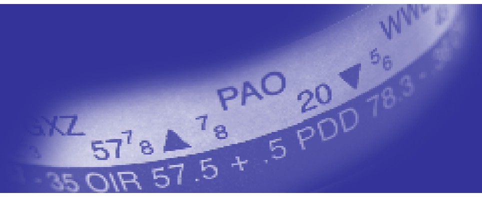
Second Half Outlook 2018



I|S|G
INVESTMENT SECURITY GROUP, INC.

Celebrating Our Third Decade of Providing Unbiased Financial Advice

> ***"I finally know what distinguishes man from other beasts: financial worries."***
>
> --Jules Renard

Key Takeaways:

- The range of possible global economic outlooks has widened. Corporate earnings growth and recent business spending in the U.S. remains a bright spot, but escalating trade tensions and increasing policy uncertainties could undermine business confidence and restrain the current economic momentum. U.S. stimulus measures (i.e., tax cuts, increased federal spending) may help in the short-term, but rising interest rates and growing inflation concerns on net argue for a slight tightening in financial conditions and make a case for measured investment tactics going forward.

- The probability of a near-term U.S. recession remains low.

- Judging from money flows, investors have once again cooled on European assets. We've heard this story before, but political risks have increased as a new anti-establishment government in Italy has upped the risk of European fragmentation. This is likely another investor overreaction and despite some recent slower earnings news, the asset class remains a viable part of a longer-term global stock strategy.

- The economic backdrop for many Asian economies remains encouraging, but with so many of these regions China-dependent, investors should expect periodic bursts of volatility as the rest of the world adjusts to a slower but more sustainable Chinese growth rate.

- Maintaining exposures in hard-to-find alternative investments whose sources of return are less connected to those which drive traditional financial assets remains a long-term strategy in our diversified portfolios.

> **SAVE THE DATE!**
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> ISG ANNUAL CLIENT EVENT
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> ISG's annual client luncheon will be held on **Friday, September 28**, at the Hilton Denver Inverness (formerly "The Inverness Hotel"). In addition to our advisor commentaries, we are delighted to have as our keynote speaker, Jeffrey Kleintop, Charles Schwab's Chief Global Investment Strategist, who will discuss international markets, trends, and their financial implications for U.S. investors.
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> *More details forthcoming.*

Global Growth Less Synchronized… but still going

2017 was a year of upside growth surprises, muted inflation, and unusually low volatility that set the stage for outsized returns across markets. Today, the growth picture remains good overall, but many of these key market drivers have shifted. In the U.S., rising rates, while not yet problematic, are tightening financial conditions and will at some point put a crimp on the growth outlook. Having monetary tightening concurrent with the fiscal stimulus of tax cuts is somewhat akin to stepping on the brakes and gas pedal at the same time. Additionally, plowing most of the calculated tax cuts into stock buybacks will not result in a new higher sustainable level of growth. That would require a significant increase in the labor force and/or increased productivity of the labor force…neither of which is happening at a meaningful pace. Inflationary pressures, while again not problematic yet, could spike up and prompt a quicker pace of Fed tightening and bring forward the end of the current business cycle. Any further escalation in tit-for-tat trade actions could have a knock-on effect on business confidence, hitting growth as well. For the balance of the year, the stock market's adjustment to these higher levels of uncertainty will be a key theme to follow. For now, the U.S. earnings outlook remains good…and rising earnings, rather than price declines, can help normalize valuation metrics like the "P/E" (price-to-earnings). Stay tuned.

The Euro region thus far in 2018 has been one of the major investor disappointments as many economic releases have surprised on the downside. Some of this may be due simply to expectations getting ahead of themselves. There remains debate, however, on whether banks have stabilized sufficiently to withstand an unexpected financial shock. Migration is adding to tensions in the EU and Italy's current political situation adds an additional uncertainty to a region which still struggles with economic, banking, and political fragility. The central bank is set to wind down its version of quantitative easing, but looks to hold off on interest rate hikes until after mid-2019. Financial fragilities will make the risk of a policy misstep more acute.

On a potential positive note, European equities may already be reflecting these uncertainties as they are trading as cheap to U.S. equities as they have in 15 years. The Euro is off its peak, benefitting European multinationals and as we've pointed out in previous newsletters, Europe's recovery cycle lags the U.S.'s, so the runway for improving earnings and corresponding higher stock prices seems like a high probability bet. The requirement for any value investor, however, is patience…and patience may be needed to allow some of Europe's economic momentum to resume and unlock some of the bargain elements of European equities.

Elsewhere in many Asian and other smaller emerging countries, all eyes remain on China. Trade tensions with the U.S. and elevated domestic debt levels are concerns, yet we see China's near-term outlook as resilient. The country continues its initiative to improve the quality of its growth, not just the quantity, as it pushes for more consumption- and less investment as a share of its economic activity. All of this comes amid reform progress, financial de-risking and slower credit growth. Getting this transition right is tricky, and any missteps could lead to bursts of volatility in Chinese – and China-dependent countries' – asset prices. The rest of the world will have to adjust to a slower but more sustainable Chinese growth rate… and this transition could be volatile if China's growth slows more sharply than markets expect. We remain hopeful for the best outcome…but position our portfolios for a less-than-best case scenario.

Data, Data Everywhere!

Today, the world is awash in new information. According to Goldman Sachs, as much as 90% of all data has been created in the last 2 years, but less than 2% of this data is being analyzed. Sorting "noise" from actionable insights from this plethora of information requires skilled and experienced investment professionals… and as the rate of data generated increases exponentially, we believe a judicious blend of human judgment and computer-led analytics will become essential in making sound decisions for our ISG investor family.

Summing it Up: Crossing the Chasm

In our view, over the next 12-18 months, investors should responsibly prepare to balance their way over a chasm filled with investment, economic, and geopolitical issues; some of which are changing swiftly and others that are uncertain in their final outcome. Today, that balancing act is over a 12-inch wide plank but later this could morph into a more delicate walk over a tightrope.

With few exceptions, easy money policies for most developed economies which have enticed money into stocks and juiced company earnings through stock buybacks and debt restructuring are winding down or are now in tightening mode. Late-cycle expansions (like here in the U.S.) are often associated with above average equity valuations, tighter financial conditions, and sometimes financial excesses. Trade policies remain in transition with an uncertain final impact on global growth. Political uncertainties abound throughout the globe. All of these taken together can heighten equity sensitivity to exogenous shocks and shifts in the operating environment.
Despite these challenges, it's worth noting that investors have endured and prospered through most of these before. According to Goldman Sachs, while risks are increasing, they are manageable and best addressed by applying the following skillsets:

Balance: Obviously, without the skills or tools to improve stability, the journey is challenging. ISG looks upon our alternative investments as potential portfolio stabilizers… much needed as volatility in both stock and bond markets pick up. Our various income-producing real estate (and real estate loans), insurance-linked securities, and less interest-rate sensitive bond strategies serve to improve overall portfolio stability. We continue to assess other alternatives on a regular basis.

Agility: Crossing the chasm recognizes the necessity of risk

-taking. For equity investors, we believe the most predictable results come through well thought out diversification in terms of company size and domicile and having the agility to make adjustments as needed. Presently, we believe all three of the world's major regions – the U.S., Europe, and Asia – have their respective merits but our investment committee is in active discussions over how these regions should be represented in our portfolios given current market and global economic conditions. We're also re-examining our exposure to smaller, "niche" companies which are less impacted by changes in global trade policies.

Focus: As the crosswinds of market volatility pick up, it challenges the participant to stay keenly cued in on the task at hand…and that is getting to the end of the line! In investment terms, this equates to a disciplined focus on one's longer-term strategic portfolio design and investment time horizon. We encourage our clients to continually dialogue with their ISG advisor on the merits of their current investment strategies in the context of their financial life stage, goals, and financial resources.

Recession, Anyone?

On a final note, we've been getting more questions about a U.S. recession and our quick answer is, "yes, we will have one… someday." But that "someday" in our view is still comfortably a ways off. Based on a comprehensive gathering of economic and financial factors, U.S. recession risk is low. U.S. growth has accelerated after a brief soft patch with most recent economic data exceeding consensus expectations. Rate hikes which can spoil the party are being implemented according to numerous sources at roughly one third the pace of a usual cycle, and while it might be argued that fiscal stimulus measures are being implemented at the wrong time in the cycle, they likely will extend the cycle. And when the inevitable comes to pass, as things stand now we believe a 2008/2009 repeat is not in the cards.

The consumer and banking system is in better shape versus pre-crisis as are financial imbalances, stock valuations, and reckless speculation. Economic contractions and subsequent market declines are part of the investment journey but today we believe our more diversified portfolios - while not immune from these effects - can enable one to cross the chasm successfully to their intended financial destinations.

In search of a health care facility?

Meet Pam Silverberg, Senior Care Manager for Stacy's Helping Hand, Inc., a business devoted to helping families find the right care facilities **for their personal circumstances**. Since 2007, they have spent thousands of hours touring care facilities: Independent Living, Assisted Living, Skilled Nursing, and Memory Care. This can save you hours of research and legwork and make the process less overwhelming. They also can assist you in finding other vital partners in this process: movers, elder law attorneys, Medicare/Medicaid consultants, homecare, and home health companies.

Pam will meet with you to assess your or your loved one's physical care, emotional and social needs, cognitive status, and with ISG's help, your financial situation. Her goal: To match your needs to the very best care options. She will even accompany you on tours of facilities and help you decipher the pro's and con's for each facility.

In short, Pam and her company are known for providing the most hands on assistance with integrity and compassion when facilitating difficult decisions related to the realities of the aging process.

If you or a friend are in need of assistance, please contact your ISG advisor.

Our Expanding ISG Team

Meet **Nicole Kobayashi** and **Seth Flory** who joined our operations team this year. Nicole is a DU graduate with extensive operations experience from another wealth management firm. Seth, a more recent DU graduate, majored in **economics** with an emphasis on international trade and business management. When not serving the ISG client family, Nicole enjoys fine-tuning her passion for the clarinet while Seth hikes and fly fishes in the Colorado outdoors.

In case you missed our previous announcement, **Odette Sahakian** joined our advisor team earlier this year, coming to us with over 26 years' experience with Charles Schwab, working as a trading specialist, managing director, and as a financial consultant for clients like you. Odette also enjoys the piano along with travel and hiking with her two dogs, Maddox and Maya.

All three of our new additions also enjoy giving back to the community through various charitable activities.

Welcome Nicole, Seth and Odette!