Integer Wealth Advisors Group, LLC

Advise, Guide and Protect

Second Quarter 2017 Market Commentary

We start every market commentary by highlighting an observation from our previous commentary. Here is what we said last quarter regarding the markets:

The rise in rates is a signal from the Fed that they are back on their game of meeting their dual mandate of full employment and price stability. Despite the recent rise in rates the fixed income market has not sold off, and for good reason. Inflation is the "kryptonite" of the bond market and as-long-as inflation is held in check, bond investors such as insurance companies, endowments and foundations have a clear message to own those securities. Had the Fed held off in beginning the rate rising cycle, a fixed income sell-off would have been understandable.

Second Quarter 2017 Highlights

The "conundrum" is back. What's the conundrum you might ask? It occurs when the Fed is on rate tightening and bonds increase in value. The 10-Year Treasury at the end of May hit 2.18%, in the face of potentially three more rate hikes during the remaining part of the year. With the economy seemingly moving forward, unemployment way down and the consumer feeling pretty good, inflation continues to remain in check. And when the "kryptonite" of the bond market is held in check, a couple more interest rate hikes that might move the interest rates to 1.25% is not a big deal to bond holders.

Now, a falling yield in the bond market suggests that there is trouble in the equity markets. Why? Because bonds are a safe-haven investment when the stock market starts to go south. So clearly the bond market investors know something the rest of us do not? A simpler explanation could be that bond investors are clearly wrong on their bet, or that people with a lot of cash are "parking" it to await the apocalypse that is sure to occur with the current administration. Stay tuned.

A big deal occurred during the quarter and nobody, especially the bond market seemed to care. In early May Puerto Rico officially filed for bankruptcy and in June the state of Illinois was close to becoming the first state to have their debt rated "junk" by Standard and Poor's. The bond market took it in good stride as the Puerto Rico issue barely registered to investors, unless you owned bond funds with a lot of Puerto Rico exposure (Oppenheimer anyone?). Our clients need not worry as any of the bond funds used in their portfolios have little-to-no exposure to Puerto Rico.
Shortly after Puerto Rico's bombshell, President Trump stunned the market as he fired FBI Chief Richard Comey, setting off a firestorm of speculation about obstruction and subterfuge. The Dow dropped 360 points over the next two days as investors digested the political news of the day, and in

retrospect, the controversy would last for the balance of the quarter until Mr. Comey's testimony in early June.

But the biggest fireworks for the quarter came in the middle of the month when Amazon, 6 days post its record breaking prime Day, announced the purchase of Whole Foods, marking Amazon's full-throated entry into the food business. The purchase price was just over $13 billion dollars and the stock of both companies soared on the news. In fact, Amazon's market capitalization increased by over $15 billion, netting the company a $2 billion dollar profit by acquiring a company.

Market timers were surely disappointed by the volatility of the markets. Just when the markets seemed to be turning south for good, or analysts were giving up on their favorite sector, unexpected news from the corporate world, Washington, D.C., or an international banker would pronounce all is well, causing a sharp reversal. It was a good quarter to remember that market timing doesn't work, but raising some cash is never a bad idea.

Finally, it is clear to us that investors are getting impatient by the paralysis in Washington on issues such as healthcare and tax reform. While they are doing a great job with regulatory rollbacks, the Republicans cannot seem to "shoot straight" and are losing their edge in passing legislation that will take markets to the next leg higher.

DOMESTIC EQUITY STATISTICS

Index	2nd Quarter 2017
S&P Small Cap	2.14%
S&P Technology Sector	3.76%
Dow Jones Average	3.32%
S&P 500 Index	2.57%

(Period Ending 6/30/2017. Source: S&P Dow Jones Indices)

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Company	Percentage Weight	2nd Quarter 2017
S&P 500		2.57%
Energy	6.0%	-7.02%
Materials	2.8%	2.64%
Industrials	10.3%	4.16%
Consumer Discretionary	12.3%	1.97%
Consumer Staples	9.0%	0.90%
Health Care	14.5%	6.65%
Financials	14.5%	3.80%
Technology	22.3%	3.76%
Telecommunications	2.1%	-8.14%
Utilities	3.2%	1.36%
Real Estate	2.9%	1.84%

Source: Standard and Poor's (www.spindices.com), price returns.

Style Return Box for the Second Quarter 2017

	VALUE	CORE	GROWTH
LARGE	1.45%	3.06%	4.42%
MID	0.48%	1.95%	3.23%
SMALL	1.15%	1.67%	2.10%

Source: Standard and Poor's (www.spindices.om), total returns.

DOMESTIC EQUITIES

The waiting game continues as Washington continues to flounder with tax and healthcare reform. The upside, obviously, is if they actually get something passed. Given the recent special election losses by the Democrats, one would assume both sides would realize their respective predicaments and come together to compromise and pass legislation. This, no doubt is wishful thinking, so investors will have to rely on corporate earnings, mergers and acquisitions and the IPO market to find some good news.

Amazon certainly delivered on the buyout of Whole Foods which caused quite a pop in both stocks as we described above. Investors seem to think tech has gotten long in the tooth, especially with their impressive first-half performance. But let's "peel the onion" back on that subject matter for a moment before giving up the ghost on tech stocks.

Tech's defining moment came in the late part of December 1999 through March of 2000 when the Nasdaq nearly doubled in value. Looking back over that time period, and subsequent months after that, the "irrational exuberance" was in full evidence but no one wanted to admit it. The ideas were relevant and interesting but the infrastructure was not capable of carrying out the promises. Amazon's idea of delivering groceries? Webvan had the same concept in operation in the late 1990's where you would shop on-line and they would deliver the groceries to you.

The only problem is that back then you surfed the web in a 1920's Model T-Ford. Pages took forever to load, graphics were non-existent and people thought mobile payments were something you did at the drive-thru. The hype outran the technological "backbone" that was required to deliver on the tt of e-commerce.

Today? Well, we don't have to waste any more space to confirm that the ideas and technology have meshed quite nicely. Sure, it took 16 years for early tech investors to make their money back (the Nasdaq reached its previous all-time high in 2016), but who could imagine back in 2000 that "Ubering" would be a verb and Amazon would be selling virtually everything, mobile payments via Venmo and other processors and the ability to video conference for free with someone on the other side of the world from your phone would be possible. Imagine the next 20 years and innovation by U.S. tech companies?

For these reasons, we continue to like domestic U.S. equities (see our comments below in International as confirmation) as the lead positions in a diversified portfolio. While some of our sector recommendations have been hurt this year (look away from energy!), healthcare and financials are feeling the love as invests seek reasonable P/E ratios and good yields.

INTERNATIONAL

We won't discount the contributions international companies have made to the advances in the markets. We still prefer an overweight to the U.S. markets in a diversified portfolio because the socio-economics of a lot of places around the world do not match the United States. And remember, international stocks are not represented in the domestic U.S. indexes, so an investor should own some international exposure to include some very good securities in the portfolio. The

transition occurring in Europe with the Brexit vote last year causes some uncertainty for investors. Place on top of that the EU Commission laying out fines because of "unfair competition" continues to restrain the impulse for CEO's to expand in markets that might not be friendly to them.

That said, Europe and some emerging markets are having a very good 2017 (despite some markets such as Venezuela and Brazil) as investors evaluate the P/E multiples of domestic US companies versus overseas counterparts. Low P/E's overseas have caused investors to rotate some cash to those areas and the "follow-on" effect has caused a good appreciation in that area. We still have concerns about international economies being able to generate opportunities for consumers by reducing red-tape, onerous work rules and taxes. Reform in these areas would certainly change our attitude on increasing international exposure.

Speaking of South America, and considering the U.S. equity market, we have an observation that makes the United States market seem positively cheap. Venezuela is descending into anarchy as the country faces shortages of food and medicine. At the end of June Brazil's government announced that they ran out of funds to issue passports. Closer to home Puerto Rico's bankruptcy highlights that governments around the world, including ours, cannot continue to run massive deficits and social programs that lead to economic calamity.

So, consider the following: Knowing what we know about Brazil, with all its economic turmoil, political instability (how about *an impeachment of a President and a pending additional impeachment of the current President)*, high inflation and unemployment, how can the Brazil Small Cap ETF be *up 18.26%* through the end of June? Forget about the United States being overpriced, there is no way you can convince us that Brazil is where your money should be! Therefore, caveat emptor and we are sticking with the USA.

FIXED INCOME

We said it in the beginning of this piece, it's a real conundrum. Are bond investors correct in making some assumptions that the equity market is overvalued? That is the most plausible explanation that could explain how Central Bankers could be raising rates and yet bond prices rise! As we said last quarter, holding down inflation by adjusting the Fed Funds rate back to a normal level (2% or slightly higher) is certainly part of the reason for the bond conundrum.

The low rates are continuing to help the housing markets but still hurting those that rely on income from bonds to supplement their income and retirement. The recent rate hikes have helped raise yields on cash holdings, but nowhere near the level bond investors from the heady 5-6% yield years in the late 1990's. What pays off for bond holders is the steadiness of the overall value they create when the equity markets start turning.

And that is the area that most investors have not seen this year, a real turn in the equity markets. Sure, we've had some bumps along the road, but we have not had the severe, gut-wrenching drops that usually shake out investors and drive them back to the bond markets. We continue to recommend bond funds in client portfolios not so much for the total return they might generate, but for their impact on reducing volatility in a portfolio.

For those in high tax brackets, municipal bond funds continue to offer relative good yields versus taxable bond funds. What is important is in knowing what is owned inside the bond funds. The funds we use in our portfolios are primarily managed by Vanguard and Dodge & Cox. Those fund managers have astutely avoided owning Puerto Rico issues. As for Illinois, while it has still not reached "junk" status, they are only a few steps away.

IN SUMMARY

What can we glean from all of this information? Here are our thoughts for the second half of the year.

We still favor the United States despite what some consider to be lofty valuations. We have had a good first half of the year, but corporate profits are good, merger and acquisitions are alive and well and the financial system was recently given a clean bill of health as no bank failed their stress test.

If the Republicans can live up to the "blind pig finds an acorn", and gets some legislation passed, you won't be invested heavily enough in the United States to catch the jump. Just imagine if they pass a tax bill that lowers the corporate rate to an even more reasonable 25%, along with repatriation? That should be good for 3-4% advance on the indexes.

We will throttle the enthusiasm just a bit with some market stresses will that can be found in a couple areas. Skilled worker shortages, wage pressures, housing prices and unexpected rise in bond yields continue to be an issue. We are seeing shortages of skilled labor of all stripes; employers are also finding it difficult to hire entry level workers.

Wage pressures. Absent the $15 per-hour crowd, if worker shortages continue, wages will have to go up to attract workers. This is not unusual when the economy is moving along. But we are not even experiencing the 3% GDP that economists suggest we should be at. Imagine if we were able to hit that level, what the demand for workers would be?

Housing prices. Without question low interest rates have caused housing values to increase causing more people to rent. Not sure this is true…rentals are down????It is becoming more difficult for

young workers to find reasonable housing. Wage pressures for expensive cities such as Seattle, New York and Chicago continue the cycle as higher wages push up rents and the relative value of single family homes. These are Fed "data points" which help drive their decisions to raise rates to chock-off inflationary pressures.

What would really set-off the alarms? A rapid rise in bond yields would be a concern because that could signal a real rotation, or capitulation by bond holders, suggesting that they have given up and are joining the equity side. While that could be one explanation, the other could be a perception that the Fed is not moving fast enough to quell inflation fears among bondholders, prompting them to move to the sidelines, or over to equities. We will take cues from the bond market: If yields continue to push downward, say getting to 2% or below, that is a sign that bondholders are worried about the overall economy. On the flipside, if yields rise above 3%, taking some cash off the table might not be a bad thing as we would expect equities to benefit from that rotation.

Finally, in a CNBC poll released on June 27th, 64% of those polled predict the S&P 500 will rally at least another 5% from the closing price on that day. By that measure the S&P 500 could hit 2,550 by the end of the year. According to the Center for Financial Research, the S&P 500's average gain in the second half of the last 70 years was 4.2%. That could portend a double-digit return for the markets.

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