Timmons Wealth Management

Client Newsletter – First Quarter 2013

Market Update

The first quarter of 2013 witnessed a continuation of strong equity market returns after a robust market environment in 2012. Despite the naysayers and doom prognosticators littering the airwaves, the S&P 500 posted a gain of +10.6% in the first quarter. With investors gaining confidence in the US economy and its recovery, we continued to see a shift out of growth into value strategies. In addition, demand for mid and small-sized companies outpaced large companies with mid-cap names sharply outperforming large caps. We view this trend as a positive sign for equity markets, as investors tend to favor growth stocks during periods of market uncertainty and then shift into value names as the economic recovery takes hold. The shift into riskier assets and improving market confidence was further confirmed by the sharp reversal of equity mutual fund outflows. For the 1Q13, JP Morgan reported that domestic and global equity mutual funds experienced a net inflow of $52B vs. a net outflow of $460B from 2007-2012[i]. Is this the beginning of the "great rotation," particularly on behalf of retail investors, out of bonds into stocks? Only time will tell and we believe it will be a gradual process when it does occur.

International equity markets, facing a number of significant hurdles during the quarter, produced a more muted return of +3.3% as measured by the FTSE Global All-Cap ex-US Index. Overwhelmingly, Europe has continued to struggle under the weight of weak economic growth (or lack thereof), broadening austerity measures and a lengthy string of sovereign bailouts. The biggest story for the quarter was surely Cyprus when its two largest banks failed and the country was forced to make significant concessions to obtain a bailout from the European Union, European Central Bank and International Monetary Fund. The story of the Cyprus financial crisis is a cautionary tale of failed regulatory oversight and the risks lurking across the European Union. Cyprus was the wealthiest of 10 countries that joined the EU in 2004 and initially operated with a balanced budget and fairly tight banking regulations[ii]. In 2008, Cyprus joined the euro and experienced major inflows of foreign capital. Bank regulators limited the amount of capital that Cyprus banks could lend domestically out of fear of creating an asset bubble. To solve this problem, Cyprus banks began lending heavily to Greece. The rest was history, and an ugly one at that. The financial crisis in Greece eventually spread to Cyprus and culminated in uninsured depositors in Cyprus banks taking massive losses along with the implementation of stringent austerity measures. Through all of this, the ancillary fear has been the potential fallout across European banks leading to a run on banks as depositors fear for the safety of their money. We have yet to see this happen, but we expect European depositors will take a long hard look at insured deposit levels and begin diversifying where possible.

Another significant drag on international equity performance was weak returns across the emerging markets. After very strong returns in late 2012, the emerging markets lagged developed markets in the 1Q13 and returned -1.62% as measured by the MSCI Emerging Market Index. The recent weak performance across the emerging markets has been driven by a number of key factors including a weakening yen, uneven economic

TWM Client Benchmarks	**1Q2013**
Aggressive Growth	9.1%
Capital Appreciation	6.8%
Balanced Return	4.5%
Broad Market Benchmarks	**1Q2013**
S&P500	10.6%
FTSE Global All-Cap ex-US	3.3%
Barclays Global Aggregate Bond Index	-2.1%
Barclays US Treasury Bill 1-3 Months	0.0%

recovery across a number of larger emerging market countries and stagnant commodity prices.[iii] Furthermore, concerns remain regarding monetary policy decisions and the potential for future tightening measures particularly in countries like China and Brazil. Despite these challenges, we still believe that the long term picture for emerging market investors is quite bright.

The story for bond investors around the globe continues to be one of depressed interest rates and the search for income. Interest rates remain at historic lows with the real yield on the 10 Year US Treasury hovering at 0.09% vs. the historical average of 2.55%[iv]. Global bonds, as measured by the Barclays Global Aggregate Bond Index, experienced a -2.1% return for the quarter. High yield bonds were the top performing credit sector while corporate bonds, treasuries, TIPS and emerging market debt all posting losses. Outperformance in high yield debt reflects the continued push into riskier fixed income investments, with spreads over US Treasuries tightening to 5% vs. the historical average of 5.9%. We believe this may suggest that the high yield area of the bond market may be on its way to becoming overvalued. Tightening credit spreads and low yields will likely continue to be the environment facing fixed income investors for the foreseeable future.

Outlook

We remain optimistic regarding the longer term prospects for equities particularly across the US and emerging markets. The US economy is firmly in the midst of a prolonged yet substantive recovery. We believe the US economy still has a number of catalysts that should buoy growth over the coming quarters. We expect the unemployment rate which currently stands at 7.6% will continue to improve albeit at a slower rate than originally anticipated. Interestingly, an often ignored benefit of higher unemployment is the depressing impact it has on wage rates thus lowering labor costs for companies and making them more competitive in the global economy. We believe the recovery in US housing will continue to materially benefit GDP growth. Home inventories are falling and mortgage applications have been on the rise. Low interest rates and high rental prices continue to make home ownership highly economical. New housing starts are on the rise but remain below historical levels thus providing an additional catalyst for growth.

Consumer finances in the US are improving with debt payments as a percent of disposable personal income falling from 14.4% in 3Q07 to 10.4% in 1Q13. During that same timeframe, household net worth has grown from $67,413T to $69,210T. Though consumers don't actually spend net worth, increases in net worth lead to improved consumer confidence and typically culminate in higher consumer spending. We can see this reflected in the continued growth trends across retail sales, personal consumption measures and rising consumer confidence levels. Inflation, as measured by CPI, remains muted and commodity prices remain below previous elevated levels thus easing the financial pressures on consumers and businesses. Corporate finances are in the best shape in years with debt levels falling precipitously and profit margins at record levels. Most importantly, valuations across the US equity markets remain attractive. S&P 500 operating earnings are at record levels with the market trading at a forward P/E of 13.8x as of 3/31 vs. the historical average of 16.2x and the previous market peak in 2007 of 15.2x. Interestingly, the earnings yield on the S&P 500 currently stands at 7.3% vs. 4.8% on Baa rated debt (the lowest level of investment grade bonds). Which would you rather own?

Despite the recent weakness across international equity markets, we continue to believe significant exposure to international equity markets is warranted. International developed equities, as measured by the MSCI EAFE Index, remain 47% below their 2007 peak and valuations are attractive on a country-specific basis thus offering significant opportunity for long term investors. Bank of Japan has joined the growing list of countries engaging in aggressive quantitative easing, and the ECB has demonstrated its willingness and ability to keep sovereign yields in check while the euro zone fights off another recession. Among international investment opportunities, we continue to favor the emerging markets. These countries do not share the same debt-laden balances sheets as their developed nation counterparts, and are poised for significantly greater GDP growth over the next ten years. We anticipate that the leading emerging market economies will experience a rebound in economic activity in the coming quarters particularly in regions such as China, India, Mexico, Russia, Korea and Brazil. From a valuation perspective, the emerging markets, as measured by the MSCI EM Index, typically trade at a discount to the developed markets. However, current valuations vs. historical averages suggest an attractive entry point for longer term investors.

We anticipate the road for fixed income investors will continue to remain challenging. Though we believe the only possible outcome in the future is for interest rates to rise, we do not anticipate this happening anytime soon. Rates continue to be suppressed at artificially low levels as a result of global central bank intervention. In essence, this “tax” on savers serves a purpose of encouraging economic activity and makes actions such as business investment and home purchases more attractive. It has the secondary impact of making riskier investments more attractive as savers seek additional yield and invest money into higher risk bonds and move out of bonds into dividend paying stocks. Though low interest rates remain a thorn in the side of many conservative investors, we must remember why we own bonds. Bonds act as a portfolio’s ballast during volatile times for those less comfortable with risk while also serving to provide a stable stream of income. We continue to take a total return approach to bond investing and remain both vigilant and opportunistic. We continue to avoid longer duration bond investments that would be most exposed to principal losses in the event of rising rates. A 1% rise in interest rates would result in a -9.2% loss for an investor owning a 10 Year US Treasury and a -20.3% loss for a 30 Year US Treasury. Not exactly an attractive proposition when the 10 Year US Treasury is only yielding 1.87% and the 30 Year US Treasury yields 3.10%. We do not believe many investors acknowledge this risk as the hunger for yield has outweighed the desire for principal preservation.

As always, we encourage our clients to maintain a long term perspective as investors and realize the inevitability of bumps along the way. We continue to believe the key to wealth accumulation and preservation is shunning the short term thinking and associated emotional tendencies that might sell newspapers and commercials but rarely lead to sound investment decisions. We encourage clients to reach out to us with any questions regarding our 1Q13 analysis or outlook.

Operational & Financial Planning Items

We hope you have received your **First Quarter 2013 Portfolio Review** package via your secure web portal (https://cwp.morningstar.com). If for any reason you have not been able to access the website or reports please contact our office for assistance. We believe your quarterly reporting package provides a critical role in keeping you abreast of what you own and how your investments are performing.

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Thinking about funding an IRA? The 2013 contribution limit is $5,500 for those under 50 and $6,500 for those over the age of 50. Please contact our office to discuss your options.

Have you reviewed your estate planning needs recently? If you are unclear what role a will and healthcare proxy should play in your estate plan please let us help. We would be happy to review your needs and put you in touch with one of our trusted partners. Because we are independent and don't get paid for referrals, we can offer you an independent perspective.

Curious about retirement planning? We would be happy to walk you through our in-depth retirement planning process that will help you get a better sense of where you stand and what you need to do in order to achieve your retirement goals.

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On behalf of Timmons Wealth Management, we would like to wish you a healthy and prosperous spring and look forward to working with you throughout 2013 and beyond. If there is anything we can do to help you please do not hesitate to contact our office.

Sincerely,

Liam Timmons, President
Timmons Wealth Management

[i] JP Morgan Market Insights,2Q13
[ii] Bloomberg BusinessWeek, March 25th
[iii] Institutional Investor, March 13th, Michael Hood
[iv] JP Morgan Market Insights, 2Q13
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