Integer Wealth Advisors Group, LLC

Advise, Guide and Protect

First Quarter 2018 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:

Based on the changes in the tax code, the continuing drive of the business of the internet and transformative technologies on the horizon, 2018 looks to be another decent year for the markets. We always hedge the bet with diversification, and each investor should always be assessing where they are on the risk-to-reward spectrum. Our advice is to set a target return that you are comfortable with and manage to that target. Other investors may earn more, some less, but at the end of the day, your ratio of "eat well/ sleep well" that matters.

Our thoughts from the fourth quarter 2017 commentary were looking pretty good until just after January 26th, the high for the first quarter. The year is still young with just one quarter in the books, and we recall a similar pattern occurred in the first quarter of 2016. Back in 2016 volatility had been a daily part of investing. In 2017, volatility went into hibernation and markets provided investors with a smooth ride higher. The return of volatility has shaken investors back into reality, and in doing so investors are having to relearn how to parse this period of volatility correctly.

Why does this relatively small quarterly loss feel so bad? Two thoughts on that question. First, we have not had a negative quarter in the S&P 500 since the first quarter of 2016, when the S&P 500 posted a -1.56% loss, so there was some sense of "expectation" that maybe we were on a new plateau for stocks. Next, we had a "moon shot" rise in the markets in January that finally caused investors to look at their equity valuations. In the span of ten trading days, the Dow rose over 1,000 points to 26,616, followed by a stumble led by tech stocks.

High Watermark Effect

From an investor psychology perspective, how you perceive losses and gains, we think, helps shape how you invest. Why? Because investors want to avoid pain.

Take the 2008-2009 financial crisis as a prime example. Back then investors would not look at their portfolios because they didn't want to experience the pain of loss. Remember everyone saying, my "401k is now a 201k"? They did not want to experience the pain of "losing" money.

Fast forward to this quarter. The rapid rise, built on top of a smooth 2017, made investors start looking at their portfolio values a bit more closely, "counting the chips" at the table if you will. "Hey, my portfolio just topped $1 million dollars!" So, when the market dropped from the January 2018 high, the "high watermark effect" was implemented and anchored in the investor's psyche. Despite the Dow being down 2.5% for the quarter, most investors feel a larger loss; that their portfolio values are down substantially.

During the first quarter of 2016, we dropped over 10% through February, only to experience a late rally to finish down 1.56%. How much did an investor lose? An investor experiencing that quarter will tell you they lost 1.56%. They won't tell you that they "made 8% from the bottom", they will tell you they lost 1.56% for the quarter. Now, juxtapose that to the most recent market episode.

The Dow was down 2.5% for the first quarter of 2018, ask an investor how much they lost this past quarter and they will tell you numbers like 7-10%. They won't say I lost "x% from the beginning of the quarter", they will tell you they lost 7-10% from the January 26th market high. A loss from a previous high is an absolute loss, despite what the return is for the quarter. While a recovery from a previous low is always an absolute loss, not a gain from that previous low.

We will wrap this session with two other analogies. If a gambler goes into a casino with a $500 stake to play a game, and during that session she gains $1,000, but then gives it back and finishes with $400, how much did she lose? If a runner starts a race with 1,000 participants and 500 finish, and he finishes number 500, was he last or did he finish in the top 50th percentile?

Integer Wealth Advisors Group, LLC

It's about perspective, risk and reward and understanding oneself as an investor. So if you can look at this past quarter and see the slight loss, versus the bigger loss from the top, it adds to a balanced perspective. You don't "lose" until you trigger the loss; paper losses stink but they are just that, paper losses. The longer-term view focuses on the more important issues of asset allocation and tactical selection of investments.

DOMESTIC EQUITY STATISTICS

Index	1st Quarter 2018
S&P Small Cap	0.24%
S&P Technology Sector	3.2%
Dow Jones Average	-2.49%
S&P 500 Index	-1.22%

(Period Ending 3/31/2018. Source: S&P Dow Jones Price Weighted Indices)

Company	Percentage Weight	1st Quarter 2018
S&P 500		-1.22 %
Energy	5.7%	-6.58%
Materials	2.9%	-5.97%
Industrials	10.2%	-2.02%
Consumer Discretionary	12.7%	2.76%
Consumer Staples	7.7%	-7.77%
Health Care	13.7%	-1.63%
Financials	14.7%	-1.38%
Technology	24.9%	3.20%
Telecommunications	1.9%	-8.69%
Utilities	2.9%	-4.20%
Real Estate	2.8%	-5.79%

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

Integer Wealth Advisors Group, LLC

Style Return Box for the First Quarter 2018

	VALUE	CORE	GROWTH
LARGE	-4.16%	-1.22%	1.58%
MID	-3.47%	-1.15%	1.06%
SMALL	-1.75%	0.24%	2.18%

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

Domestic Markets

From the style return box presented above, it's clear that investors were still favoring technology stocks in lieu of value oriented, dividend payers. With the focus on interest rates and tariffs, it is understandable that investors would step away from the dividend payers such as utilities, telecommunications, real estate and energy companies and focus on companies that might be able to side-step the tariffs issue.

Only technology and consumer durable sectors of the S&P 500 posted positive returns for the quarter. Despite upbeat economic projections, low unemployment and continuing strong earnings guidance for the upcoming year, interest rates and a potential trade war dominate investor thinking. We are now in an interest rate cycle where rates are moving higher, and the question is how many hikes and how fast will they come? As for tariffs, will this be a game of "chicken", or simply a strong position for new negotiations at the trade table?

For many, this is their first experience in a rising interest rate environment so managing a stock portfolio will require more due diligence and attention, let alone trying to figure out complex trade treaties. From the peak in the market on January 26th, the broad market indexes are off around 9%, from the beginning of the year, much less. February, as hard as this might be to imagine, was the first negative month in the markets since October 2016. And that is where the majority of the damage for the quarter was done.

Toss on top of all this the revolving door in the White House and the turmoil gets put into a bit more perspective. In March alone Gary Cohn resigns, Trump fires Rex Tillerson as Secretary of State and names Larry Kudlow as the new National Economic Council chair. Not only are we experiencing new gyrations in the market, we have simply not seen a Presidency like the current White House. Adjustment is the key word of the day!

International Markets

International markets followed the U.S. domestic markets by posting a negative quarter. After having a big fourth quarter rally, concerns about brewing trade wars took center stage and weighed in on investor's appetites for non-U.S. investments. Improving international relationships, such as North Korea and the United States, did help take the pressure off the international markets. While no one can predict the outcome of the upcoming U.S. and North Korea talks, one less geopolitical risk on the table is a good thing.

Still to be ironed out are the trade agreements such as NAFTA and the TransPacific Partnership (TPP). President Trump has vowed to renegotiate those and until we "see the whites of their eyes", investors will remain cautious. Despite the International Monetary Fund raising its 2018 global growth forecast due to the U.S. tax cuts, there is more uncertainty around trade and growth than investors might acknowledge.

In the emerging markets arena, there is concern that rising rates will put a damper on what has been a bright spot in equities. Rising rates impact raw material costs which are a backbone of most emerging market countries. While the rates have not yet done damage to emerging market investments, a continued rise could put a chill on this area. As commodities rise in price the ability to pass along costs to the end consumer will help determine the overall impact. Failure to be able to pass on price increases will have a negative impact on emerging market stocks.

Fixed Income

The bond market had one of the craziest rides we have experienced since 1994 when the Fed raised rates six times. No other market segment was so in focus with investors and market pundits than the bond market. The question on everyone's mind was "would there be four rate hikes instead of three, and how quickly might they occur"? This drove the bond market into overdrive, with the benchmark 10-year Treasury yield pushing above the 2.9% mark during the quarter. Since yields and bond prices move inversely, investors got a double-whammy during the quarter as nothing seemed like a safe haven from volatility. Bonds did retreat from their haven for safety.

As the Treasury yield moved toward the 3% mark, investors took it as a sign that maybe the party was over and hit the sell button. That drove investors *back into* the bond market which drove yields down. For the balance of the quarter, the 10-year Treasury stayed below the 2.9% mark, a psychologically important level. What will happen when it pushes above 3% is a question many are waiting to see. It's hard to imagine that investors will trade-off equities for a 3% taxable return, but we are sure it will have an impact on shorter term investor sentiment.

Along the way money market funds have come back to life as interest rates pushed higher. This makes "cash" an emerging asset class, available to be used in a strategic asset allocation. Money market funds are slightly different from liquid cash in that you buy and sell them like a mutual fund (with no transaction charge). And while we are not suggesting a large slug should go to cash as an asset, it's more important that we manage the cash to maximize return. With cash paying next to nothing, investing in a Government money market fund that currently pays 1.37% is a smart way to manage cash and perhaps to minimize allocations to longer dated fixed income or holding until there is an opportunity to balance out a strategic allocation.

Integer Wealth Advisors Group, LLC

Summary

Investors had new data to include with their decision making, namely a President that uses the power of social media to shape his agenda. As a result, investors now have to become conversant on issues around tariffs, White House intrigue (meaning the turnover of staff and implications), trade policies and their impact on the markets, as well as figuring out new tax laws. Investing gets more complex!

Thanks to Twitter and other social media outlets, the information an investor needs to synthesize is coming fast and subject to change at a moment's notice. This means that investors who try to "zig" while Washington is "zagging", will find successful investing challenging. Better to leave a portfolio within the guidelines of a strategic allocation than to try to figure out how to be one-step ahead.

Interest rates will continue to dominate the landscape as investors who have never experienced a 5% mortgage assess the impact on the housing market, and the ripple that can send through the economy. Our view is that in the short-run, like the impact on stocks, it will have a dampening effect. But the real impact on housing will be inventory, and that has been worked down considerably over the years. Eventually the interest rates will find a equilibrium at which investors are comfortable, and homebuyers realize that rates are still historically low.

In the end, it comes down to earnings and profits, that's why investors invest in companies. New challenges are occurring that have not been around for decades, namely, rising interest rates. That is where investors need to focus their time and resources. The "twitter-sphere" is simply "noise" that has to be filtered accordingly. There is always going to be something that seems like the end of the earth is upon us, and investors will react as if the world is truly ending. The key is to recognize the issues confronting the markets, realize that the threat eventually passes, and we get back to the work of companies making profits.

Integer Wealth Advisors Group, LLC

Integer Wealth Advisors Group, LLC

Atlanta Office:
3440 Blue Springs Road, Suite 403
Kennesaw, GA., 30144
(o) 770.974.2787

Philadelphia Office:
790 Penllyn Blue Bell Pike, Suite 304
Blue Bell, PA., 19422
(o) 215.643.6490