# Integer Wealth Advisors Group, LLC

***Advise, Guide and Protect***

## Third Quarter 2016 Market Commentary

We start every market commentary by highlighting an observation from our previous commentary. Here is what we said last quarter regarding the Fed and raising the Fed Funds rate:

*With a tip-of-the-hat to the Cleveland Cavaliers, the market had its own remarkable comeback during the second quarter of this year. Considering the shaky start for the markets, (recall the Cavs were down 3-1 in the series) at the beginning of the year, things went south quickly to hit bottom on February 11th, with the Dow closing at 15,660. It is hard to imagine that in five short months the markets have gained by 3,000 points. So much for timing the market.*

## The "Three D's" of Investing

Just when you think you are a pretty smart person, you get to go to a dinner party and sit with really smart people. That happened recently when we attended a school function and found ourselves at the Headmaster's table. Sitting to the left of us was a young chap and his wife. After the normal dispensing of pleasantries, the exchange of business activities followed. Turns out our table guest couldn't figure out what he wanted to do in life. After graduating from Georgia Tech with a degree in biomechanical engineering, he decided to become a fighter pilot and fly F-15's, which he did for eight years. Upon leaving the military he decided to go to med school and become an orthopedic surgeon while maintaining an adjunct professor role at Georgia Tech teaching biomechanical engineering. By the time he was done, we were an inch tall.

Obviously we thanked him for his service in the military and asked how it felt to fly F-15's. That's when he shared with us the secret of successful flying (which we converted to successful investing,). First, flying the F-15 was simply the coolest thing ever. Precision machinery that responds to the lightest touch with no need to fight the stick to make it go where you wanted to go. Second, it was enjoyable so long as he remembered what he was taught in flight school. He told us that while he was training to fly his flight instructor started every lesson with the same admonishment: Don't do anything Dumb, Dangerous or Different.

And there you have it, the "three D's" of successful investing. Avoid doing dumb, dangerous and different things with your investments, and use a light touch! Pretty simple advice especially coming before the throes of an election that will be unlike anything we have seen in our history. Everyone is trying to figure out the best "position" heading into the election. What will it be like if Hillary wins, what about "The Donald"? We have some thoughts on the subject in the following pages. But first, a review of the markets.

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## DOMESTIC EQUITY STATISTICS

| Index | Returns for the Quarter |
|---|---|
| S&P Small Cap | 7.20% |
| S&P Technology Sector | -1.26% |
| Dow Jones Average | 2.78% |
| S&P 500 Index | 3.85% |

(Total Returns. Period Ending 9/30/2016. Source: S&P Dow Jones Indices)

| Company | Percentage Weight | Year to Date 2016 |
|---|---|---|
| S&P 500 | | 7.84% |
| Energy | 7.3% | 18.72% |
| Materials | 2.9% | 3.71% |
| Industrials | 9.7% | 10.87% |
| Consumer Discretionary | 12.5% | 3.64% |
| Consumer Staples | 9.9% | 7.55% |
| Health Care | 14.7% | 1.37% |
| Financials | 12.8% | 1.40% |
| Technology | 21.2% | 12.51% |
| Telecommunications | 2.6% | 17.86% |
| Utilities | 3.3% | 16.13% |
| Real Estate | 3.1% | 8.07% |

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

## Style Return Box for the Third Quarter 2016

| | VALUE | CORE | GROWTH |
|---|---|---|---|
| LARGE | 2.94% | 3.85% | 4.76% |
| MID | 4.52% | 4.14% | 3.73% |
| SMALL | 7.23% | 7.20% | 7.17% |

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

**Becalmed Markets**

Becalmed is an adept description for the markets during the third quarter of the year. For those with a nautical flair, becalmed describes the state of a sailing ship when it cannot move because there is no wind. To put it in perspective of "becalmed", the Dow started the quarter at 17,929, trading as high as 18,613 on August 11th, only to enter the "scary" month of September with barely a wave above 3 feet!

For the month of September, the Dow finished below its starting point by 111 points and had two days of some big moves greater than 100 points. It's a month like September that drives "volatility" traders crazy because there is none. Traders did get *some* volatility as a result of a nuke test by North Korea and differing Fed views on whether rates should go higher. Other than that? Nothing.

August was pretty much the same, the market started and stopped within a four-point range. August did, however, see the all-time high for the Dow, S&P 500 and the Nasdaq. On August 15th those three averages set all-time highs on the same day, the first time that occurred since December 1999.

Now December 1999 was the final month of what turned out to be one of the best five year stretches in decades, only to be followed by three years of misery. We are not suggesting the same (unless your guy or gal doesn't win the Presidency), but market pundits like to point out such occurrences. Back then the technology sector was nearly 40% of the S&P 500, today it is just cracking 20%. So no need to hit the panic button just yet.

The Fed punted once again at the September 21st meeting, delaying the inevitable rate hike until, many believe, December. Regardless of how they played it, the move is seen as political in many circles. Not moving, or moving, they were damned either way. Their message however was quite befuddling and mixed. During the conference after the meeting, Janet Yellen cited short-term issues that were completely opposite of longer term forecasts. Business growth looks good longer term, but weak in the shorter term. So investors will wait for November, for both the outcome of the elections and the decision of the Fed. It will all be very interesting.

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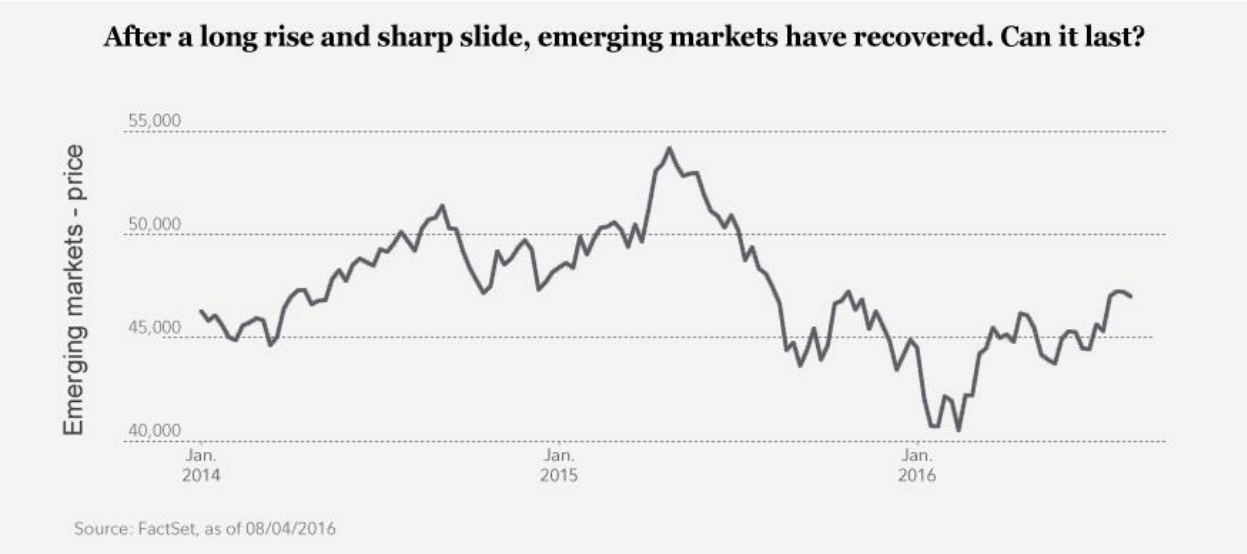
**INTERNATIONAL**

With Brexit firmly behind the markets for the moment, international investing began to look a bit more interesting, that was until the EU Competition Committee decided to move the goalposts on one small company called Apple. In August, the EU Competition Committee announced the imposition of a $13 billion fine on Apple related to Ireland's tax treatment of Apple's profits. Is it any wonder that the U.K. wanted to leave the European Union in order to control its economy and regulatory bodies? This attempted theft makes London all the more appealing since the tax laws would not be re-written overnight.

Despite that news, Fidelity suggests a brighter outlook for developed international markets while emerging markets are still rebounding after a hangover from China's infrastructure boom. There is still a lot to recover from the early 2015 emerging markets peak, and recent interest rate movements continue to rattle the section. When central bankers lower rates, the commodity driven emerging markets rally; when they "take the punchbowl away" by raising rates they drop. It's a tough space for investors.




Toward the end of September, the international markets were given a slight jolt as Deutsche Bank was hit with a $14 billion penalty related to mortgage security deals. What drove investor concerns was if the bank would need to raise capital following the proposed settlement with the Department of Justice. With new capital requirements in place as a result of the 2008 financial crisis, most market observers seem to think DB has plenty of capital on hand, and could do another raise if necessary without spooking the markets.

Finally, we were reminded that not all market moves are due to economic activity. North Korea rattled the markets, literally, by exploding a nuclear device on the 9th of September. The largest device they have exploded to date, the test confirmed that the "little dictator" Kim Jong-un, has his ambitions set on becoming a nuke power.

**FIXED INCOME**

If there were an MVP award for securities this year, the fixed income market would definitely be in the running for the award. Like the energizer bunny, it just has kept going and going. And why not? With the Fed on perpetual hold regarding rates, investors have piled into the sector, perhaps in some areas with reckless abandon. Having said that, the municipal market is one area that investors can consider. Municipals have kept their "steady Eddie" façade as cities and states collect taxes and pay out income like an ATM machine. The move into the perceived "safety of bonds has resulted in significant yield compression in the high quality fixed income space. Over one-halfof the rate of return on many municipal bond funds has come from appreciation over yield. This will provide some cushion for those that have been in these positions for some time. The eventual rise in rates will take back some of this appreciation which will be offset to some extent by yield A current look at the yield curve suggests keeping the average duration between 3 and 4 years.

Meanwhile, on the corporate bond side of the equation, companies continue to take advantage of favorable low interest rates by issuing more debt. With eager investors willing to take all they can shovel out, companies find themselves with the inevitable problem of what to do with the cash? Pay off old debt, invest, increase the dividend of the stock or buy back stocks? Most are opting for dividend increases and buy backs which further enhance the desire to own equities. So the low interest rate environment can be accused of helping to push the stock market higher.

What's an investor to do? We suggest the following:

- Anchor your portfolio with high quality bonds
- Stay short to lessen interest rate sensitivity
- Add municipal bonds for lower correlation to the equity market

One word of caution, especially with the municipal bond market. If there is a "bubble" brewing in the municipal market, it can be found in the liabilities section of most states, cities and counties. The state of Illinois is a poster-child on the subject matter. Years of low rates of return have masked a problem that your local Mayor does not wish to confront: Most places are "upside down" on their pension liabilities because of low actual returns and high expected return assumptions. Clearly there

is a disconnect. So, when investing in the municipal bond market make sure to use the first two bullets noted above when building the bond portfolio.

**EQUITIES**

What's not to like about an asset class that has had an extremely good, resilient year for investors for the first three marking periods? Despite August and September being somewhat non-volatile, their march higher was driven by continued good earnings, lower unemployment and continued low interest rates. Energy prices, no doubt, had some role to play which put more disposable income in the pockets of consumers.

What areas did investors favor? Well from the charts at the beginning of this report they liked the small guys, in both value and growth stripes. With the improvements cited in the economy, the backbone of America's productivity is found in the entrepreneurial spirit of small and mid-sized companies.

**IN SUMMARY**

The first three quarters were challenging for investors to stay focused and attentive to their portfolios, especially when you look back to February 11th when the Dow hit 15,660. That is not a typo, the market was nearly 3,000 points lower than the market close on September 30, 2016. Yet another lesson as to why it is so important to tune out noise and concentrate on the asset allocation and tactical moves for the portfolio.

As we stated earlier, the next big item for investors comes in November with the elections. Investors had the same apprehensions today as they do in most major elections, only this time it's a bit more interesting! As in elections past, regardless of which party occupies the big seat, investors learn to adjust. One mistake to avoid is becoming a "sore loser investor". By that we mean an investor validates his or her unhappiness with the election by making radical shifts in portfolio allocation. A close companion to this was the same investor habit that was exhibited in March of 2009 when investors, upset with the state of the markets, swore off "ever investing in stocks again" and opting for Treasury bonds. Colossal mistake for sure.

Our recommendation? Remove emotion of the election from the emotion of investing. Somebody is going to win and somebody is going to lose. Which side you fall on will make you happy or sad, try to stay level-headed because there is a lot of work to accomplish for the winning candidate. The "sore loser investor" is a bad persona to take on; it will lead you to make mistakes with your portfolio. Fortunately, the election is in November so you have time to prepare.

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