TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

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EXECUTIVE SUMMARY

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Stocks Have Wild BREXIT Ride In Last Week Of Q2

In the Second Quarter, the domestic S&P 500 Index was up a modest 2.46% and is up 3.84% through two quarters. However, it was a wild ride. The S&P 500 Index fell more than 5% in the two trading days subsequent to the June 23 BREXIT vote, yet almost fully recovered by quarter end. European stocks did not fare nearly as well. Year-to-date, the S&P 500 Index is the only developed market in positive territory. Emerging Markets (+0.66%) was led again by Brazil and Russia versus China. The Barclay's bond index rose 2.49% and is up 5.35% year to date.

The BREXIT Vote: A Strategy Game-Changer

The U.K.'s decision to leave the EU was a surprise. While we were relieved to see a quick initial market recovery, we are not discounting the longer-term implications of BREXIT. We believe they are serious.

We have three concerns about Europe: First, the ECB initiatives to grow the economy are barely working. Second, the existence of the EU is being threatened. Third, the investment environment is uncertain. We will reduce European exposure.

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The BREXIT Vote: A Strategy Game-Changer

The United Kingdom Voted To Exit The European Union On June 23

In a referendum vote on June 23, the United Kingdom decided to exit the European Union (the media has given the name "BREXIT" to this event). The vote was very close (roughly 52% for leaving and 48% for staying) and it was a surprise result. What happened? There are many possibilities. A liberal Britain likely worked better for the younger generation (who tended to vote "stay") than the older generation. Many "leave" voters were upset about EU-mandated immigration. There was sentiment that EU participation cost more than the benefits it provided. And finally, the British media said there was no cost to voting "leave".

Leading up to June 23, the stock market rose in anticipation of a "stay" vote. When the vote went the other way, there was initial shock. Global stock markets fell hard. Money flowed to bonds. The British Pound fell over 11%. Fortunately, the S&P 500 Index almost gained back everything it lost in only one week. While we were relieved to see a quick initial recovery, we are not discounting the longer-term implications of BREXIT. We believe they are serious and a strategy game-changer. We will reduce our European exposure.

Our Original Thesis: Increase European Stock Exposure

In the beginning of 2015, we began to raise our European stock portfolio weighting from 9% to 14% by year-end. There were several reasons why we became more enthusiastic about Europe:

1. Oil prices were low and we felt Europe would benefit more from declining energy prices than the U.S.
2. We believed the weak euro would stimulate the economy by making exports more competitive.
3. From a valuation standpoint, European stocks were cheaper than U.S. stocks.
4. The European Central Bank (ECB) had started quantitative easing (QE) - creating money to buy financial assets—in order to encourage business investment and lift the low level of inflation. This had worked well previously in the U.S. under Fed Chair Ben Bernanke. We thought that money would flow to European banks, who in turn would lend the money and stimulate economic growth.

Our Revised Thesis: Decrease European Stock Exposure

While relative performance was fairly close in 2015, European stocks (-7.26%) have significantly lagged the S&P 500 Index (+3.84%) through the first half of 2016. Three factors went wrong with our original thesis.

1. Meager European Economic Progress Over The Last Year

Despite the aggressive ECB actions of QE and lowered negative interest rates (see ECB Deposit Facility rate), the European economy did not improve much over the last year. In fact, the Euro area now faces deflation.

Key Economic Indicators	June 30, 2015	June 30, 2016
ECB Deposit Facility Rate ("Negative Rate")	(0.20%)	(0.40%)
Oil Price (US Dollars Per Barrel)	$60	$50
Gross Domestic Product (GDP growth)	1.0%	1.7%
Inflation / (Deflation)	0.3%	(0.1%)

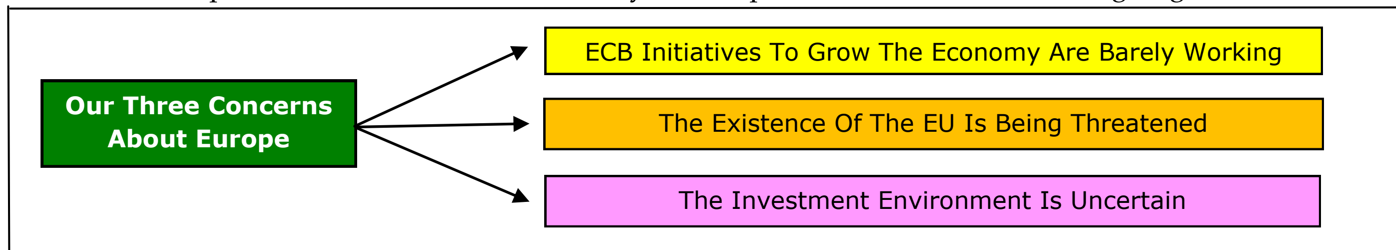
2. Unexpected Refugee Crisis

More than a million refugees crossed into Europe in 2015 (the big driver was the conflict in Syria). This sparked a crisis as countries struggled to cope with the influx, which created significant division in the EU.

3. Stress Tests Did Not Reflect The Severe Under-Capitalization Of European Banks

Following the 2008 financial crisis, the European Banking Authority (EBA) conducted stress tests designed to test bank resilience to adverse market developments. These tests showed that less than 10% of the banks were under-capitalized. Even in 2014, only 24 out of 123 banks failed the stress test. Now the banks face severe challenges (see discussion below) and cannot effectively carry out the ECB wishes to lend. It is apparent from the banks' lack of lending capacity that the stress tests did not reflect the severe under-capitalization of the banks. European bank stocks have fallen to September 2011 levels as they face a crisis in investor faith.

There is serious political and business uncertainty in Europe. We have three concerns going forward.



1. ECB Initiatives To Grow The Economy Are Barely Working

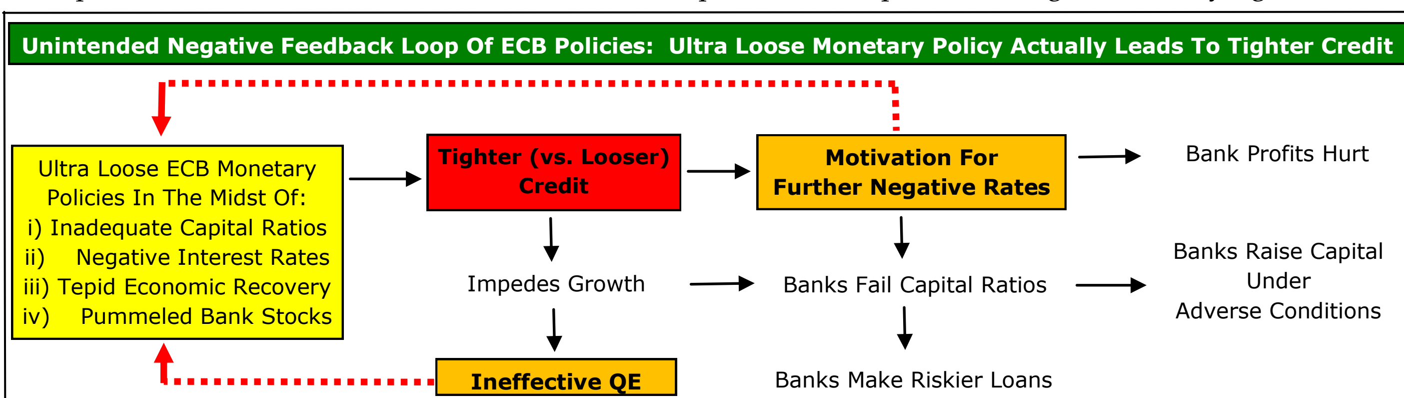
Neither quantitative easing (QE) nor negative interest rates are propelling the European economy. The ECB is effectively "running out of bullets".

A) Quantitative Easing (QE)

The ECB has a lone mandate to aim for an inflation rate of below but close to 2% over the medium term. In January 2015, the ECB announced a QE program - creating money to buy financial assets - in order to lift the low level of inflation and circulate money for economic expansion. Through September 2016, a total of €1.1 trillion (60 billion euros per month) would be deployed to purchase euro-area bonds from central governments, agencies, and European institutions. Despite increasing its monthly bond purchases to €80 billion in March and extending its purchases to include corporate bonds, the ECB has failed its mandate - inflation has dropped over the last year from 0.3% to a point of deflation (- 0.1%).

B) **Negative Interest Rates**

The ECB Deposit Facility Rate is negative (-0.40%) to push banks to lend money versus paying to leave funds on deposit. However, the European banks have failed to lend adequate funds because they face severe challenges. First, they are still suffering the effects of the 2008 financial crisis by facing continual pressure to raise capital ratios to offset troubled loans. Second, the very low interest rate environment pressures profits (there is a smaller spread between lending and borrowing). Third, without the green shoots of an economic recovery, banks have further difficulties meeting capital ratios. Fourth, the combination of pummeled bank share prices and bank assets makes it difficult to raise provisional capital. Lending has actually tightened.



2. The Existence Of The EU Is Being Threatened

The EU has 28 member states (including the U.K.). Each state must adhere to the founding principles of the union and is subject to the privileges and obligations of membership. Although there is considerable disparity in the size, wealth and political system of member states, they all have equal rights. Smaller states have disproportional representation compared to their population. The largest members (Germany and France) will head discussions, yet they have no more rights than a small member (such as Greece). A number of states are less integrated into the EU than others - there are certain things to which they can "opt out". The most notable member opt-out is the right to retain their own currency (U.K., Switzerland and Denmark).

The BREXIT vote highlights the two essential problems facing the EU. First, the European migration crisis has caused considerable member discord. German Chancellor Angela Merkel's decision to open up Germany to refugees disrupted normal everyday life across the EU. Frustration led to utter panic, and many EU members besides the U.K. are not on board with the current EU immigration policy. Second, different EU members have different interests and motivations. It is impossible to have 28 members on the same page when the membership is comprised of economic "haves" (such as Germany) and "have nots" (such as Greece).

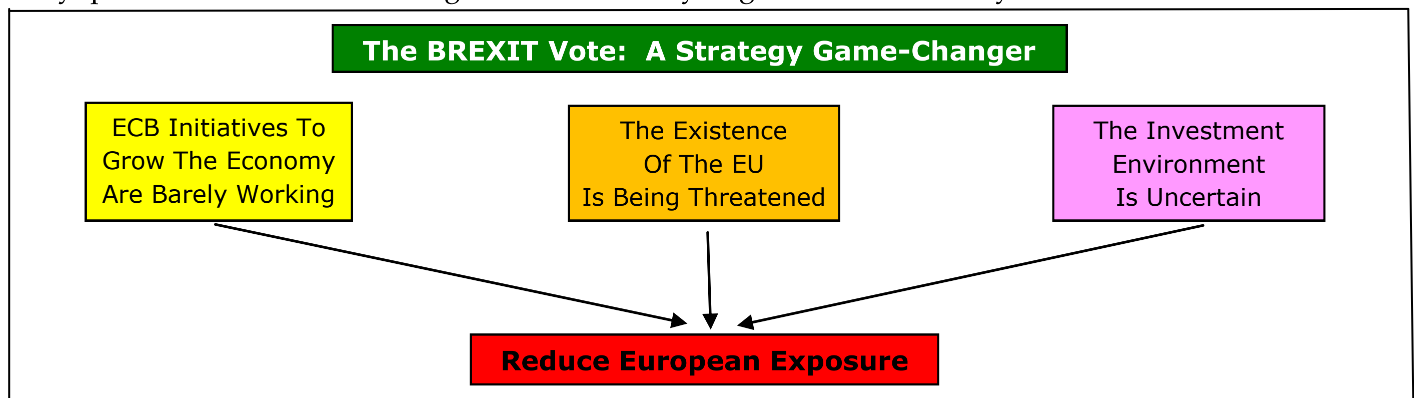
BREXIT may have opened the floodgates for others to consider leaving the EU. France's National Front has already called for "Frexit" while Dutch populist Geert Wilders is promoting "Nexit". Will others follow the U.K.'s lead?

3. The Investment Environment Is Uncertain

An uncertain future existence of the EU naturally leads to an uncertain European investment environment.

We believe it will be much tougher for the countries who use the euro to leave the EU because there is considerable risk in switching back to your own currency - look how hard and fast the British Pound fell (over 11%) the day after the vote. Having said this, the possibility of further "member exits" exists.

It is tough to invest in the future when the future is uncertain. Note how hard European stocks sold off in the first two days after BREXIT. Investors are demanding a higher risk premium for the political uncertainty and discounting lower earnings growth because of a higher recession risk in the U.K. and Europe. Companies with most of their earnings in the British Pound and the euro were hit harder than companies that generate revenues in other currencies. While there is a possibility that European stocks will bounce hard off the bottom, we believe it is prudent to reduce European exposure over a reasonable time frame. There are too many question marks about the region that will likely linger for months and years to come.



Stock Market Spotlight

Stocks Have Wild BREXIT Ride In Last Week Of Q2

In the Second Quarter, the domestic S&P 500 Index was up a modest 2.46% and up 3.84% through two quarters. However, it ended up as a wild ride. The S&P 500 Index fell more than 5% in the two trading days subsequent to the June 23 BREXIT vote, yet almost fully recovered by quarter end. European stocks did not fare nearly as well. Year-to-date, the S&P 500 Index is the only developed market in positive territory. Oil prices rose 35% ($36.91 to $49.85 per barrel). While Emerging Markets was slightly positive in Q2 (+0.66%), it was led again by Brazil (+13.90%) and Russia (+4.05%) rather than China (+0.11%) and India (+3.72%).

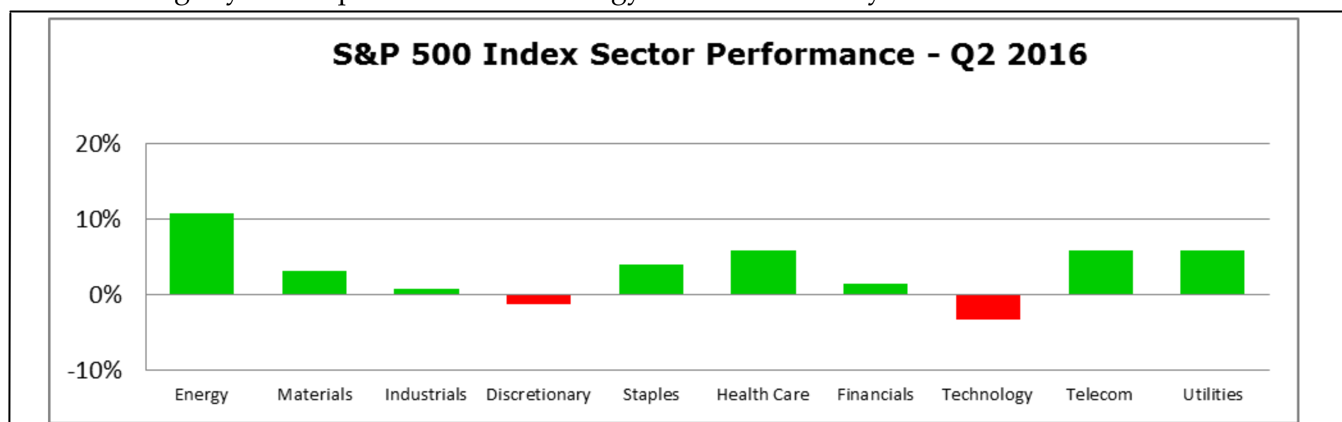
Equity Index Performance

Index	Q2 2016
S&P 500 (Domestic)	**2.46%**
MSCI EAFE (Foreign) *	**(1.46%)**
MSCI Emerging Markets	**0.66%**
MSCI EMU (European Monetary Union)	**(5.28%)**
MSCI Japan	**1.01%**

* Europe, Australia and the Far East

Sector Performance Was Tighter In Q2 Than Q1

With the exception of Energy (+10.81%), Q2 sector performance was in a fairly tight range as compared to Q1. Two sectors slightly under-performed: Technology and Discretionary.



We Will Reduce European Exposure Over A Reasonable Time Frame

At this time, roughly 13% of our stock portfolio is in European stocks. We will reduce this exposure over a reasonable time frame. There is not a "gun to our head" to do so immediately - indeed there may be a bounce in European stocks because they got hit so hard and fast.

We anticipate US Dollar strength relative to the euro and British Pound as BREXIT plays out. Reasons include a suddenly riskier and less robust European economy, coupled with relatively higher US interest rates that will not likely be lowered by the Fed (see upcoming Bond Market Spotlight for further Fed rate discussion).

We will likely divest the European stocks that are more closely tied to the European economy and the euro. The "European keepers" will likely be those companies that are less tied to the euro and can benefit from a strong US Dollar.

Bond Market Spotlight

Bonds Rise In Q2

The Barclay's Capital US Aggregate Bond Index, a broad-based representation of bond performance, rose 2.49% in the Second Quarter and is up 5.35% year to date. The yield curve further shifted downward in Q2 as it slightly flattened. A flattening yield curve is less favorable for banks as they make less money on their lending spread (Financials is the worst performing sector so far in 2016).

Key US Interest Rates	March 31, 2016	June 30, 2016	Change
Federal Reserve Board Funds Target Rate	0.25%	0.25%	0 basis points
5-Year Treasury (Constant Maturity)	1.26%	1.01%	- 25 basis points
10-Year Treasury (Constant Maturity)	1.83%	1.49%	- 34 basis points
30-Year Treasury (Constant Maturity)	2.65%	2.30%	- 35 basis points

Note: 100 basis points (bp) = 1.00% Source: Telemet

Global Stability Is Apparently Part Of The Fed Mandate

On December 16, 2015, the Fed raised its target rate from zero to 0.25%. Its policy makers forecast a rate of 1.375% at the end of 2016, implying four quarter-point increases during 2016. So far, we have not seen a rate increase, and the probability of seeing a single rate hike in 2016 continues to drop. What happened?

The Fed has had a long-standing dual mandate of full employment and stable inflation. So far this year, the unemployment rate has fallen from 5.0% to 4.7%, and inflation has fallen from 2.3% to 1.0% (source: Bureau of Labor Statistics). Given moderate US economic expansion, it would seem reasonable that the Fed could have made a second rate hike by now. This didn't happen. Why? Global stability is restraining the Fed from its mandate. There have been numerous references to this effect by Fed Chair Janet Yellin.

Fed Mandate: The Non-Transparent Shift To Global Considerations		
Date	**Event**	**Statement From Fed Chair Janet Yellin**
March 5, 2014	Ceremonial Swearing In	Chairman Bernanke took a number of steps to make the Federal Reserve more transparent and accountable, and I promise to build on his legacy.
December 16, 2015	Signal: Four Rate Hikes	The committee currently expects that, with gradual adjustments in the stance of monetary policy, (US) economic activity will continue to expand at a moderate pace.
March 29, 2016	Decision: No Rate Hike	It is appropriate for US central bankers to proceed cautiously in raising interest rates because the global economy presents heightened risks.
June 15, 2016	Decision: No Rate Hike	It was fair to say it (BREXIT) factored into today's decision.

We anticipated rising interests rates in 2016 given the Fed signals leading into the year, and positioned our portfolio accordingly. Now we know how much the Fed is weighing global versus domestic factors. We wish Janet Yellin was as transparent as she promised to be when she was sworn in as the Fed Chair.

Current Bond Strategy

We anticipate interest rates will remain low for an extended period of time. Our bond portfolio is roughly 70% corporate bonds (an average duration of 7 years) and 30% inflation-protected government bonds.

Your Portfolio

The Second Quarter ended with the surprise BREXIT vote, which marked the second market roller coaster ride of 2016. Over two trading days, the S&P 500 Index fell over 5%, only to gain almost everything back in a matter of days. You may recall from January 1 through February 11, the S&P 500 Index fell roughly 10% before finishing Q1 slightly positive. We view market resiliency as a good sign. Of course, we know how tough it is for you to endure these market volatility swings.

Year to date, our portfolio has faced two main challenges. First, European stocks have lagged. Second, we were positioned for rising interest rates at the beginning of the year, and Fed rate hikes have not materialized.

As we enter the second half of 2016, we hope to see increased stability in Europe. It should take a while for things to settle down. At home, we will soon have political clarity with the upcoming Presidential election.

Earlier in the quarter, we bought Facebook (symbol: FB) and sold Qualcomm (symbol: QCOM). At the end of the quarter, we bought Cimarex Energy Company (symbol: XEC) and sold Oracle (symbol: ORCL). The net effect of these transactions was to increase our exposure to Energy and decrease our exposure to Technology.

Over the next few months, we anticipate further adjustments to both the stock and bond components of your portfolio. Stay tuned for updates.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

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Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.