THE LUBITZ FINANCIAL GROUP

Market Watch
2nd Quarter 2017

July 2017 www.LubitzFinancial.com

Summary

- Stocks enjoyed strong positive returns over the last 12 months, in both the U.S. and overseas.
- U.S. markets, as represented by the S&P 500 Index, rose 17.9% in the last 12 months. Small U.S. stocks were even better at 24.6% (Russell 2000).
- The world's developed economies, as represented by MSCI EAFE, rose 20.8% over the last year while small overseas companies were up 23.6%.
- Emerging market stocks rose 24.2% year-to-date (MSCI Emerging Markets Index).
- With interest rates rising, bond market returns over the past year have been impacted and most bond indexes were slightly negative.
- Economists believe that inflation will remain benign for the immediate future, and that interest rate increases from the Fed will likely be implemented slowly, with careful consideration.
- Given the variety of alternative strategies we hold, inevitably some performed better than others during this period. The category as a whole was comfortably positive. Among the leaders were real estate and reinsurance.
- We remain optimistic that markets and the economy will continue to grow.

The Lubitz Financial Group

9350 S. Dixie Hwy., Suite 1500

Miami, FL 33156

www.LubitzFinancial.com

305.670.4440

LindaL@LubitzFinancial.com

Overview

There were few surprises in the second quarter of 2017, as market performance continued the positive progress achieved in the first quarter of the year. International and domestic markets again produced positive returns for equity investors. In the United States, large company stocks showed nice gains. Smaller company returns, while still positive, were more muted. Both large and small company returns in the developed overseas markets were stronger than those in the U.S., thanks in part due to currency valuation changes. Despite significant positive performance, developed international market returns notably lagged behind returns achieved in the emerging markets (where returns were benefited from both strengthening currencies and improved economic growth).

In the U.S., large companies (especially technology companies such as Facebook, Apple, Amazon, Netflix, Microsoft and Google) did well this quarter, and have been strongly positive year-to-date (YTD). The Standard & Poor's 500 (S&P 500) rose 3.1% for the quarter, and is up 9.3% YTD. The tech-heavy NASDAQ Index experienced even stronger growth, rising 4.2% for the quarter and 14.7% since January 1. In contrast, domestic small caps lagged behind their larger U.S. counterparts. The Russell 2000 Index was up a more modest 2.5% for the quarter and has risen 5.0% YTD.

Market Returns

2015	2016	YTD
REITs 2.8%	Small Cap 21.3%	EM Equity 18.6%
Large Cap 1.4%	High Yield 14.3%	DM Equity 14.2%
Fixed Income 0.5%	Large Cap 12.0%	Large Cap 9.3%
Cash 0.0%	Comdty. 11.8%	Asset Alloc. 6.8%
DM Equity -0.4%	EM Equity 11.6%	High Yield 6.5%
Asset Alloc. -2.0%	REITs 8.6%	Small Cap 5.0%
High Yield -2.7%	Asset Alloc. 8.3%	REITs 4.9%
Small Cap -4.4%	Fixed Income 2.6%	Fixed Income 2.3%
EM Equity -14.6%	DM Equity 1.5%	Cash 0.3%
Comdty. -24.7%	Cash 0.3%	Comdty. -5.3%

Bonds were generally positive for the quarter as well as on a year-to-date basis. As is normally the case, thanks to higher yields, intermediate bonds slightly outperformed shorter-term bonds. International and emerging market bonds both enjoyed a positive boost from the weakening dollar.

Given the diverse nature of the various strategies involved, the alternatives sector experienced both good and bad this quarter and over the last 12 months. Business development companies, found in our more aggressive portfolios, fell back this quarter, but have risen 4.3% YTD and more than 19% over the last 12 months. Timber showed a very small loss for the quarter but is up 12.7% YTD and over 17% for the last 12 months. On the other end, the managed futures category has consistently struggled over the last year, declining by 5% during the quarter and by more than 13% over the last 12 months. Declines in the energy sector combined with volatility in many of the underlying asset types have both contributed to this weak performance.

Signaling their belief in a strengthening U.S. economy, in June the Federal Reserve again raised interest rates. The Fed has also signaled its intention to continue to slowly bring interest rates back to more "normal" levels from the extraordinarily low rates we've enjoyed for several years. Along with gradually increasing interest rates, the Fed must also address the huge accumulation of Treasury bond holdings it amassed in its effort to stimulate the U.S. economy following the financial crisis. To this end, this quarter the Fed announced its plans to begin selling off some of the $4.5 trillion in Treasury bond holdings in its portfolio.

The U.S. Economy

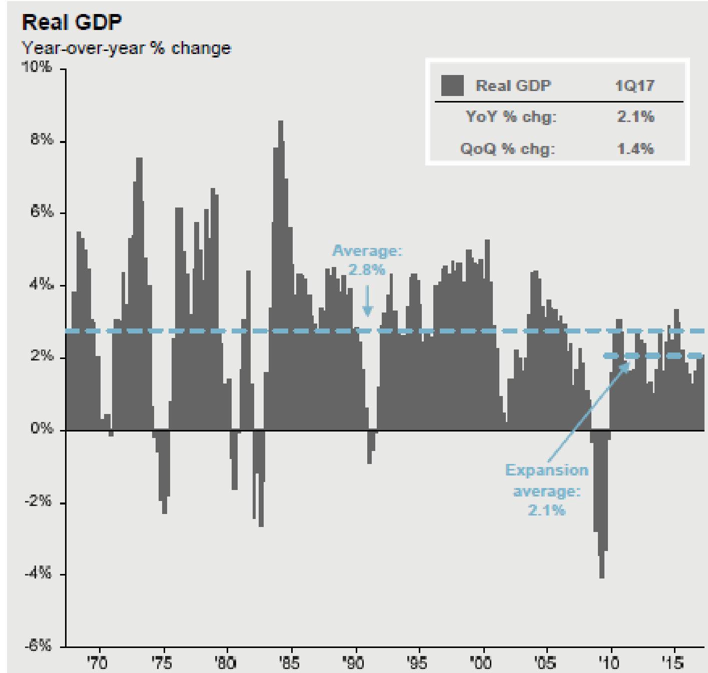
Mainstream experts largely agree that the U.S. economy is experiencing relatively positive economic growth. Record low unemployment numbers, improving wage growth, a benign inflationary environment, and growing consumer confidence are all strong indicators that both the U.S. economy and capital markets have largely returned to more "normal" functioning.

GDP Forecast

According to the Commerce Department, the U.S. GDP expanded at a seasonally and inflation-adjusted annual rate of 1.4% in the first quarter of 2017. This economic expansion, which began in July 2009, is already the third-longest expansion in contemporary U.S. history (only the expansions of the 1960s and 1990s were longer). Despite its longevity, the current expansion has been weaker than past recoveries. Since 2009, GDP growth has averaged just 2.1% a year. This compares to a growth rate of 3% or more in past recoveries (a growth rate not seen since the 1990s). It remains to be seen whether the administration will be successful in implementing its planned economic program of tax cuts, regulatory rollbacks, and infrastructure spending.

Employment

Employment numbers are important: if people are working and wages are healthy, spending increases. This creates opportunities for continued growth and economic development. The U.S. has continued to add jobs, bringing the economy to nearly full employment. The jobless rate was 4.4% in June. While this number suggests good economic health, only 60% of all Americans 16 years and older are working. According to data from the Bureau of Labor Statistics, this is notably below historic norms. Moreover, wage gains continue to be modest—rising only 2.5% year over year. Some economists, including the Fed, believe that weak productivity is the main reason for constrained wages.



U.S. Housing

The U.S. housing market can be characterized as having strong demand limited by tight inventories. This continues to push prices higher. According to the National Association of Realtors, new home sales rose 2.9% over last year, while previously-owned property sales rose 1.1%.

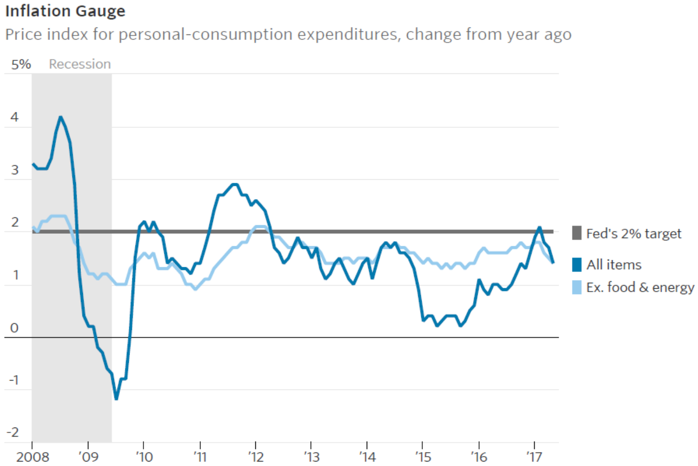
Home prices for new homes have climbed steeply since their decline during the recession. This May, prices reached all-time record highs. The median sale price for a new home sold in May was $345,800 (the highest recorded dating back to 1963). The average sale price also came in the highest on record at $406,400.

Mortgage rates stood at 4.0% for a 30-year fixed-rate loan in May. This is still considered quite low by historical standards.

Consumer Confidence and Inflation

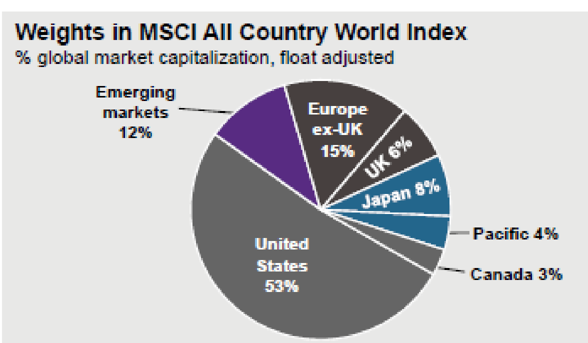
U.S. consumer sentiment declined in June, continuing a trend begun following last fall's presidential election. While American optimism has edged down, consumer spending hasn't slowed much. Consumer spending, which accounts for more than two-thirds of U.S. economic activity, rose 0.1% last month, according to the Commerce Department.

Despite positive job growth and a continuing rise in consumer spending, inflation still remains modest. On an annualized basis, consumer prices, excluding food and energy, rose 1.4% in May.



The World Economy

Over the past few years, although returns in the U.S. stock market have been attractive, international returns have experienced more challenges. This relationship shifted in the first half of 2017 with non-U.S. stocks experiencing the strongest returns. This can be attributed to growing overseas corporate profits, relatively attractive valuations and a weakening U.S. dollar. Global developed markets, as measured by MSCI Europe Australia Far East Index (EAFE), were up 6.4% in the second quarter of 2017 and 14.2% YTD. The MSCI Emerging Market Index finished the second quarter up 6.4% and is up 18.6% year-to-date. While volatile oil and commodity prices remain a concern in economies like Brazil and Russia, stronger global growth and a weakening U.S. dollar have been boosting emerging market returns.



The Euro Area

The eurozone continues to exhibit positive signs of economic growth, with the equity markets responding accordingly. With the results of French election and no major political surprises expected from Germany, Europe's political climate has stabilized, for the present. Brexit's surrounding uncertainty has seemingly had little effect on the economic stability of the eurozone. Moreover, Italy has finally taken important steps to rein in their banking problems. The eurozone economy expanded by 1.9% in the first quarter of 2017 while unemployment fell to 9.3% (still a very high rate). Inflation also appears to be under control, coming in at 1.3% in June. This remains below the European Central Bank's 2% target rate.

Japan

In the Asia-Pacific region, Japan has been able to moderate the need for current stimulus policies as its economy has begun to show moderate growth. Japan's GDP expanded 1% in the first quarter of 2017. A number of other economic indicators suggest a continued growth in exports and factory output. Wage growth and household spending remain lackluster despite a tight job market. Core consumer prices rose just 0.4% in May from a year earlier, well below the Bank of Japan's 2% target.

China

News from China has also been largely positive. The Chinese government is well aware of its over leveraged debt situation and appears to be taking action to address this situation. The government's capital control regulations have also been moderately successful in managing the renminbi currency. Recently, the MSCI Emerging Market Index announced it would begin to include mainland Chinese stocks as a small portion of its index starting in 2018. While a small step in actual investing impact, it is an indicator of the slowly maturing character of Chinese capital markets. The good news from China is that its capital controls have become effective and the volatility of the local currency has diminished. During the first quarter of 2017, China's economy expanded at an annualized rate of 6.9%, exceeding the government's full-year growth target of around 6.5%.

Elsewhere

Emerging markets have been through a lot over the past few years, but the first half of 2017 has been a bright period. For the first time in almost three years, four of the world's biggest emerging markets, the BRIC economies (Brazil, Russia, India, and China) are all growing at the same time. Russia has regained its footing with the ruble gaining 15% against the dollar over the past year. Brazil's political scandals remain far from resolved, but its economic situation has improved with the economy growing at roughly a 4% annualized rate. Inflation has eased in Brazil, just as it has in Russia and India. India has been taking important steps to rationalize its economy, leading to improved optimism.

Investments

Since the beginning of 2017, global stocks have enjoyed one of their strongest periods in several years. Only four of the 30 major country indices have failed to show positive returns. Improving economies, central bank support, rising consumer sentiment and vigorous tech industry growth in both the U.S. and China have all contributed to robust capital market returns. Despite the many questions that may still exist, we continue to enjoy the second longest bull market in modern capital market history.

United States Equities

Major U.S. market indexes again reached record highs during the second quarter of 2017. The S&P 500 Index rose 3.1% for the quarter and is up 9.3% year-to-date. Except for energy, all major sectors of the U.S. economy posted positive quarterly returns. The healthcare and financial sectors experienced the strongest, gains rising 7.1% and 4.2% respectively over the quarter. The S&P 500 has now risen more than 258% from its March 2009 lows (excluding dividends) and at year-end was 91.2% above its October 2007 peak.

Stock valuations are somewhat above historical norms. To some, this suggests stock prices are too high. Others believe stock valuations are about right given still low interest rates and the improving nature of world economies. The current dividend yield for the S&P 500 stood at 2.1%.

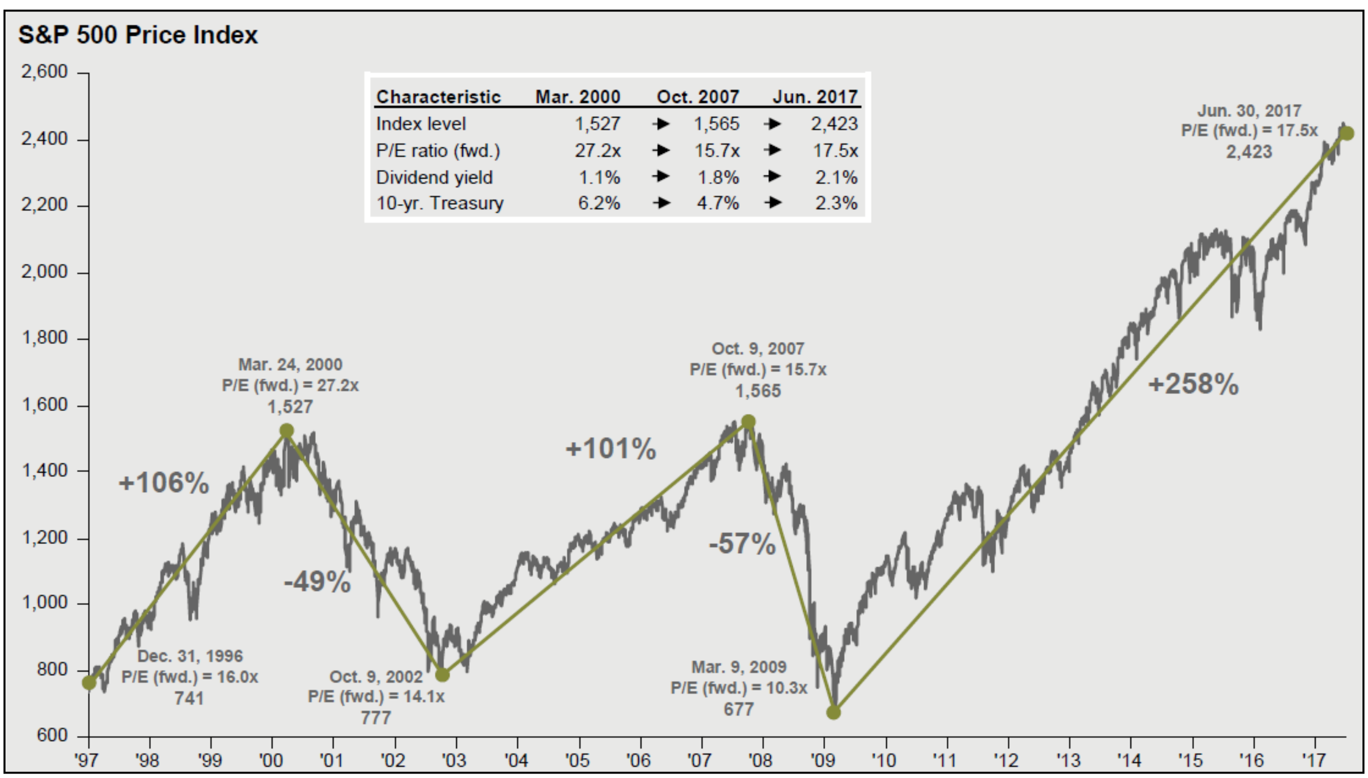
International Equities

International markets posted even better performance than U.S. markets both in the second quarter and on a YTD basis. Continuing U.S. dollar weakness during the second quarter added to investors' gains overseas. The MSCI EAFE Index, the most widely-used international index, rose 6.4% during the second quarter and 14.2% year-to-date. Japan, by itself, posted a solid gain of 5.2% and is up 10.1% YTD in dollar terms. European markets posted gains of 7.7% for the quarter and are up 15.9% year-to-date in U.S. currency.

The developing world showed a somewhat similar growth story. The MSCI Emerging Markets Index rose 6.4% last quarter. The returns of the emerging market economies were boosted by a weaker dollar and an improving domestic economic outlook. Year-to-date, the MSCI Emerging Markets index was up 15% in local currency, while gaining 18.6% for U.S. investors. Of the BRIC countries, only Russia was negative during the second quarter of 2017, mostly due to volatile oil prices and a reaction to the additional economic sanctions proposed by the U.S. government.

Fixed Income

Fixed income markets had little reaction when the Fed increased interest rates by another 0.25% in June. The Fed's key interest rate will now hover in a range between 1% and 1.25%. The highly anticipated rate hike did not adversely affect bond market performance during



Characteristic	Mar. 2000		Oct. 2007		Jun. 2017
Index level	1,527	→	1,565	→	2,423
P/E ratio (fwd.)	27.2x	→	15.7x	→	17.5x
Dividend yield	1.1%	→	1.8%	→	2.1%
10-yr. Treasury	6.2%	→	4.7%	→	2.3%

the second quarter. The Barclays Capital U.S. Bond Market Index posted a 1.4% gain for the quarter and was up 2.3% year-to-date. The yield on 10-year Treasuries fell to 2.3% (from 2.4% in Q1). The return on the 10-Year has been 2.1% YTD.

Treasury Inflation-Protected Securities (TIPS) reflect investor expectations about future inflation trends. Given softer inflation numbers during the last 3 months, U.S. TIPS were down 0.4% for the quarter. TIPS returns are still positive for the year, having gained 0.8% so far.

Emerging market debt posted positive results for both U.S. and local investors. The JP Morgan Emerging Markets Bond Index (which tracks bonds issued in dollars) was up 2.4% in the second quarter and 6.3% year-to-date. For EM bonds issued in local currency, the gains were 1.9% in the second quarter and 7.2% YTD.

Alternatives

Our alternative holdings produced mixed returns during the second quarter of 2017:

- Global real estate—as represented by the NAREIT Global Index, was up 3.7% for the quarter, and is up 7.2% year-to-date. The index was down in the latter half of 2016. Accordingly, one-year returns are up a more modest 3.1%. Overseas real estate returns have benefitted from the weaker dollar.
- MLPs—as measured by the Alerian Master Limited Partnership Infrastructure Index, energy infrastructure MLP prices fell as oil prices were falling in 2014 and 2015. The index rebounded in 2016 as oil prices began to recover. With oil prices again declining so far in 2017, the index declined 6.9% for the quarter and is down 3.1% year-to-date. The index is up modestly over the last 12 months with a gain of 1.2%.
- MultiAlternatives—as measured by the Credit Suisse Hedge Fund Index, was slightly positive for the quarter with an increase of 0.76%. The index is up 2.8% since the beginning of the year.
- Managed Futures—as measured by SG Trend Index, declined 5.0% this last quarter and is down 13.2% over the last 12 months. Although returns have been weak, we believe managed futures is a valuable diversifier in our portfolios. Historically, they have virtually no correlation with stocks or bonds and have been able to provide helpful ballast in past periods. Declines in the energy sector combined with volatility in many of the underlying asset types have both contributed to this weak performance over the past few years.
- Reinsurance—as measured by the Swiss Re Global Cat Bond Index, increased modestly this quarter, up 1.0%. The index is up 2.0% since the beginning of the year.

Conclusion

The recent quarter and last year-to-date have been good to investors. Investment returns are reflecting the continued economic growth in the U.S. and improving economic stability and growth in Europe, Japan, and the developing world. While the state of U.S. and world politics makes many understandably nervous, the near-term future for almost all the world's economies and markets looks positive. We've hit record highs with U.S. stocks, but prices still seem to be within reason. Europe and Japan have plenty of catching up to do, but the building blocks seem to be in place. We feel generally positive about the future.

Thank you for allowing us at The Lubitz Financial Group to be of service to you. We feel honored and privileged that you have chosen us and we will do our best to continue to earn that trust.

Your Team at

THE LUBITZ FINANCIAL GROUP

Personal Financial Planning & Investment Management

Sources: *Morningstar, JP Morgan, Reuters, Blooomberg.com, NYtimes.com, WSJ.com, U.S. Bureau of Labor Statistics, Fact Set, Standard & Poor's, Russell Investment Group, National Association of Realtors, University of Michigan.*