I|S|G
Investment Security Group, Inc.

Celebrating Our Third Decade of Providing Unbiased Financial Advice

"Our clients may like us more when the market is doing well, but we will be worth more when it is not."

Roy Diliberto

Stock Market Party Continues…

US stocks continued their dance to the music of low interest rates, easy money policies, and the expectation that the subpar recovery will pick up the pace in the year's second half. Stocks were up on average 7%, with larger companies generally faring the best. Recent data points showed some improvements in the labor markets although all important wage growth remained constrained and other data to suggest anything other than an economy slow on the mend remained spotty.

Developed foreign market stocks also had a decent showing, posting 4%-5% returns as the European central bank took further easing steps to deal with deflation concerns. Japan, meanwhile, continued its multi-pronged efforts to generate "healthy" inflation to get its citizens spending again to revive its stagnant economy. After faltering in the first quarter, emerging market stocks finished up with six month results in line with US stocks.

On the defensive side, core bond strategies did well, earning 3%-4% and benefitting from a drop in interest rates which pushed up prices and bolstered total returns – a surprise to most bond "experts."

…And We Remain Cautious Participants

Today, the US economy is clearly on sounder footings than a few years back. Fed actions –whether one agrees with them or not – have prevented a worst-case economic collapse and enabled households, corporations, and banking institutions to mend debt laden balance sheets. There's been an unexpected oil and gas production renaissance that has lowered energy costs and foreign oil dependency while creating new jobs. Cutting edge technology is keeping US companies profitable and globally competitive. Investors have taken note of these developments and stocks have staged a significant comeback post financial crisis.

While these developments are good news, we carefully note that the economic recovery continues to be subpar…despite unprecedented stimulus efforts put forth by the Federal Reserve. Easy money policies and low interest rates have contributed to new stock market highs on Wall Street …but Main Street has lagged behind in terms of job creation, wage growth, and all-important consumer spending. Current stock prices, while not yet rich, do reflect an optimism that the recovery will pick up steam. And investor complacency is alive and well, as exhibited by US stock volatility measurements that have dropped to levels last seen in early 2007. This bears watching as conditions such as these become more vulnerable to negative, unexpected surprises.

News Notes

2014 ISG Annual Investment Update and Dinner

Please join us for Cocktails, Dinner and Guest Speaker: Kelly J. Brough, President and CEO, Denver Metro Chamber of Commerce

Saturday, September 20th
5:00-5:30 Registration
5:30-6:30 Cocktails and Reception
6:30-9:00—Dinner, ISG Outlook and Guest Speaker: Kelly J. Brough

Invitation will be forthcoming with more information.

Looking ahead, we are keeping our eyes on a number of items. Current Fed Policy, if pursued too long, could lead to asset bubbles or inflation spikes that exceed expectations. European deflation risk remains a concern. How China unwinds from its credit bubble is another concern. And, there is the current lineup of geopolitical tensions to keep on the radar screen. These items keep our portfolios both underweight stock risk and core bond interest-rate risk until either lower prices or a more stable global economic backdrop improves the risk/return outlook for these asset classes. This remains a period when patience and discipline are particularly critical.

Family Care

According to Kestler Financial Group, in the U.S., approximately 78% of care is provided by family members.

Investment Security Group, Inc. (ISG) is a Registered Investment Advisor providing individuals with creative investing and financial planning solutions. ISG's research is thorough and independent and our ultimate goal is to enhance your life experience through prudent financial decisions.

"Hybrid" Investments

In recent years, these investments have occupied more of the conversation in our client investment meetings. They refer to an investment (or strategy) that is expected to generate returns and risk levels that fall between the extremes of a core stock or bond approach. This could denote non stock or bond investments, like the real estate or business loan programs we have included in many of your portfolios, or various unique bond or combination strategies which aim for this middle-of-the-road result.

Importantly, many hybrids fall into a popular industry category known as "alternative investments" which aim for the return potential of stocks or defensive attributes of bonds (or a little of both) but lack correlation to either asset class. In our portfolios, our reinsurance-related bond funds represent a unique bond strategy that is not tied to the interest rate risks associated with conventional bonds. Their results are instead tied to how well insurance companies model and manage their widely distributed book of risk exposures…not the whims of Wall Street.

With stocks and bonds both with their own set of upcoming challenges, increasing exposure into hybrids has in our assessment been a more risk-controlled strategy to achieving satisfactory results. As of this writing, several of our top performers in 2014 come from this category, and looking back, the last several years this category has generated a very favorable return relative to risk (ie. volatility). The ISG Investment Team will continue its research and due diligence in this growing area.

Simple Tax Strategy for 2014

Unbeknownst by many, 10% & 15% tax bracket investors pay ZERO on long-term capital gains in 2014. Lower bracket investors should consider selling winners from their taxable accounts to take advantage of the 0% rate, particularly in the wake of last year's stock run-up. They can even re-buy the same stocks immediately thereafter and reset their cost basis to a new, higher level so when they later sell, perhaps at a higher taxable bracket, they will owe tax on a smaller gain than if they held continuously. Check with your tax advisor before implementing.

Court Case Changes Rules on IRA Rollovers:

A recent Tax Court decision will change the way the IRS applies the law on IRA rollovers.

For years, the IRS has interpreted the IRA rollover rules to mean that a taxpayer could do one rollover per year for each IRA he or she owned. In doing a rollover, the taxpayer is not taxed on the funds taken from the IRA so long as the funds are re-deposited into an IRA within 60 days of the withdrawal.

The recent court decision changed the way the tax rule is applied, ruling that the limit on rollovers should be applied on an aggregate basis – that is, only one rollover per year is allowed for all the IRAs a taxpayer owns. If a taxpayer takes funds from one IRA and rolls the money back into an IRA within 60 days, he or she can't do any other tax-free rollovers within the following 365 days.

This change goes into effect January 1, 2015; therefore, the aggregate rule won't apply for rollovers done during the remainder of 2014. Note, also, that trustee-to-trustee transfers can still be done as often as the taxpayer likes; the limit doesn't apply to these transfers because the taxpayer never has possession of any of the IRA funds.

Please contact us if you have any questions.

Pondering Corporate Earnings

- Of the 74 S&P 500 companies reporting thus far, 72% have beaten their second quarter mean estimates (per FactSet, 7/18/14).
- A common tactic, however, is for companies to revise (downward) their guidance during the quarter so that estimates come in low so they can be "beaten."
- Instead of investing in profitable projects, companies are buying back stock to increase earnings per share by spreading profits across a smaller base of shares.
- Executives are turning to another old device to boost sluggish internal growth: Takeovers. Mergers and Acquisitions in the first quarter were 36% higher than the same period of 2013.
- While earnings growth is expected to improve significantly in the second half, revenue growth is not. Projected revenue growth for 2014 is scheduled to remain flat at 3.6%.