ATR Advisors

ABSOLUTE TOTAL RETURN
FIRST QUARTER 2013 COMMENTARY

By: Shawn Blau, PhD

The Great Rotation and the US Stock Market

The first quarter saw many major US equity indices approach or exceed their 2007 peaks. Our ATR strategy was fortunate to ride along and our clients also saw substantial gains in the quarter. Even more important for our clients is that their holdings either maintained or actually *increased* their cash distributions to investors. While it is nice to have "bragging rights" about how high your investments look on paper, it is even nicer for them to actually increase the cash they pay back to you, and thus increase their long-term value as income-producers.

Among our investment categories, US Energy Master Limited Partnerships (MLP's), represented by the AMZ index, were up over 18% on average during the quarter. The MLP's had lagged last year, and the first quarter represented something of a "catch-up" for them. Fortunately, we recognized their inherent value last year and stuck with them. Business Development Companies (BDC's), represented by the WFBDC index, were up over 7% on average. US Real Estate Investment Trusts (REIT's), represented by the RMZ index, were up over 8% in the quarter.

Our ATR strategy continues to be highly ranked by the rating firms. As of the end of the 4th quarter, 2012, Morningstar, for the fifth consecutive quarter, gave our strategy their "5-star" rating, which is the highest rating they give. In addition, Informa – the other major rating firm – has ranked us in the top 10 managers in the country within our category for 5 out of the past 6 quarters.

Even more important for the future is that the past quarter may also represent the beginning of what Merrill Lynch researchers have termed "The Great Rotation." What this means is that retail investors in the United States have begun to "rotate" from investments in bonds, to investments in the stock market. While this is a slow trend, it may well have long "legs."

There are many reasons why investors would begin to make this "rotation" at this point in time:

First, bond investments are no longer the great "bargain" they have been in the past. The US Fed – working alongside other central banks around the world -- has driven down both short-term and long-term Treasury rates to very low levels. This has forced bond investors into lower and lower credit qualities and into longer and longer maturities – which has had the effect of driving yields to very low levels in these riskier investments as well.

Second, with the passage of the American Taxpayer Relief Act of 2013 (averting the December 31 "fiscal cliff"), income from bonds now incurs more taxes for many investors than equivalent income from stocks and publicly traded partnerships.

Third, publicly traded companies in the United States have repaired their balance sheets, cut their costs, and are producing very strong profits on average. This gives many of them the ability to return substantially more cash to shareholders.

Fourth, the US economy is growing, but at a much slower rate than in previous recoveries, and employment has grown especially slowly compared to previous recoveries. This means that demand for many US companies remains low, and they are reluctant to invest their cash hoards into expanding their production. Returning cash to investors is often a more attractive alternative to managers in this environment.

Fifth, many sectors of the US economy – especially the energy sector and the financial sector – are in the midst of major re-structurings. This means that many firms will need to attract large sums of new equity capital to finance their re-structuring. Returning cash back to shareholders on a regular, consistent, and reliable basis is one of the best ways to attract equity investors.

What does this mean for the ATR strategy, and for our investors? Well, for one thing it means that it's likely that many investors who used to invest in bonds will begin to invest in our investment categories. This should make them even more valuable over the long term.   Secondly, our investment categories may attract more interest from major brokers, and from popular "sell-side" researchers. This may make these categories even more transparent and "investor-friendly."

Of course these are all long-term trends, and we cannot predict exactly when the "tipping points" will take place. But they do bode well for the continued long-term health of the ATR strategy.

We will continue to monitor all these trends and seek to take maximum advantage of them for the benefit of our clients' portfolios.