Integer Wealth Advisors Group, LLC

Advise, Guide and Protect

Second 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:

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.

That was a pretty good observation if we must say so ourselves especially when comparing the first quarter performance and "noise", to the performance in the second quarter. The turnaround was welcome and had investors been listening to the "noise" rather than really digging into the details, a nice rally might have been missed if they abandoned ship and headed for the shore. So, we thought we would pull together two concepts in this market commentary: The rise of social media and sfumato (that's not a typo!)

The Rise of Social Media

There is an old saying that goes: "May you Live In Interesting Times." We agree that since the beginning of the 21st century, that we have been living in interesting times. What makes this saying somewhat generic is that regardless of what century or how many decades you have been alive, *anytime* is an interesting time to live, as it sure beats the alternative. However, this is a particularly *more* interesting time because of the dichotomies taking place that now intertwine politics, both locally and globally and investing to a much greater degree. As wealth managers our job has morphed because of the interesting times that we live in. Information is cheap today. Everyone has

access to information via the Web and near non-stop access to cable and satellite which turns the television into a 24-hour news stream.

The "democratization of information" has resulted in good things like lower prices to invest. But the flip-side is that there is more information today than ever before so analyzing, translating and incorporating that into a wealth management strategy is more daunting today than just 10 years ago. And with the new tax law changes that just went into effect, it gets more complicated as some taxes are gone for good, while others will come back in the not-too-distant future.

When we collectively started in this business back in 1993, we liked to say that information came out of a "garden hose". There was no social media, no Google, you actually had to do your own research on a topic, consult others who were actual experts in the field, or rely on experts who produced reams of documentation on the subject matter at hand. Anyone remember "pink sheets"? Or remember when you found the price of a stock in the Wall Street Journal, quoted in quarters, eights, half's and seven-eights? Or figured out the changes to the tax code back in 1986?

Fast-forward to today and information comes out of a "firehose", information is readily available and does not require much work to locate it. As a result, too many people have become "experts" in fields where they have no expertise, or where they have book leaning but no practical experience. Anyone can put together a thesis on the economy, find information to support it, then put it out on their blog, Instagram, Podcast or any number of social media vehicles. Doing hard research and translating that in an unbiased way is the real challenge.

Compounding this tangle of politics and investments is the advent and growth of social media. In no other time than the most recent can it be said of the power to create and destroy than that of social media. Today anyone can become an "expert" with a Twitter or Instagram account. And why is that? Three things come to mind as follows:

First, there is no "barrier to entry" in creating a social media account and letting the world know of your every thought or fluctuance (for some they are one in the same). Second, social media allows you to be an "instant expert" on virtually any subject because you have immediate access to an unlimited trove of data (real or fake). Furthermore, social media doesn't require face-to-face interaction for rebuttal or presentation of facts. Why should I care about what you think when my stream of social consciousness is as valid as yours? If I'm wrong, so what? I can be using a pseudonym for my tweets and posts, and as long as I have followers (real or purchased, which I can do to make my number of followers look bigger), I have an audience, who can re-tweet or forward my posts which stay in the blogsphere indefinitely. I simply need gullible acolytes to repost and retweet and not question or bother with pesky facts. Which leads to the third point: Most social media users act before they think which, for many users, leads to an unfortunate downfall in social status or the loss of a high-ranking position. Social media has, therefore, added unnecessary complexity to the decision-making process of the average investor.

Sfumato Experts

In one of our summer reads "Leonardo da Vinci", by Walter Isaacson, da Vinci distained those that had "book" learning but lacked practical experience (he had only limited education, as hard as that is to believe). Unfortunately for today's investor, the plethora of "experts" generated from social media has multiplied exponentially to the point where it is "sfumato" (sfumato being the painting technique introduced by da Vinci that blurred lines in his paintings to the point of disappearing). The lines have blurred between what passes for good analysis from a true expert and that of the rank amateur. Combine this with what constitutes "good information" from "bad information" and you get a new investor mix paradigm on trying to make investment decisions.

A "sfumato expert" exists in order to generate followers and/or eyeballs that he/she can convert to advertising numbers, or to sell a newsletter or feed. If they are wrong with their information or predictions, there is little recourse from the investor. The

ever-expanding circle of Tweets and Blogs simply finds new candidates for those exiting the door.

Now, many of the analysts on CNBC, Fox Business News and Bloomberg are reputable individuals working in the trenches daily, in front of clients owning both their successes and failures. Many times, their failures are highly public with no pseudonym to hide behind, Jim Cramer comes to mind as the most obvious. Too many failures by these real experts and they are soon out of business, so they must achieve a high degree of expertise and precision decision-making. The "sfumato expert" simply disappears into the background.

DOMESTIC EQUITY STATISTICS

Index	2nd Quarter 2018
S&P Small Cap	8.41%
S&P Technology Sector	6.75%
Dow Jones Average	0.70%
S&P 500 Index	2.93%

(Period Ending 6/30/2018. Source: S&P Dow Jones Price Weighted Indices)

Company	Percentage Weight	2nd Quarter 2018
S&P 500		2.93 %
Energy	6.3%	12.69%
Materials	2.6%	2.05%
Industrials	9.5%	-3.66%
Consumer Discretionary	12.9%	7.84%
Consumer Staples	7.0%	-2.34%
Health Care	14.1%	2.66%
Financials	13.8%	-3.58%
Technology	26.0%	6.75%
Telecommunications	2.0%	-2.33%
Utilities	2.9%	2.80%
Real Estate	2.9%	5.13%

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

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Style Return Box for the Second Quarter 2018

	VALUE	CORE	GROWTH
LARGE	0.8%	2.9%	4.9%
MID	4.8%	4.3%	3.0%
SMALL	8.1%	8.7%	8.7%

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

Domestic Markets

What a difference a quarter makes. If you wish, you can pull down our First Quarter 2018 Market Commentary (https://www.integerwealth.com/market-commentary) to review the performance of the individual sectors for the first quarter. A real turnaround to be sure despite the political and economic machinations that were churning in the first quarter of this year. Without question we were heading to war with North Korea, alienating our partners and looking for a trade war with the rest of the world. On March 23rd the Dow fell 700 points on trade war talks. The revolving door at the White House continued revolving as Rex Tillerson was fired as Secretary of State, there was more turnover in the White House, it was all looking bad and confusing. The silver lining was corporate earnings, an unemployment rate that was falling and more individuals realizing a bigger paycheck from the 2017 tax reform.

Fast forward to the second quarter and, as usual, things have a way of working themselves out. United States and North Korea sat down for the first time in over 50 years. Unemployment hit new lows. Investors began to understand the subtlety of trade negotiations (no different than trading your lunch with another kid in elementary school), and the interconnectedness of the globe. There were more job openings than job seekers, the first time since 2000 when statistics for this metric began. Clearly something was clicking in the domestic economy as the trade discussions began to take form. The idea was not to punish, but to level the field for fair trade. Further, Washington began to rollback additional regulations to allow for small businesses and banks to invest and expand. Coupled with the newly

implemented lower tax rates and suddenly the United States began looking appealing again to investors from around the world.

Corporations that find themselves flush with cash are beginning to deploy that cash in a variety of ways. There are been bonuses paid to workers, dividend increases, and most notable mergers and acquisitions are back in vogue. Witness the AT&T / Time Warner merger that was recently approved, along with the bidding war for 21st Century Fox assets between Comcast and Disney. Initial Public Offerings have had one of their best years in nearly a decade, with more than 100 IPO's offered this year. So, it is no wonder that despite the doom-and-gloom scenario some analysts and politicians might suggest, the facts paint a different picture. So far, the U.S. economy is growing and getting stronger.

One way to measure that growth is to look at the returns in the chart above. Aside from large growth performance, the mid and small cap indices trounced the big caps. And that helps underscore the strength of the economy as mid and small businesses employ the vast majority of workers in the United States. With tax relief passed for these corporations, with small banks unburdened from the yolk of regulations, and a growing global economy, where better to reinforce a growing economy than in this sector?

International Markets

A much tougher time was being had for international markets as the "black hole" of the United States began to slowly suck investors back into its realm. The performance for international and emerging equities was downright awful for the second quarter of the year. The developed markets, as represented by the MSCI EAFE Index was down 2.84% through June 30th. For the second quarter it was down 1.96%. The emerging markets were down 7.44% through June 30th, and for the second quarter down 9.66%. Now, this is not necessarily the fault of the strength of the United States as a magnet for investors. Some of this is partially the result of poor economics, high tax rates and feckless political leaders not able to appreciate the dynamics of the model employed elsewhere in the world.

And just like the stock market is a market of stocks, so to is the international market. It isn't all bad, there are some countries within the international community and the emerging markets countries that are doing well. Part of the challenge for international investing is finding the right vehicle. While it is possible to invest in country specific exchange traded funds, there are only a dozen or, so countries represented for investors to select.

Granted on a price/earnings multiple, international markets are "cheap". Many international markets are trading around 25-year averages, some below that number. But there continue to be challenges. Eurozone unemployment stands at 8.4% with barely 2% GDP growth. Emerging markets are not much different. And Japan, the perineal underperformer for decades, has had a 20-year average GDP of 0.8%. Like we said, international is tough.

Fixed Income

First, it is nice to see investors getting paid something for holding cash. At the time of this writing, many money market funds are paying north of 1.5%. Much better than in the dark days of the financial crisis when they were getting 0%. The major concern today in the fixed income world is the flattening yield curve. Right now, a 30 Year Treasury bond pays 3%, while the short end of the curve, a two-year bond pays 2.6%. Therefore, who would buy a 30-year bond?

What market observers look for is the spread between the 2-Year Treasury and the 10-Year Treasury. Right now, there is about 20 basis points (.0020) of difference between those two. Economists suggest if that curve inverts, meaning 10-year Treasuries yield less than 2-year Treasuries, it could signal a recession. That is because as the price of financing goes higher, as represented by the short-end of the curve, business demand for loans slows. We are keeping our eye on the spread and the conversation, as there are some economists that do question the relationship since we are at historical lows in rates, even for the short-end of the curve.

What we can assume is that the Fed will do two more rate hikes then pause. With corporate earnings continuing to shine, the Fed has room to maneuver because they want that interest rate a bit higher. This gives them some room to cut rates should the economy hit an air-pocket. At current levels there is a thin-line for them to be able to stimulate the economy if needed.

What can an investor do during this period? Stay short, stay liquid and stay with quality. In fact, with cash yielding 1.5%, investors may simply put a bit more into cash as an asset class and eliminate any interest rate risk. As the Fed moves rates higher, that will only benefit investors who hold cash and many investors can begin looking at "de-risking" the portfolio. For example, investors that were forced into dividend paying stocks to generate income, can now consider paring that back and holding cash. Just a thought to consider.

Summary

It has been an enjoyable summer so far and the equity markets have found a continued reason for advancing despite the rhetoric from Washington, D.C. While we are not close to the conversations in the White House, it reminds us of President Roosevelt setting the prices for products from the comfort of his bedroom during the Depression. If this market is advancing with the talk of tariffs in the air, imagine what it could do if those talks are dropped? All the more reason to be in the markets with a solid balanced portfolio.

And as we outlined at the beginning of the commentary, it is important sift through and tune out the noise of "sfumato experts" and really focus on real facts and related analysis from those that know the markets best. We have a few that we like, Rick Santelli of CNBC comes to mind, Josh Brown, the CEO of Ritholtz Wealth Management, along with the likes of Leon Cooperman and Ken Langone who are folks that make a lot of sense.

Our job is to make sure to separate the "wheat from the chaff" as we continue to watch over client total wealth; from their investments to their estate plans. We've

been in this business long enough to know that it isn't easy growing wealth; it takes time and patience, sort of like watching the first coat of paint dry when you are eager to start the second coat. More importantly, it's equally important to recognize when you have made a mistake with a market thesis. It's part of the process that successful investors have mastered.

Our thesis continues to be diversification, weighted toward domestic markets with a high degree of tax efficiency. The thesis is highly interconnected, with tax efficiency being the linchpin, since it is what you keep, after taxes, that measures wealth creation. We know that from the sage advice of Warren Buffett. So far, it's been a winning strategy and we will continue to promote that thesis for the foreseeable future.

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