I|S|G
Investment Security Group, Inc.

Celebrating Our Third Decade of Providing Unbiased Financial Advice

> ***"Let no feeling of discouragement prey upon you, and in the end you are to succeed."***
>
> --Abraham Lincoln

Key Takeaways:

- Lower stock prices and lower investor expectations make a case for a better showing in stocks worldwide in 2019.
- The U.S. economic cycle is getting long in the tooth, so market volatility will likely continue as investors reconcile both bullish and bearish trends.
- A U.S. recession, however, remains a lower probability scenario in 2019 unless the Fed "overshoots" in its rate hikes and chokes off economic growth.
- Despite poor results relative to U.S. markets, foreign stocks remain a valid asset class — especially following last year's correction. Allocations slightly favor the Asian region over Europe, which offers cheap stock prices, but continues to wrestle with slow growth and geopolitical uncertainties.
- Bonds should do better in 2019, as Fed-induced rate hikes look to be closer to the finish line than the starting gate. Holding higher quality bonds will serve as an effective ballast against late-cycle growth scares.
- Less volatile "hybrid" strategies, which often have low or no correlation to stocks or bonds, continue to play a role in building resilient portfolios which should fare better in the uncertain period ahead.

Good Riddance 2018

For most investors, 2018 was a forgettable year. Most all asset categories ended in the red (see box, "No Place to Hide") as global markets struggled with a growing list of economic and political concerns. U.S. stocks were one of the few winning asset classes until they rolled over at year-end. At one point in the fourth quarter, they were down almost 20% from their peak levels. This magnitude of decline for most market pundits marks the technical definition of a bear market. Foreign stocks fell similarly and by year-end both asset categories suffered their worst showing since 2008. U.S. stocks were down between 4% and 11% (depending on which index one used) with many individual companies not covered by an index faring much worse. Foreign stocks gave up around 14% due to additional carnage incurred earlier in the year.

U.S. bonds also waivered in response to Fed rate increases (high quality bond prices typically decline as rates rise). The Barclays Aggregate Bond Index nudged just above zero and barely staved off a double negative showing

No Place to Hide

2018 tested investors' resolve with sub-par results across most all asset classes and regions. Blackrock, the world's largest asset manager, reported that 89% of the 125 global categories it covers ended the year in negative territory in 2018. Another asset manager, Deutsche Bank (DB) which does similar tracking, added that this scope of negative returns is highly unusual with only 29% of the financial market categories it covers finishing with losses in an average year. These results contrasted greatly with 2017, where according to DB, only one category ended in the red. This unusual confluence of negative results challenged even the most diversified of investment strategies.

News Notes

Tax Information from Schwab
You should receive your pertinent forms by mid-February. ISG, however, encourages clients to delay filing until *early March*, as 1099 forms are frequently amended by Schwab.

Meet Kevin Dibala
A 2014 business grad from Colorado State University, Kevin joined our operations team in December. Kevin has previously worked in the financial and marketing research sectors and is looking to learn the ISG business from the inside out. In his spare time, Kevin enjoys all aspects of the Colorado outdoors, gives back to various charities, and pursues his special passions playing piano and scuba-diving whenever he can (now a PADI certified Divemaster). Welcome to the ISG team, Kevin!

Happy New Year!

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.

by both stocks and bonds—something the markets have seen in only 2 out of the last 93 years.

A multitude of issues seem to be weighing on investors. U.S./China trade rifts, political disarray in Europe, uncertainty over future Fed interest rate policy, Trump/ Democrat "spats," and an extended government shutdown are some of the line items. The main culprit, however, was concern over slowing growth both here and overseas. 2018 was a banner year for U.S. earnings growth (up 22%) but investors seem to be focusing on recent economic data that suggests growth, while still positive, is slowing some. Among the investor issues are a potential profit squeeze given rising wage costs and constrained demand, waning short-term stimulus from the corporate tax cuts, and concerns that the Fed might push the economy into a recession by tightening financial conditions too much while the economy takes a breather.

Meanwhile, global investors have nervously been eyeing China's slowing growth rate (albeit at a much higher rate than most other major economies) along with disappointing growth in Europe—all happening at a time when many foreign central banks are winding down their easy money policies. This has sent ripple effects throughout the foreign investor community and its markets.

Some Silver Linings for 2019?

A clear positive is that the major price pullbacks in 2018 have reduced much of the frothiness in stocks—particularly here in the U.S.—that could have made future stock gains in 2019 more difficult. Investors have reset their expectations about near-term U.S. growth so meeting or barely exceeding these lower expectations sets the stage for a better year for stocks in our view for 2019. Additionally, the Fed has gotten much closer to bringing rates back to more "normal" levels and along with its balance sheet reduction is better positioned to fight the next economic slowdown. Inflation continues to remain relatively benign which takes pressure off the Fed to be as vigilant as it might normally be this late in the economic cycle. With the right Fed actions and continued modest growth, recession fears could fade and restore investor risk appetites for stocks.

Do You Have a "Trusted Contact Person?"

Regulatory authorities in the financial services industry have made "senior exploitation" a top priority in their 2018 audits of investment advisory firms. In response to this, ISG will be adopting procedures to make a reasonable effort to obtain the name and contact information for a "trusted contact person" for senior clients who are 65 and older. This contact is intended to be a resource for your ISG team in administering your account, protecting your assets, and serving as your advocate should your physical or mental capacity deteriorate. Charles Schwab now includes a trusted contact designation section in their account paperwork. Your authorization to name a trusted contact person however, is always optional.

We will be sending out more information on this timely topic in the near future.

Overseas, the Chinese authorities appear to be focused on supporting its economy with more fiscal and monetary stimulus. Tax cuts and a modest increase in infrastructure spending have been announced while bank reserve requirements have been lowered to boast lending to private firms. If these initiatives prevail and China's growth rate levels off, global markets could take a collective sigh of relief, thus paving the way for future gains in many China-dependent markets. In Europe, stocks appear to have priced in much of the bad news in that region so any minor improvements in the growth numbers and/or resolution to some of Europe's problem spots (Italy's budget deficit violations, UK's departure from the European Union) could also break up the current investor complacency throughout the region's stock markets.

Our Bottom Line for 2019: Hope for the Best, Plan for the Worst

Putting it all together, the uptick in market volatility investors experienced in 2018 should continue as a tug-of-war emerges between bullish and bearish investor impulses, depending on the "data du jour." Lower stock prices and lower expectations heading into the year make a great case for further stock gains in 2019. Nevertheless, we remain mindful that the balance between a good and sub-par outcome in 2019 will likely be a delicate one…and one to watch closely. A Fed "overshoot" in rates which could

knock the economy into recession, an unexpected China slowdown along with continued sluggish growth and political disarray in Europe, the U.S. corporate debt overhang, a deepening U.S./China trade impasse, U.S. political dysfunction, and a pick-up in the global backlash against globalization are all on our radar in the coming year.

The long-term solution to all of this uncertainty is to build resilient portfolios which can effectively navigate through the market's inevitable disruptions and surprises. Given the late cycle environment we are in, ISG's investment committee (IC) is in discussions to steer our stock strategy towards reasonably priced companies with higher quality balance sheets and more earnings predictability. Our allocation between U.S. and foreign stock exposure remains a top IC topic but, for now, we maintain a U.S. bias with our overseas exposure skewed towards the Asia region. China's growing consumer appetite cannot be denied (domestic consumption now makes up over half of China's GDP) which takes pressure off its traditional levers for growth - exports and infrastructure build-up—and bodes well for its future as a more balanced economy. Europe's stocks are cheap—but growth and political issues dissuade us from a higher weighting to this asset class. This could change as the economic and political issues previously cited play out in the year ahead.

On the defensive side of the ledger, high quality bonds (bought individually or via a fund strategy) are once again looking more attractive as Fed–induced rate increases get closer to ending. With higher rates becoming available, this asset class will serve as a better source of income and ballast against late-cycle growth scares so they will continue to be a mainstay in most portfolios. Finally, we continue to rely on our allocation in "hybrid" investments which often come with better-than-bond return potential and lower volatility or lower correlation to stocks or bonds.

In sum, while we know that it is impossible to deliver satisfactory results year after year, it is paramount that we build portfolios that can enable you to meet your financial goals and lifestyle aspirations. On that note, we thank you for your trust and confidence in us.

A Smart Way to Give to Charity

For the charitably inclined who are post 70.5 years old and who are taking required minimum distributions (RMD) from their IRA's, there's an often overlooked tax provision known as "qualified charitable distributions" that enables one to direct some or all of their RMD to the charity (or charities) of their choice. The amount that goes to the charity – and it has to be a direct transfer from your IRA to the qualified charity – is excluded from your income and the amount that goes out satisfies your RMD. So it's a way of excluding your RMD from your income and meeting your charitable goals at the same time.

This strategy can be more advantageous than just making the contribution to the charity and then deducting it on your return because with the new tax laws some people don't have enough deductions to itemize. Also, if your income is lowered by excluding your RMD, Medicare premiums can go down substantially because of your lower reported income and less of your social security may be taxable as well.

Qualified charitable distributions can be an effective financial planning strategy and if interested, we encourage you to discuss it with a qualified tax advisor.