CENTURION
ASSET MANAGEMENT

Market Letter - May 2013

In this edition of our market commentary we will review some economic highlights from the first three months of 2013 as well as the equity and fixed income market's performance, and what may lay ahead.

Economy

The year began with a bit of uncertainty as to how the impact of spending cuts that came as a result of the fiscal cliff negotiations would affect our economy. Thus far, despite a significant tax hike, many leading economic indicators have surprised to the upside. Consumption has held up better than expected, in large part due to an improving labor market as well as rising home prices. Consumers have continued to deleverage and increase their household net worth, a positive sign for consumer balance sheets. And while the actual figure is subject to revisions, 1st Quarter GDP estimates are coming in much higher than anticipated with many of the large investment banks projecting 3.0%. So while we continue to see trouble in Europe as they wrestle with a Cyprus bailout plan, the U.S. is showing signs of completing a recovery.

One of the main headlines during the first quarter came on March 1, when President Obama issued a sequestration order resulting in approximately $85 billion in automatic, across-the-board federal spending cuts in fiscal year 2013, focused almost exclusively on discretionary spending. In an effort to gain control of our federal budget, an average of 8.4% will be cut from various discretionary programs due to this sequester. The end result could lead to furloughs and job losses for thousands of federal employees. While the estimated drag on GDP is believed by many to be around 0.6%, we have yet to really feel the effect of this sequester. While we do believe this could create a potential headwind to our economy as we move forward in 2013, a slight pullback in the markets is likely. Regardless, the U.S. economy has proven that it is resilient and we believe that a moderate economic environment persists.

EQUITY MARKET REVIEW

The positive momentum in U.S. equities during 2012 carried over nicely into the first three months of 2013. As we moved past the fourth anniversary of the global equity market bottom on March 9, 2009, the final week of March saw the S&P 500 return 1.55%, closing the quarter up an impressive 10.61%. We also saw the Dow Jones Industrial Average eclipse 14,000 for the first time in more than five years.

While we certainly do not expect this pace of growth to continue, we do believe that stock valuations for the most part remain attractive as they are still below historical averages.

Q1 2013 Market Barometer*

	Value	Blend	Growth
Large	12.3	10.6	9.5
Mid	14.2	13.0	11.5
Small	11.6	12.4	13.2

*All figures listed in performance percentage. Return figures provided by Morningstar.

While returns early in 2013 were strong, and mostly unexpected, it was not without anxiety. During the first quarter, investor trepidation materialized out of the sequestration pronouncement and the U.S. fiscal policy debate. Once these headlines abated somewhat, those equity investors who remained invested were rewarded.

Heading into Q2 2013, there is still a tail-wind resulting from the relief over the fiscal cliff negotiation. The January 1 deal averted the worst-case scenario of across the board tax increases, and severe spending cuts, which may have led to an extremely conservative swing in spending, resulting in possible economic stagnation. In preparation for this, some investors sold off stocks with gains late in 2012 before a pending tax increase in 2013 would go into effect. Now those same investors are trying to buy back into the rally.

For the remainder of 2013 we expect equity markets to continue to advance and stay comparatively favorable to the fixed income market. It is difficult to predict the exact outcome for stocks, but our position is to overweight the large cap sector even while there are reasons to believe the near-term rally in equities is overextended.

Looking at a variety of valuation metrics, such as price-to-book, price-to-forward earnings, and price-to-cash flow, stocks seem inexpensive relative to their long-term averages. By example, the S&P 500 Index is trading at a much lower forward P/E ratio than when it reached its 2007 peak index level of 1600. Looking at past bull markets, investors have historically paid more for stocks

as they move higher, suggesting there is still room for equity markets to rise.

Fixed Income Securities

The combination of lower interest rates and tightening credit spreads led to a generally positive return for bonds in 2012, but less so in the first quarter of 2013. The broad market as measured by the Barclays Capital Aggregate Bond Index returned 4.41% in 2012, but was slightly negative during Q1 2013 (-0.12%). High Yield bonds were the strongest sector in the U.S. Market, up 2.89% in Q1, while U.S. Investment Grade bonds and Treasuries were slightly negative for the quarter (-0.11% and -0.19%). International bonds performed poorly, finishing down -3.51%.

Corporate bonds outperformed government bonds as corporate credit spreads narrowed. By example, as the yields on government bonds have sunk to extremely low levels over the past 5 years due to a flight to safety, fixed income investors have sought other areas of value aside from traveling far out on the risk curve and exploring stocks. Thus, investors have put money to work in stable corporate, and during 2011-2013 the yields have lowered - a good thing as lowering yields is an indication of rising prices for bonds.

While it does not appear that Fed action will pick-up soon, and rates will rise dramatically in the next few quarters, we do feel there are factors that indicate Treasuries are less attractive than their recent past. Treasury yields are well below historic norms, and below the rate of inflation. This creates little value for Treasuries in our view, unless they are used as a risk hedge. This leads our bias for adopting a stronger weighting toward non-government related securities in fixed income portfolios.

For 2013, it will be mathematically very challenging to enjoy anywhere near the 2012 returns for bonds unless one assumes that either credit spreads return to the tightest level recorded (think February 2007) or that interest rates will drop significantly below where they are currently trading – which is already near the lowest rate on record. Assuming corporate spreads tighten modestly and interest rates remain steady, and considering that the yield on the Corporate Bond Index is currently 2.4%, investment-grade bonds appear to be poised to return low to mid-single digits in 2013.

Conclusions for a Macro Allocation

For the remainder of 2013, an investor will need to position themselves to endure mixed signals. We suggest a flexible position that is balanced between equities and fixed income holdings that allow for tactical changes as markets dictate. This is nothing new to Centurion, as we have maintained a balanced approach for the past few years. The fixed income portfolio has seen nearly double digit average annual performance since 2009, but we feel this run-up in bond prices will slow in 2013 and we need to be cautious with expecting strong performance to continue for this asset class. We favor equities but with tactical rotation among categories (market caps), countries (domestic vs. international), and sectors (consumer driven, financial, industrials, etc.). Barring an extreme unforeseen event, we see much of the same playing out in the last 3 quarters of 2013 as we did in 2012.

Past performance is no guarantee of future results. Indexes are unmanaged, do not incur fees or expenses and cannot be invested in directly. Investing in sectors may involve a greater degree of risk than investments with broader diversification. International investments are subject to additional risks such as currency fluctuations, political instability and the potential for illiquid markets. Investing in emerging markets can accentuate these risks.

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