how you should reallocate your retirement plan assets.

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Closing

During the late 1990's, many investors, looking at recent stock returns, became comfortable allocating 100% of their portfolios to equities. The 1982-1999 bull market provided equity returns well above historical averages and pushed valuations for stocks much higher than today (see chart on page 2). The subsequent 14 years provided significantly lower returns for equities and episodes of scary volatility (2000-2002 & 2008-2009). This disappointment and anxiety combined with reasonable bond yields enticed investors to adopt higher fixed income allocations. Today, those higher yields are unavailable, but for many investors their equity anxieties remain. We believe portfolios that are overweight fixed income may experience similar disappointing returns that stock heavy portfolios suffered in the 2000s.

Investors shouldn't rely on repeat performances, and while history should not be ignored, they need to think differently about how to manage risk in this unprecedented environment of intervention by the Fed. Our strategy continues to evolve accordingly- with an eye on the rearview mirror, an awareness of our current surroundings and a focus on what lies in the road ahead.

Disclosures

Any opinions are those of the professionals at Ascential Wealth Advisors and not necessarily those of Raymond James. Inclusion of indices and benchmarks is for illustrative purposes only. Investors cannot invest directly in an index or benchmark. Past performance may not be indicative of future results. Bond prices and interest rates have an inverse relationship. The recommendations included in this newsletter are designed for clients. Please consult an investment professional concerning your unique situation. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. U.S. government bonds and Treasury bills are guaranteed by the U.S. government and if held to maturity, offer a fixed rate of return and guarantee principal value. Please note that international investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility. Investing in emerging markets can be riskier than investing in well-established foreign markets. Investing involves risk and investors may incur a profit or a loss. The S&P 500 index is a broad based measurement of changes in US stock market conditions based on the average performance of 500 widely held common stocks. The Dow Jones Industrial Average covers 30 major NYSE industrial companies, representing approx. 25% of the NYSE market capitalization and less than 2% of NYSE issues. The MSCI EAFE Index is a free float-adjusted market capitalization index designed to measure the equity market performance of developed markets. The Barclays Capital Aggregate Bond Composite Index measures investment grade, fixed-rate, taxable bond markets of roughly 6,000 SEC registered securities with intermediate maturities averaging approx. 10 years. The S&P Dow Jones Relative Risk Indices intend to measure total portfolios of stocks, bonds, and cash, and represent investor risk profiles assigned based on efficient frontier risk analysis. They track the three asset classes represented by sub-indices tracked by Dow Jones and Barclays (ex Dow Jones Large Cap Growth Index, Barclays Corporate Bond Index), and are reweighted monthly. This is not a complete description of the securities, markets. Or developments referred to in this material. Diversification does not ensure a profit or guarantee against loss. Investing in small cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor. There are additional risks associated with investing in an individual sector, including limited diversification.