INVESTMENT MANAGEMENT & CONSULTING GROUP

VIEWPOINTS

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MARKET COMMENTARY

FREDRIC W. WILLIAMS

Brand New Day…Really?…

"Turn the clock to zero, boss
The river's wide, we'll swim across
Started up a brand new day"
Gordon Matthew Thomas Sumner – 1999
(a.k.a. – Sting)

With the first quarter of the new year defying the legions of fiscal cliff-phoebes, the domestic equity markets overcame imminent sequestration fears and marched to new highs as the initial 90 days of 2013 came to a close. As is noted in the market commentaries below, the abatement of daily market updates predicting the end of the financial world as we know it, caused investors to venture out of the investment bunkers in their global quest for yield in our zero-interest rate environment. And although we're fundamentally constructive on equities over the longer term, it would seem that a 10% or so move up in the indices might be pulling a tad ahead of the 5-6% earnings growth, and suggests that the new found affection that the retail public has for stock funds may be more the driving force, as underexposed investors do their typical "buy-at-the-high" attempt to catch up with the indices.

"When things are going well and prices are high, investors rush to buy, forgetting all prudence. Then when there's chaos all around and assets are on the bargain counter, they lose all willingness to bear risk, and rush to sell. And it will ever be so."
- Howard Marks, Oaktree Capital Mgt.

Despite Sting's optimistic ode, we're not fully convinced that this is, in fact, a brand new day…just not yet. But instead find it a "less bad" day than at the depths of the financial crisis, while still a wide river to cross to get us back to where we were earlier in the preceding decade. Although nominal prices in the capital markets have been hitting new highs, we still see challenges in the unemployment rate, total jobs, housing, auto sales and industrial output – hinting that after a great run in the first quarter, a pause to digest those gains would not seem out of the realm of possibilities.

As we pointed out last quarter, mom-and-pop investors pulled $445 billion out of domestic stock funds from 2007 through the end of 2012, while deposits to taxable government, international and corporate bond funds amounted to a sizeable $1.1 trillion during approximately the same time period. We speculated then that minuscule bond yields would eventually start a rotation into equities, a hint of which we saw in the 1st quarter as stock funds broke their outflow trend and brought in a net of $33.6 billion – although still leaving sizable demand lurking in the background when rates rise and bond prices actually take a hit.

And although the U.S. continued to be the "best house in a bad neighborhood" from a global investment standpoint during the opening quarter of 2013, we do believe that the macro backdrop of a more rapidly growing developing world continues to be intact. Once the "fear trade" has completely subsided, the demographic challenges in the developed world (an aging population not contributing to GDP as much) and fiscal headwinds (government deficits crowding out the private debt markets), the investment advantages in the emerging world will become evident to those willing to take advantage of educated risks.

> *"Risk control is the best route to loss avoidance. Risk avoidance, on the other hand, is likely to lead to return avoidance as well."*
>
> \- *Howard Marks*

As such, we will be gradually expanding our developing world exposure, to both the equity and fixed income markets, while taking advantage of any pull backs in the domestic equity markets as attractive entry points to expand exposure in anticipation of the wave that will eventually roll out of the overly extended credit arena.

EQUITY MARKET OVERVIEW — J. FOSTER & F. WILLIAMS

What?...Wall Street Worry?...

There is industry lingo in every profession, and the investment world is no exception. One common cliché about stocks is at times they sometimes climb a "wall of worry" and in the first quarter of 2013 stocks did just that, continuing their ascent despite a number of headwinds. Markets looked past the continued dysfunction in Washington as we went from the fiscal cliff standoff to worries over the sequestration. Then right on queue the focus was back on Europe, when Cyprus, a little known island country and Euro member, decided the solution to its fiscal problems would be to place a tax on bank deposits, something as yet unheard of in the aftermath of the financial crisis.

Underneath the negative headlines it was not just about "worry" as investors voted with their wallets, ignoring the politics and focusing on the improving economy here at home. The U.S. continued with measured improvements in corporate earnings, household balance sheets, unemployment, and housing. Technological advancements in energy exploration coupled with Americans becoming more energy efficient continued to lead the U.S. toward a path of energy independence. Asset values reflected this strength, with the S&P rising 10.61% as of March 31st, dramatically outperforming widely followed international benchmarks. Although, the MSCI EAFE index still managed to edge up +5.23% despite Europe's recession and the assorted lingering Euro issues. Slow growth in Emerging Markets saw their benchmark finish down -1.57%, making U.S. returns a clear standout among developed nations. What's more impressive, the U.S. rally was broad based across all sectors, compared to recent times when markets were buoyed by a select few companies, i.e.

Apple. Investors traded in their iPads for basic necessities, and the stocks favored were those with dividends, such as those in sectors with predictable cash flows like healthcare, consumer staples and utilities. In fact, the biggest deal of the year came when Warren Buffet's Berkshire Hathaway & 3G, a private equity hedge fun, took action to acquire a little ketchup company called Heinz.

This steady rise in prices has many "bears" calling for a correction, and although we wouldn't necessarily disagree, the long-term view for stocks appears intact. Looking forward, the S&P trades near 14 times earnings, and this is roughly 15% below its 15-year average. Add in a dividend yield of over 2%, a Federal Reserve hell-bent on keeping rates low for the foreseeable future, and a 10-year Treasury bond yielding around 1.87%, there isn't much competition. Not to mention the recent peaks the market has reached is only marginally higher than where it sat *13 years ago* (excluding dividends). At the end of the day we continue to favor stocks over bonds.

Table 1 - Index Returns				
Equities	*03/28/2013 Closing Level*	*Percentage Change Quarter-to-Date*	*Percentage Change Year-to-Date*	*Trailing 12 Months*
DJIA	14579	12.02%	12.02%	13.89%
S&P 500	1569	10.61%	10.61%	14.38%
Nasdaq	3268	8.52%	8.52%	7.01%
MSCI EAFA	1674	5.23%	5.23%	12.58%
MSCI EM	1035	-1.57%	-1.57%	3.20%
Fixed Income	*3/29/2013*	*12/31/2012*	*12/31/2012*	*3/29/2012*
2 Yr US Treasury Yield	0.25%	0.25%	0.25%	0.33%
10 Yr US Treasury Yield	1.87%	1.78%	1.78%	2.18%
30 Yr US Treasury Yield	3.10%	2.95%	2.95%	3.27%
	Levels			
Commodities	*3/29/2013*	*12/31/2012*	*12/31/2012*	*3/29/2012*
Oil (WTI)	97.23	91.82	91.82	102.78
Gold	1598	1658	1658	1662

BOND MARKET OVERVIEW — J. FLOWER & F. WILLIAMS

Right Back Where We Started…

The first quarter for bonds was a forgettable one to be sure. As the chart below shows, the 10-year Treasury ended the quarter almost exactly where it started. The broader Barclays Aggregate Index actually finished slightly in the negative, down -.13% for the quarter. The best performing fixed-income asset class were high yield bonds coming in at +2.85%. One of the more noteworthy developments in the credit markets during this period has been the shift in asset flows away from solely fixed coupon bonds to floating rate or bank loan securities. This, we expect, is due to concerns over impending inflation, historically high valuations in corporate and high yield bonds and continued demand for stable incomeproducing investments. As we've mentioned in this space before, the underlying reasons investors look to fixed income haven't changed but some of the strategies we must use going forward will have to change considering the current low interest rate environment and likelihood that rates will revert back to the mean over the coming years.

Source: Interactive Data

In the last quarter ETFs and mutual funds that invest in bank loans took in over $15 billion in new assets versus just over $12 Billion in all of 2012 according to Lipper data. These types of investments, while included in the fixed income category, are actually quite different from the typical corporate or treasury bond. These investments are loans made by banks to companies that do not have a fixed rate or coupon but a floating-rate that is linked to LIBOR. Therefore, these types of instruments can act as a hedge against rising rates since they continually reset thus shielding them from duration risk. These types of loans typically have yields associated with them that are comparable to high yield bonds yet they are higher on the capital structure than bonds so if the company were to go bankrupt the banks get paid back before bond holders.

Bank loans are just one of number of non-core fixed income-type investments that our Investment Policy Committee has been analyzing as we prepare to manage our client's assets through this challenging pivot-point in the bond market. For the last three decades bonds have generally been a safe and easy way to make money (not only for generating income but also on a total return basis) while the only real consideration has been credit risk, not duration risk - remember Enron, Worldcom, Bear Sterns, Lehman Brothers. Duration risk has now become our primary concern and we continue to explore options for diversifying our client's fixed income allocation in order to hedge against inflation, and look to fixed income to generate income and provide stability through volatile equity markets. We look forward to talking with you and sharing our ideas in more detail soon.

Making the Case for an Independent Investment Fiduciary…

QUESTION: Why retain an independent investment fiduciary for your retirement plan?
ANSWER: Because it will probably save you and your participants a lot of money...

At least that's what a recent study by an assistant professor of finance at Indiana University suggests. Oh, there have been other studies, notably a white paper by Joshua Itzoe and Matthew Hutcheson in 2008 that explored the true value of an independent fiduciary. They indicated that a good fiduciary could be worth upwards of $450,000. PER PARTICIPANT. That study centered around the premise that if a participant increased investment performance by two percentage points while decreasing fees from 2% to 1%, they would have accumulated $450,000 more over a 30 year period.. While theoretically and mathematically accurate in a vacuum, those situations usually do not exist in the "real world" for that length of time. Pressure to reduce fees has permeated the industry, rendering those results as unlikely.

More interestingly, the recent study published January 20, 2013 by IU - "*Ït Pays to Set the Menu: Mutual Fund Investment Options in 401(k) Plans*," by Veronika Pool (and profiled in the 3/16/13 issue of *Barron's*) – took a different path to arrive at the same destination about the importance of an independent investment fiduciary. The researchers initially set out to review 401k plans in general, since those plans comprised a third of all assets in held mutual funds ($3.5 *trillion*), and they wanted to learn more. As they researched, they became familiar with the platforms that provided recordkeeping and administrative services, and the funds that those platforms offered. When they separated the data between proprietary funds (those managed by the platform doing the recordkeeping) and non-proprietary funds (managed by others outside the platform), they discovered the following:

- **Non-proprietary funds were being deleted from platforms and lineups at a rate of 21.4%, while proprietary funds were only removed 11.6% of the time. Among the funds in the "worst performing" categories, the numbers separated even more: 29.6% removal rate for other manager's funds versus 11.9% for their own.**

There are a variety of explanations for this phenomenon (target-date funds, proprietary fund requirements, platform requirements, broker compensation, revenue sharing, internal pressure to grow asset levels, etc.) and none is good for participants. As the study found, the worst performing proprietary funds (those least likely to be removed as compared to their non-proprietary peers) ***underperformed by an average of 3.6% annually***. As Veronika Pool says in the Barron's article "*It's not a problem to have [a platform's proprietary] funds in the plan, it's a problem to have bad funds in the plan for a long time.*"

This is why independent investment fiduciaries like IMCG create tremendous value, savings and potential growth for retirement plans. We are platform and fund agnostic; we are not compensated by the platforms we choose; we look for true institutional share class open architecture - the platforms and funds that operate in the best interests of our clients and participants (i.e. that are not focused on revenue sharing models that force plan sponsors and participants to unknowingly foot the bill); we will recommend replacement of a fund or platform at any time we are not comfortable that it doesn't fit into the policies of the investment/retirement plan committee and/or our standards as the independent investment fiduciary. We always look for the best possible investment returns, experiences, education and outcomes for our participants and plan sponsor clients.

INSIDE THE MARKETS **FRANCIS J. DAVIES, III**

Managing Risk in the Market…

"Rule No. 1: never lose money; rule No. 2: don't forget rule No. 1"
The Tao of Warren Buffett

The investment process will always entail risk - it is the basis of the risk/reward concept. When money is invested, there is always the risk that some or all of it might be lost. The reward for assuming the risk is the potential for gain - the return of principle plus profit. Without risk there is no potential for gain. What Mr. Buffett means is not to avoid all risk at all times and bury our money in coffee cans in the backyard, but to be aware of potential downside in any opportunity.

Along with maintaining a healthy skepticism, investors can take steps to mitigate risk. Although risk cannot be eliminated, it can be reduced. Investors get into trouble because conditions always look great as the market rises and they do not want to limit the upside by, in effect, buying insurance for their portfolio. IMCG takes gradual measures to preserve gains and reduce volatility while still staying in the markets, beginning with diversification which entails spreading assets into non-correlating instruments. We seek to diversify currency risk by holding non-dollar-denominated instruments; inflation risk through commodity-based holdings and inflation indexed bonds; and economic risk by allocating amongst fixed income, equity and cash. Within the equities, we reduce risk by owning shares in companies from different industries, from various size concerns, both growth and value stocks, based in different countries.

Diversification should not be confused with hedging, which is the taking of offsetting risks. With diversification, risks are uncorrelated. This means that the investments do not move in lockstep under varying market conditions. With hedging, investments have negative correlations. When one goes up, the other goes down. Hedging can be used as insurance against extreme events. It seems like these events are becoming more common. The past few years saw a global financial meltdown, the Japanese tsunami, the Arab Spring, the debt ceiling standoff in Washington, the downgrade of US Treasury debt, the ongoing European sovereign debt crisis, and the list goes on.

Each event seemed to catch investors off guard and the stock market gyrations were devastating to many undiversified portfolios. From its high of 1565 in October 2007, the S&P 500 fell 55%, finally bottoming out below 700 in March 2009. Some investors sold near the bottom. Those who were 100% in trendy growth stocks are just getting back to even.

Many remain too nervous to consider equities and are still on the sidelines, not participating in the current market advance.

As Mr. Buffett makes clear, limiting risk must be job One. It is much easier to make money in good markets than it is to preserve it in difficult times. THIS is why IMCG uses an investment process that seeks to identify and diversify risk. The true value of professional asset management is the ability to protect capital during the inevitable market downturns.

IMCG NEWS

FRED WILLIAMS **–** Once again this year Mr. Williams attended the Morningstar Ibbotson Conference in late February. Ibbotson's analyst's symposium continues the tradition of bringing academic theory to industry practice, with thought leadership on asset allocation, investment research, economic analysis and portfolio strategy - this year's gathering featured a presentation by founder Roger Ibbotson, who spoke on the advantages of lower volatility/lower beta (i.e. lower risk) actually outperforming higher volatility/higher beta equity selections.

SAVE THE DATES:

We're entering the time of year when a variety of non-profit organizations begin their fundraising efforts. In these challenging economic times financing the continuation of their programs and services requires even more effort from their dedicated volunteers. Although by no means complete, the events below are but a sampling of the organizations that our firm, employees, colleagues and clients are involved with:

> ***5th Annual Dancing With The Local Stars*** – On Friday April 26th at 7:00 PM the Strom Auditorium in Camden will be host to a benefit for The Community Schools at Opportunity Farm and Camden. CSOFC (www.thecommunityschool.org) offers relational learning programs that transform the nature of a high school education by providing students with the skills and experience necessary to discover their strengths, connect with their families, practice personal responsibility, and contribute to their communities, and which culminate in awarding a high school diploma from the State of Maine.
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> ***Walk MS*** **–** The annual spring walk to benefit the MS society will take place on April 27th at The Portland Expo starting at 9:00 AM. Participation provides help for today and hope for tomorrow through education, support, advocacy, and research funded by the National Multiple Sclerosis Society through its Greater New England Chapter. Details can be found at www.walkmam.nationalmssociety.org.
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> ***20th Annual Child's Play Golf Benefit*** **–** The Dream Factory of Maine is celebrating its 26th anniversary of granting dreams to the children of Maine and is holding its Child's Play tournament Friday June 7th at Sable Oaks and starting at noon. The Dream Factory grants dreams for critically and chronically ill children nationwide, is based in Louisville, and has 2 chapters in Maine. Additional information can be found at www.dreamfactoryincmep.org.

10th Annual Camp Ketcha Golf Tournament – To benefit the Camp's programming, youth development and community support services, this event is scheduled for June 12th at the Prout's Neck Country Club – registration begins at 10:00 AM. Additional information can be found at http://campketcha.com.

Fore The Kids Golf Classic – Big Brothers Big Sisters of Southern Maine's annual fundraiser will be held June 17th at The Woodlands Club. Additional information on this popular two-ball/best-ball event can be found at www.SoMeBigs.org.

Greg Francoeur Memorial Golf Tournament – The 10th annual event to benefit the scholarship fund managed by the Maine Community Foundation which provides support to students enrolled at Carrabassett Valley Academy who would not be able to take advantage of educational and training opportunities without financial assistance. Contact Gary Francoeur at garyfrancoeur@comcast.net for more information about the event to be held Friday morning July 12th at the Val Halla Golf Club in Cumberland, Maine.

WEB SITE UPDATE – We recently revamped our web site (www.imcgrp.com) so do drop by and pay us a "visit". We can also be followed on Linkedin (www.bitly.com/theimcgrp) and Facebook (www.facebook.com/imcgrp).

In case you missed our IMCG Team from last quarter…

Back Row (l to r): Jason Foster – Vice President-Portfolio Manager; Ben Daigle – Relationship Manager; Terry Davies - Vice President-Portfolio Manager; Tracy Rogers - Vice President-Portfolio Manager; John Warme – Relationship Manager; Jordan Williams – IT Staff

Front Row (l to r): Jay Flower - Vice President-Portfolio Manager; Noelle Surprise – Intern; Fred Williams – Managing Director; Jeannine Plourde – Client Service Associate; Steve Eddy – Vice President-Fiduciary Consultant; Chris Walker – Relationship Manager

(Missing from photo – Larry Bowlan – Portfolio Manager; Camille Shiffler – Operations Manager; Ben Fulmer – Intern)