TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

July 2017

Quarterly Insights

Second Quarter 2017

In This Issue

EXECUTIVE SUMMARY

Stocks Rise In All Major Regions In Q2; Bonds Also Rise

In the Second Quarter, the domestic S&P 500 Index was up 3.09% and is up 9.34% year-to-date. Noteworthy global regions were Europe (+7.97%) and Emerging Markets (+6.27%). Health Care (+6.65%) led Q2 sector performance. Energy (-7.02%) and Telecom (-8.14%) were laggards. The Barclay's bond index rose 1.81% in Q2 and is up 2.75% year-to-date. We remain bullish due to the prospect of tax reform and infrastructure spending in the midst of a healthy economy.

Don't Judge An Inflation-Indexed Bond By Its Coupon Rate

The stated coupon rate of a US Treasury Inflation-Indexed Security (commonly called a TIPS) is usually lower than the stated coupon rate of a similar maturity "regular bond" (a US Treasury or a corporate bond). Why would we buy a lower coupon bond?

The short answer is that the coupon rates are not directly comparable. With a regular fixed income investment, investors bear inflation risk: the purchasing power of interest payments and bond face value could be eroded by inflation. A TIPS, in contrast, is guaranteed to keep pace with inflation as defined by the Consumer Price Index (CPI).

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Don’t Judge An Inflation-Indexed Bond By Its Coupon Rate

“Why On Earth Would We Buy A Bond That Has A Coupon Rate Of Only 0.125%?”

A few months ago, one of our clients called us and was troubled about part of the bond component of her portfolio. She noticed we bought her a US Treasury Inflation-Indexed security (commonly called a Treasury Inflation-Protected Security, or TIPS) that offered a coupon rate of only 0.125%. The corporate bonds in her portfolio all had a similar maturity date to the TIPS, but had coupon rates in the range of 2.00% to 6.00%. Her question was blunt: “Why on earth would you guys buy a bond with a coupon rate of only 0.125% when you can select a similar-maturity bond with a much higher coupon rate”? Great question!

The short answer is that the coupon rates of US Treasury inflation-indexed bonds and “regular” bonds (such as corporates and US Treasurys) are not directly comparable. While both bond types bear interest risk (when interest rates rise, bond price falls), only the regular bonds bear inflation risk. With a regular bond, investors bear inflation risk because principal (par value) and interest payments are fixed and could be eroded by inflation. With a TIPS, principal and payments are guaranteed to keep pace with inflation as defined by the Consumer Price Index (CPI) through semi-annual adjustments.

A US Treasury Inflation-Indexed Security Provides Inflation Protection

The quoted coupon rates are low on TIPS as compared to other regular bond holdings such as corporate bonds, so why do we hold them? We hold TIPS because they are a simple and effective way to eliminate one of the most significant risks to fixed-income securities - inflation risk. Inflation protection is an important component of our bond strategy. The principal value of the TIPS adjusts (appreciates) for inflation.

Bond Type	Interest Risk (Yes/No)	Interest Rates Rise	Interest Rates Fall	Inflation Risk (Yes/No)	Inflation Rate Rises	Inflation Rate Falls
Regular Bond	**YES**	Bond Price Falls	Bond Price Rises	**YES**	Bond Price Falls	Bond Price Rises
TIPS	**YES**	Bond Price Falls	Bond Price Rises	**NO**	Bond Price Rises	Bond Price Falls (par value limit)

Judge An Inflation-Indexed Security By Its Total Return (Not Its Coupon Rate)

Looking only at the quoted coupon of a TIPS can be misleading. It is the total return (appreciation) that is key. Calculating the total return of a TIPS is complicated because there are two components to consider:

1. The value of the TIPS will adjust upward for rising inflation and downward for falling inflation
2. The value of the TIPS will adjust upward with falling market interest rates and downward with rising rates

SIMPLE ILLUSTRATION (assume no adjustment for interest rate risk)

Suppose a $1000 US TIPS was purchased at par value with a 3.00% coupon rate (a $30 coupon payment).

Assume the inflation rate during the first year was 10% (TIPS are adjusted semi-annually for inflation).

The face value of the TIPS would adjust upward by 10% to $1,100. ($1000 * (1 + 0.10) = $1,100)

The coupon payment, which is based on face value (paid semi-annually), would be $33. ($1,100 * 0.03 = $33)

At Year 1, the TIPS is worth $1,133: the total return is $133 (13.3%), higher than the (initial) 3% ($30) coupon

With TIPS, both the interest payments and face value are protected against inflation (unlike regular bonds)

Anatomy Of A US Treasury Inflation-Indexed Security

Lets take a close look at the specific TIPS that concerned our client. Here is how the security market value is noted on her May 31, 2017 Schwab monthly statement:

U.S. Treasuries	**Par**	**Market Price**	**Market Value**
UST INFL IDX 0.125% 01/23	25,000.0000	100.1406	26,442.13
CUSIP: 912828UH1			
INFLATION FACTOR = 1.0562			

Here is the cost basis information noted at Schwab:

Symbol	Name	Acquired/ Opened	Quantity	Market Value	Cost Basis	Cost Basis Per Share	($) Unrealized Gain/(Loss)	(%) Unrealized Gain/(Loss)
912828UH1	UST INFL IDX 0.125% 01/23 INFL INDEX DUE 01/15/23	12/18/2015	25,000.0000	26,442.13	24,721.36	98.8854	$1,720.77	6.96%

The TIPS interest payments were paid as follows:
01/15/2016 - $16.08
07/15/2016 - $16.23
01/15/2017 - $16.35

WHAT DOES ALL OF THIS MEAN?

A TIPS (originally issued on January 15, 2013) was purchased on December 18, 2015 with a coupon rate of 0.125% and matures on January 15, 2023.

The Inflation Factor is the cumulated inflation factored into the TIPS (January 15, 2013 to May 31, 2017).

A total of 25 bonds (face value of $1,000 per bond) were purchased on December 18, 2015 at a discount ($98.8854 per bond) for a total purchase price of $24,721.36.

The Market Price reflects interest rate exposure inherent in the TIPS (the Inflation Factor reflects inflation).

Market Value = (Inflation Factor) * (# of bonds) * (Market Price)

$26,442.13 = 1.0562 * 25 * $1001.406

As of May 31, the bond has a total return of $1,720.77 (Market Value - Cost Basis). The total return (+6.96%) is a lot higher than meets the eye (the annual coupon rate is only 0.125%) because the TIPS coupon payments and Market Value have been adjusted (upward) on a semi-annual basis (January 15 and July 15) for inflation.

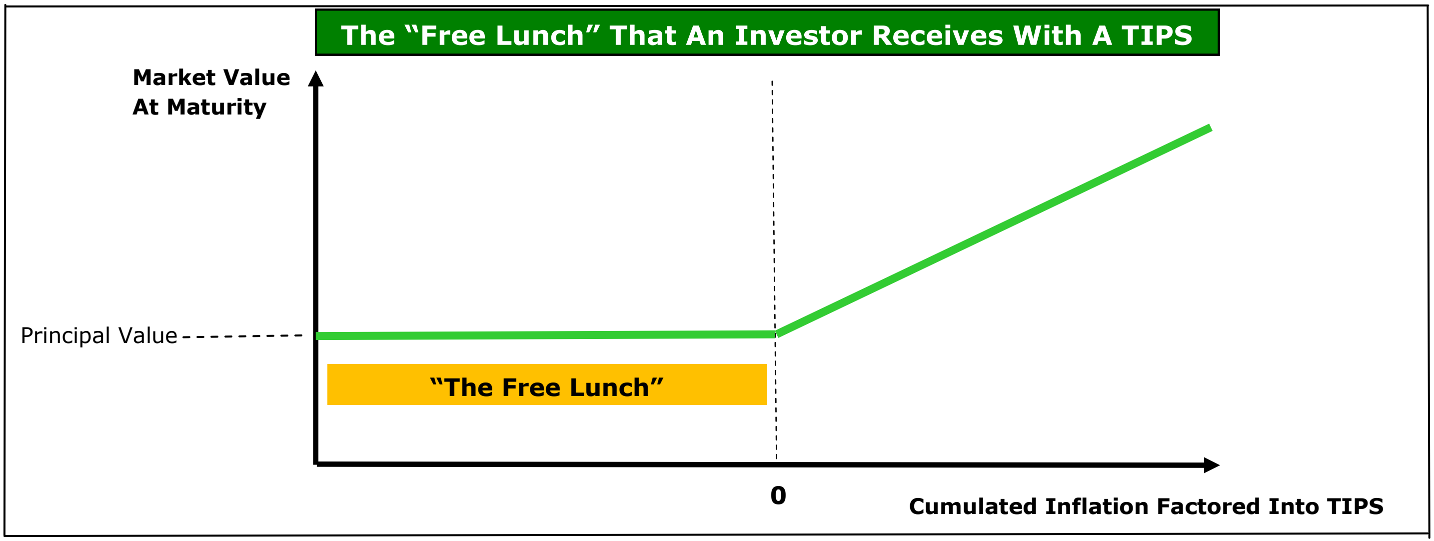
Coupon Payment = (Market Value) * Coupon Rate) * 0.5 (semi-annual payment)

01/15/2016	**$16.08**	**=**	**$25,725.00**	*****	**0.00125**	*****	**0.5**
07/15/2016	**$16.23**	**=**	**$25,960.00**	*****	**0.00125**	*****	**0.5**
01/15/2017	**$16.35**	**=**	**$26,160.00**	*****	**0.00125**	*****	**0.5**

The "Free Lunch" That An Investor Receives With A TIPS

With positive inflation, the market value of the TIPS will increase, as will its coupon payments. With negative inflation (deflation), the market value of the TIPS will decrease, as will its coupon payments.

A nice safety feature of the TIPS is that, at a minimum, an investor will receive the principal value of the TIPS at its maturity no matter what happens with inflation over the duration of the TIPS. In other words, TIPS have limited downside risk regarding deflation (a "free lunch") and unlimited upside potential with inflation.



US Treasury Inflation-Indexed Security (TIPS) Portfolio Considerations

Because TIPS protect investors against inflation, they behave differently than regular bonds (which do not protect investors against inflation). As inflationary expectations increase, regular bonds will become less attractive as future interest payments are eroded by inflation. As inflationary expectations decrease, regular bonds become more attractive as compared to TIPS.

TIPS provide an additional level of diversification above regular bonds because they eliminate inflation risk for whatever portion of the portfolio they constitute. Therefore, the inclusion of TIPS reduces portfolio risk.

TIPS can be used in terms of a tactical strategy to anticipate (longer-term) expectations for inflation. For the sake of illustration, let's compare a TIPS coupon rate to that of a regular US Treasury bond. If a regular 10-year Treasury bond is priced with a yield to maturity (YTM) of 4% and a similar TIPS is priced with a YTM of 2%, this implies that there is an inflation expectation of 2%. In this example, if an investor believes that inflation will exceed 2%, he/she should buy the TIPS because it will become more valuable if actual inflation exceeds the market's expected inflation. If an investor believes that inflation will be lower than 2%, he/she should buy the regular US Treasury bond.

When we buy TIPS, our priority is not to speculate on whether actual inflation ultimately exceeds expected inflation. Rather, we are simply trying to "round out" your bond exposure by having some inflation protection. We believe inflation protection is important, especially for investors who are at or near retirement and have a component of bonds in their target asset allocation. When inflation is in check, TIPS may not be the best or most exciting investment. But when inflation appears, you will be glad you have them.

Stock Market Spotlight

Stocks Positive In All Major Regions In Q2

In the Second Quarter, the domestic S&P 500 Index was up 3.09% and is up 9.34% year-to-date. Note-worthy global regions were Europe and Emerging Markets. European stocks (+7.97%) maintained their momentum from Q1 (+8.61%), and are the co-leaders in global performance year-to date (+17.27%). Emerging Markets (+6.27%) followed up a torrid Q1 (+11.44%) and is +18.43% year-to-date. China did very well again in Q2 (+10.57%%) and is up 24.86% year-to-date. India tapered off in Q2 (+2.91%) but is still +20.53% year-to-date. Investors continue to move funds outside the US.

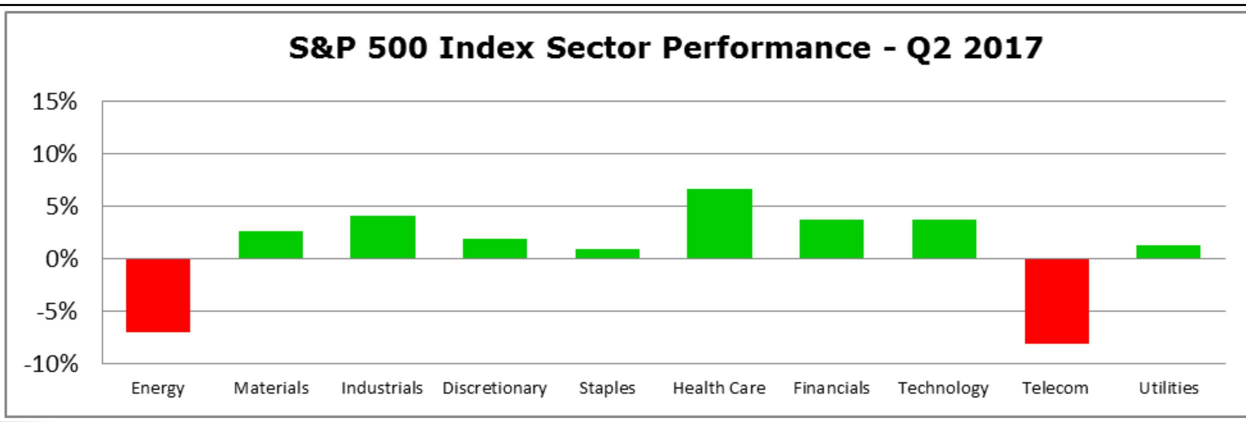
Equity Index Performance

Index	Q2 2017
S&P 500 (Domestic)	**3.09%**
MSCI EAFE (Foreign) *	**6.12%**
MSCI Emerging Markets	**6.27%**
MSCI EMU (European Monetary Union)	**7.97%**
MSCI Japan	**5.19%**

* Europe, Australia and the Far East

Health Care Leads Sector Performance In Q2

Health Care (+6.65%) led Q2 sector performance. Energy (-7.02%) and Telecom (-8.14%) were considerable laggards. Year-to-date, Technology (+16.38%) and Health Care (+15.06%) lead, while Energy (-13.81%) lags.



Q2 Was Deja Vu All Over Again - We Remain Bullish

It is remarkable how identical Q2 was as compared to Q1. In both quarters, stocks were positive in all major global regions, with Europe and Emerging Markets leading the way. Technology and Health Care repeated as the sector leaders while Energy and Telecom continued to be the considerable laggards. All remains well from a US economic standpoint. GDP growth slightly rose from 1.9% to 2.0% (source: Bureau of Economic Analysis), unemployment fell from 4.7% to 4.3% (source: Bureau of Labor Statistics), inflation fell from 2.7% to 1.9% (source: Bureau of Labor Statistics), and the Leading Economic Indicators index has now risen 9 consecutive months to 127.0 (its highest level in over a decade). The Fed continued to endorse the health of the US economy through its third rate hike in six months (the Fed raised its target rate by 0.25% on June 14).

We still await tax reform and infrastructure spending - the two main drivers of our bullish stance. Despite the delays in legislative reform, we continue to anticipate it will happen. When it does, stocks should benefit.

Bond Market Spotlight

Bonds Rise In Q2

The Barclay's Capital US Aggregate Bond Index, a broad-based representation of bond performance, rose 1.81% in the Second Quarter and is up 2.75% so far in 2017. The yield curve slightly flattened in Q2. On June 14, the Fed raised its target rate from 0.75% to 1.00%. This was the third rate hike in six months (the Fed raised its target rate from 0.25% to 0.50% on December 14, 2016).

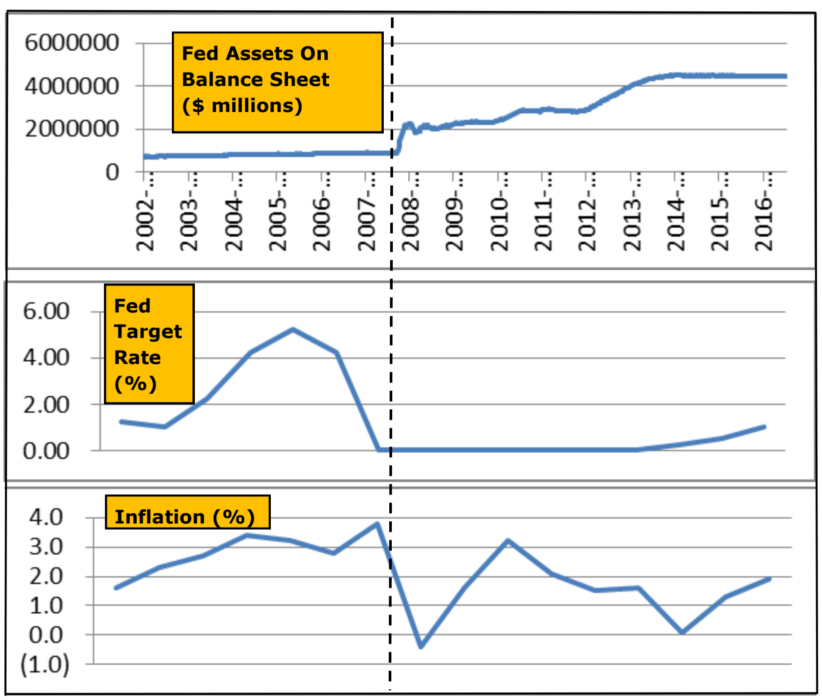
Key US Interest Rates	March 31, 2017	June 30, 2017	Change
Federal Reserve Board Funds Target Rate	0.75%	1.00%	+ 25 basis points
5-Year Treasury (Constant Maturity)	1.92%	1.89%	- 3 basis points
10-Year Treasury (Constant Maturity)	2.38%	2.31%	- 7 basis points
30-Year Treasury (Constant Maturity)	3.01%	2.84%	- 17 basis points

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

Recent Fed Actions Indicate Further Confidence In The US Economy

At the end of 2008 (a year no one wants to remember), the Fed initiated two aggressive measures to help the US economy recover: it lowered the Fed target rate to 0% (a target that remained for the next 7 years) and it bought assets (quantitative easing). By all accounts, the Fed actions were successful - the US economy recovered over time and is now in good shape. Now the Fed does not need to be as aggressive.

Along the way, the Fed significantly increased the assets on its balance sheet (US Treasury Securities and Mortgage Backed Securities) from under $1 trillion to over $4.4 trillion, a level that has remained steady since 2014. To the surprise of many (not us, see Quarterly Insights July 2013, page 4), the increased money supply through quantitative easing did not cause inflation. It is only in the last 18 months that the Fed has raised its target rate from 0% to 1% through four 0.25% rate hikes (three of the hikes in the last 6 months).



Recent target rate hikes show that the Fed is confident in the US economy.

In a further move of confidence, on June 14 the Fed announced its intention to gradually reduce balance sheet assets by decreasing reinvestment of the principal payments it receives from securities held. For Treasurys, the reduction will start at $6 billion and ultimately peak at $30 billion (per month). For mortgage-backed securities, the reduction will start at $4 billion and peak at $20 billion (per month).

Your Portfolio

We made several portfolio adjustments in Q2. The rationale for these moves included a desire to maintain Technology weighting in the midst of a company acquisition by Qualcomm, maintain Financials weighting, and raise Emerging Markets exposure.

We bought Dell Technologies (symbol: DVMT), a mid cap ($38 billion) information technology company. DVMT helps organizations manage cloud-based technology resources and enjoys a strong position in a mature industry segment. The company's server/storage software creates "virtual" servers and maximizes storage efficiency. Half of its revenues are international and 60% of its revenues are derived from services.

We also bought AIA Group (symbol: AAGIY), the leading insurance company in Asia. The company sells life and medical insurance, annuities, savings and retirement products, and employee benefits. Its business is concentrated in China, Hong Kong, Thailand, Singapore and Malaysia. We believe AAGIY will benefit from strong industry secular growth - both the Asian economies and the Asian middle class continue to expand.

We sold NXP Semiconductors (symbol: NXPI), a Netherlands-based mid-cap ($37 billion) leader in mixed signal chip applications that is in the midst of being acquired by Qualcomm. It is our belief that the NXP stock price has likely peaked pending acquisition. We also sold Synchrony Financial (symbol: SYF), the largest provider of US private label credit cards. We became increasingly concerned about a payment industry trend that is moving more toward mobile payments than credit card payments.

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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