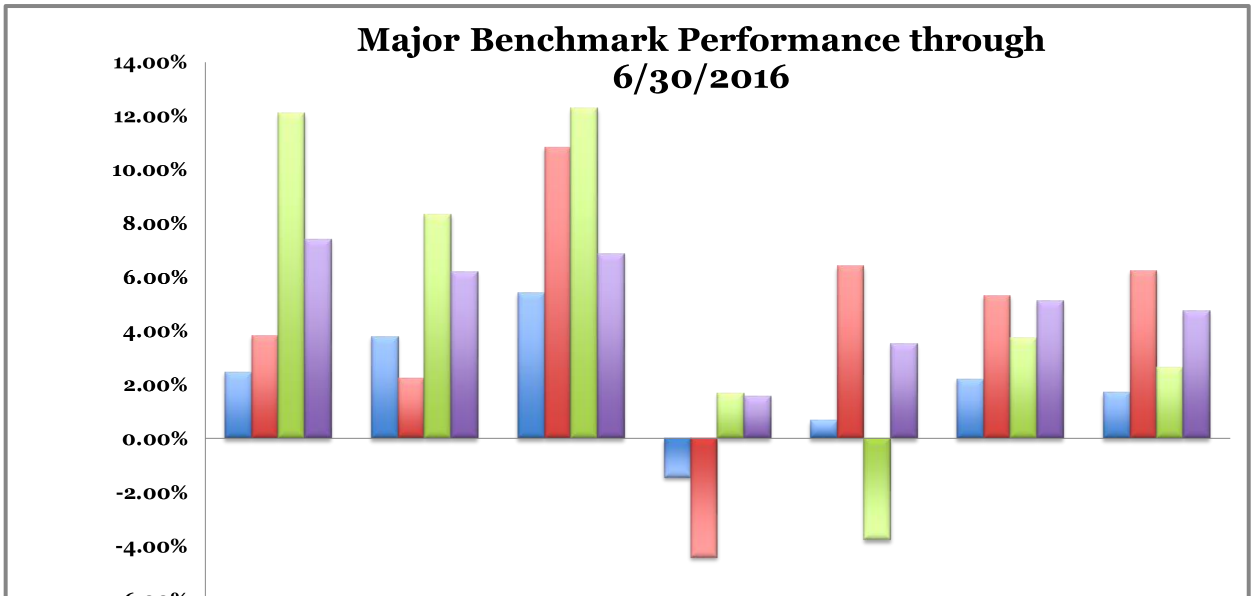
integral financial solutions

Integral Financial Solutions

Market Summary and Outlook Second Quarter 2016

All major market categories are positive for both the 2nd quarter and year to date through June 30 with the exception of developed market equities. The UK is about 20% of this benchmark so it is not surprising the unexpected Brexit vote affected those markets.



	S&P 500	US Small Cap	US REITs	Foreign Developed	Emerging Markets	US High Quality Bonds	TIPS
2Q16	2.46%	3.79%	5.42%	-1.46%	0.66%	2.21%	1.71%
YTD	3.84%	2.22%	10.82%	-4.42%	6.41%	5.31%	6.24%
5 Year (ann.)	12.10%	8.35%	12.30%	1.68%	-3.78%	3.76%	2.63%
10 Year (ann.)	7.42%	6.20%	6.86%	1.58%	3.54%	5.13%	4.76%

Source: DFA

There are several developments that stood out in the 2nd quarter, the biggest being the Brexit vote that blindsided stock markets all over the world. The Dow Jones Industrial Average dropped about 1,000 points in the first two business days after the vote but fully rebounded within two weeks. Currently (as of July 18), US equity markets are at all-time highs. European and the UK markets have also rebounded although this issue is by no means settled.

The 10 year US Treasury yield dropped to an all-time low of 1.36% following the Brexit vote. When demand increases for a Treasury (in times of equity market volatility), it drives bond yields down. Now that markets are more settled, the 10-year yield is back up to 1.58%, still very low historically.

We were surprised by how quickly headlines that dominated the news earlier in the year such as the Panama Papers have receded back into the shadows. In this newsletter, we will comment more on this quarter's concerns: Brexit and negative interest rates.

Brexit
On June 24, the UK voted unexpectedly to leave the European Union. The result took everyone by surprise, including the politicians who led the LEAVE campaign. Since the vote, these leaders have all resigned. Prime Minister David Cameron, a Conservative who was in favor of staying in the EU, also resigned.

With this power vacuum, the blind are leading the blind. The move is unprecedented. Now British politicians are trying to backtrack with the EU and maintain some of the economic ties while restricting immigration. The EU's response is to push ahead with the "divorce" sooner rather than later.
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Negative Interest Rates
Post-2008, central banks all over the world have lowered their interest rates to encourage borrowing and spending. Some have increased rates faster than others but all remain historically low. Our central bank, the Federal Reserve, raised rates in December 2015 by .25%. This was the first increase in 10 years. The market reacted by promptly pushing rates back down. With all the uncertainty in 2016, including Brexit, the likelihood this dovish Fed will raise rates in 2016 is now quite low.
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Gold - A Safe Haven?
During times of market uncertainty individual investors frequently invest in gold and since these are uncertain times, it is no surprise that gold is attracting attention. Despite all the scary headlines, we generally do not recommend commodities (e.g. gold) as an investment.

Contrary to what many investors think, gold has not been an effective hedge against inflation in the short- or medium-term. For an investor to enhance earnings by investing in gold, they have to actively time the market, knowing when to buy and sell. As you know from our discussions, the empirical data shows that investors cannot accurately time the market over the long term (their own investment horizon). CLICK HERE TO READ MORE

US Economy
We continue to plod along in a slow recovery. With the possible exception of the UK due to the Brexit vote, PIMCO and JP Morgan do not expect any other developed markets to enter into recession in the near term.

Within the US, GDP is averaging an annualized 2%. Unemployment continues to drop. As of the last report (July 8), the unemployment rate is 4.7%, low enough that it is starting to put upward pressure on wages. Considering 2/3 of the US economy is consumption, an increase in wages is a welcome change.

Earnings expectations for the quarter are more muted. Analysts expect earnings per share to be down, making this the 5th straight quarter of lower earnings. Factors to consider are lower oil prices, low interest rates, and a slowing merger market. However, these same analysts believe earnings will pick up in the 3rd and 4th quarters. It is because of this uncertainty that the Fed is reluctant to raise rates now.

CONCLUSION
Prior to the Brexit vote, the odds of the UK leaving the EU were around 30%. The result of the vote reinforces our philosophy that trying to predict the future and attempting to profit from noticing what others miss is an exercise in futility. We fully acknowledge the markets have been relatively flat over the past two years. However, that does not change our philosophy of NOT trying to time the markets or find the new hot investment. Our recommendations take into account your specific time horizon (which is generally long term) and your specific financial plan. More time (i.e. more than two years) allows for flat and down years, offset by positive ones.

While we are at a crossroads politically in this country, we do not see it as a justification to make major changes to your portfolios.

We thank you for your confidence in us and encourage you to call or email any time.

Sincerely,
Janet & Barry

Sources: Dimensional Fund Advisors (DFA), PIMCO, JP Morgan, Morningstar, New York Times, Schwab, Vanguard, Wall Street Journal.