INVESTMENT MANAGEMENT & CONSULTING GROUP

VIEWPOINTS

FIRST HALF 2014	ADVISORY NEWSLETTER

2014 - 20TH ANNIVERSARY YEAR

MARKET COMMENTARY **FREDRIC W. WILLIAMS**

Boring Can Be Beautiful…

"When one door is closed, don't you know, another is open."
- Bob Marley

After playing second fiddle to the new-tech and momentum stocks last year, the first half of 2014 saw the return of the meek and mundane, as the value side of the investment-style tug of war brought "boring" utility, real estate and consumer staples shares to the front of the stock parade. As we noted in this space earlier in the year, the outsized advances in the domestic indices may have gotten ahead of the more modest rise in corporate profits last year, so it wasn't a complete surprise when last year's leaders encountered some head winds mid-way through the first half of 2014 – perhaps under the banner of "too far, too fast". And although the momentum crowd dusted themselves off in the second quarter, the "tortoises" from the value side of the equity ledger easily outdistanced the indices as Q2 2014 drew to a close.

The data summarized in Jay's Table 2 in the following article suggests a respectable first six-month's returns for the indices, although they were far surpassed by the Dow Jones Utility Average, up 18.3% during the first two quarters, and REITs, which jumped 17%. Even the more-broad based Russell Mid Cap Value Index, a proxy for smaller low price-earnings and higher dividend paying companies, advanced 11.14% by the halfway mark in 2014, suggesting that the positive value bias was not merely focused on a limited number of sectors.

The never-ending debate between the risk-adjusted supremacy of the value-vs-growth investment styles will likely never be resolved in the minds of some, but does lead one to a bit of empirical analysis so that the data can be separated from the "noise" of its ardent advocates. And although a ten-year view does not make an investment lifetime, it is a good starting point for purposes of gaining a more rational perspective on the discussion.

Post Office Box 4802 ♦ 130 Middle Street ♦ Portland, Maine 04112
207.774.6552 ♦ 800.605.6552 ♦ FAX 207.775.2969
www.imcgrp.com ♦ info@imcgrp.com

What Table 1 below summarizes is not only the longer-term traditional risk/return paradigm (the Emerging Markets represent a higher relative risk than the S&P 500, therefore you should expect a higher rate of return), but also highlights the somewhat counter-intuitive observation that lower beta sectors (i.e. less volatile or “risky”) can outperform over time. This is seen below with the returns generated from the REIT and Utility sectors, as well as with the anecdotal performance of the aforementioned Russell Mid Cap Value index which boasts 10-year average annual returns of 10.66%, the best of any of the major domestic indices.

Table 1 – The Longer View	
Equities	*Annualized 10-Year Returns*
S&P 500	7.78%
DJIA	7.63%
NAREIT Equity REIT Index	8.5%
DJ Utility Average	10.61%
Nasdaq 100	10.62%
MSCI Emerging Markets	11.94%
Fixed Income	
Barclays Aggregate	4.93%

This dynamic, interestingly enough, is not a new phenomenon and has been the foundation of our research discipline since we started the firm 20 years ago. We, however, don’t want to lay claim for the heavy lifting in uncovering this data, as we’ve merely ridden on the back of folks like Roger Ibbotson at Yale (http://som.yale.edu/roger-g-ibbotson) and Jeremy Siegel at Wharton (https://fnce.wharton.upenn.edu/profile/982/) who highlighted, and refined, the basis for the outperformance of relative value AND low price earnings/high dividend stocks respectively.

Although Jeremy gets more press as a media talking head, Roger’s years of research and publication were thought so highly of by Morningstar that they bought Ibbotson Associates outright in 2006. Both are compelling, and entertaining, speakers, and we’ll highlight more details of their work in our next issue. Suffice it to say that their empirical analysis tends to support the tortoise over the hare in the investment-style race – suggesting that the methodical compounding of cash flow could provide better total returns, and less volatility, than their higher beta alternatives.

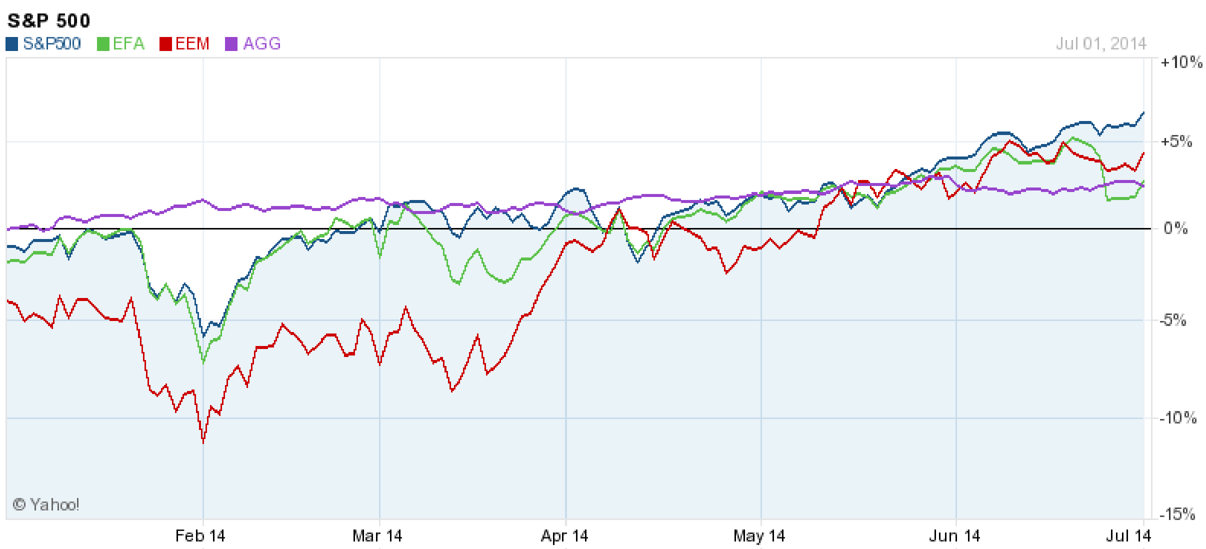
From a prospective standpoint, and given that it’s been three years since we’ve seen a correction in the indices of more than 10%, we wouldn’t be surprised by (and, in fact, would welcome) a pull-back in the intermediate future. With the market’s P/E near the top of its historical range, market advances will need support from more earnings growth that is based on overall revenue increases - not just financial engineering and cost cutting on the expense side of the equation. We, however, identify any such market declines, all things being equal, as opportunities for the allocation of capital to alternatives with favorable valuations, as both the domestic and global economies continue to gradually recover from what has been dubbed the "Great Recession".

CAPITAL MARKETS OVERVIEW — JAY O. FLOWER

The First Half of 2014…

The equity markets stumbled out of the gate to start off the year as the S&P 500 posted the first negative January since 2010 closing down about 5% for the month. Money was flowing out of equities and into long-term U.S. Treasuries as investors took the opportunity to realize considerable gains from 2013. This forced treasury prices higher and the yields down to 2.65% on the ten-year, after opening the year just over 3%. The selling was even stronger in the emerging markets as the MSCI Emerging Markets index fell almost 10% in January as concerns over slowing growth in China continued to mount. This slow start in January prompted many capital markets prognosticators to dust off their Stock Trader's Almanacs to remind themselves of what a negative January means for the full year outlook. The answer is an underwhelming 50/50 chance of positive returns for the year.

As the chart below shows, the markets recovered quickly and by mid-February they were even for the year, and actually bumped up into positive territory on the S&P 500 for the last half of the first quarter. What is most interesting and encouraging to us is the strength we saw in the emerging markets the last two weeks of March, as investors have seemingly shrugged off concerns regarding the impact of Putin's takeover of Crimea.



(Key: **EFA** = iShares MSCI EAFE ETF , **EEM** = iShares MSCI Emerging Markets ETF, **AGG** = iShares Core Total Bond Market ETF)

Real Estate Investment Trusts are an asset class we have owned and liked for a long time due to their above average income and typically low correlation to both equities and fixed income. Last year REITs were the worst performing equity sector returning just 3.21% (FTSE NAREIT All REIT Index) yet we are pleased to have held onto these positions as the index was up 16.2% in the first half of the year versus the S&P 500 up 7.17%. As the chart below shows, there has been a wide disparity in returns amongst the ten S&P sectors with Utilities up almost 19% and Consumer Discretionary barely positive for the first half of the year, up just 0.6%.

MARKET INSIGHTS

Returns and Valuations by Sector

Equities

		Financials	Technology	Health Care	Industrials	Energy	Cons. Discr.	Cons. Staples	Telecom	Utilities	Materials	S&P 500 Index
Weight	S&P Weight	16.1%	18.8%	13.3%	10.5%	10.9%	11.8%	9.5%	2.4%	3.2%	3.5%	100.0%
	Russell Growth Weight	5.2%	27.7%	12.8%	12.3%	6.4%	18.4%	10.5%	2.3%	0.1%	4.3%	100.0%
	Russell Value Weight	28.5%	8.9%	13.1%	10.5%	13.9%	6.3%	6.9%	2.3%	6.3%	3.4%	100.0%
Return (%)	YTD	5.0	8.9	10.6	4.0	13.0	0.6	5.2	4.3	18.7	8.6	7.1
	2Q14	2.3	6.5	4.5	3.9	12.1	3.5	4.7	3.8	7.8	5.6	5.2
	Since Market Peak (October 2007)	-26.8	62.0	93.0	44.3	43.2	97.9	92.5	24.0	41.6	35.6	45.2
	Since Market Low (March 2009)	299.8	239.4	211.1	296.7	162.3	358.1	170.0	136.8	147.9	223.0	224.4
β	Beta to S&P 500	1.43	1.12	0.70	1.20	0.99	1.13	0.57	0.63	0.48	1.28	1.00
ρ	Correl to Treas. Yields	0.33	0.09	-0.08	0.29	0.23	0.18	-0.15	-0.35	-0.43	0.16	0.11
P/E	Forward P/E Ratio	13.1x	15.2x	16.7x	16.2x	14.7x	17.7x	17.7x	13.4x	16.6x	17.1x	15.6x
	15-yr avg.	12.4x	21.8x	17.0x	16.5x	13.7x	18.0x	17.3x	16.6x	13.6x	15.8x	15.8x
	Trailing P/E Ratio	15.9x	19.0x	24.1x	18.0x	16.2x	21.1x	20.0x	10.8x	20.4x	19.4x	18.5x
	20-yr avg.	16.3x	26.3x	24.4x	20.3x	17.4x	19.2x	21.2x	20.0x	14.8x	19.3x	19.5x
Div	Dividend Yield	1.8%	1.6%	1.7%	2.1%	2.3%	1.5%	2.7%	4.9%	3.7%	2.1%	1.9%
	20-yr avg.	2.1%	0.7%	1.4%	1.7%	1.7%	0.9%	2.1%	4.2%	4.3%	2.1%	1.7%

Source: Standard & Poor's, Russell Investment Group, FactSet, J.P. Morgan Asset Management.

Another set of interesting, and admittedly, unexpected data points from the first half is that the Barclays Aggregate Bond index, High Yield index and Municipals (10-year) index finished in positive territory up 3.82%, 5.45% and 5.66% respectively. New Federal Reserve Chair, Janet Yellen, kicked off her first post-Fed-meeting press conference in March with a remark riddled with plenty of nervous "ummm"s and "uhhhh"s that seemed to shake the market albeit very temporarily. When asked about the expected timing between the end of QE and the first rate hike she eventually said, "something on the order of six months or that type of thing." So at the current rate, QE3 will most likely wind down by the end of this year and that would mean a rate hike sometime in mid-2015. Treasury yields spiked immediately following the statement which seemed to be a typical overreaction to any Fed remarks. There were plenty of caveats clearly drawn out in the Fed's official commentary, which was rather mundane. Of note, the 6.5% unemployment rate was removed as a rate hike trigger and the FOMC will obviously be looking at a wider range of indicators. Chairwoman Yellen's press conference after the June meeting left some lingering questions about the condition of the labor market. As we have discussed in this space in the past, the correlation between inflation and unemployment rates is typically very high. Thus, with initial monthly claims continuing to drop, it would imply that an increase in inflation should be expected in the coming months. As is always the case, we know that economic data does not increase or decrease in a predictable or linear fashion so investors should expect turbulence along the way as the markets have a tendency to overreact to any unexpected news.

Standard & Poors upgraded two of the major bond insurers in the first quarter which helped the rebound in the tax-free debt markets. Both Assured Guaranty and National Public Finance were upgraded which helped improve at least perception of additional safety in owning insured municipal bonds. This perception has certainly proved to be true as the insured bonds related to Detroit's bankruptcy have continued to pay interest to bond holders. Other factors helping municipal bonds rebound in the first half are decreased supply and increased demand. Municipalities have issued less debt compared to this time last year as their financial conditions have improved and they can now wait to for potentially lower rates.

Table 2 - Index Returns			
Equities	*Percentage Change for the 2nd Quarter*	*Percentage Change for the Year*	*Annualized 10-Year Returns*
S&P 500	**5.23%**	7.14%	7.78%
DJ UBS Commodity Index	**0.8%**	7.08%	0.87%
MSCI EAFA	**4.09%**	4.78%	6.93%
MSCI EM	**6.60%**	6.14%	11.94%
NAREIT Equity REIT Index	**7.2%**	17.0%	8.5%
Fixed Income			
Barclays Aggregate	**2.04%**	3.93%	4.93%
Barclays U.S. Treasuries	**1.35%**	2.71%	4.53%

FIDUCIARY CORNER — STEPHEN L. EDDY

DOL Target Date Guidance, 1 Year Later…

The massive popularity of target date funds (TDF's) has the Department of Labor (DOL) taking notice. Some estimates have TDF's holding HALF of all retirement funds by the year 2020, which will represent several trillion dollars. A little over a year ago, in February of 2013, the DOL issued a publication called "Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries". The document listed eight "tips" for plan sponsors to use in evaluating the proper TDF for their retirement plans. As a general rule of thumb if the DOL is issuing publications with tips for ERISA fiduciaries, plan sponsors should take notice of the topic and incorporate the "suggestions" into their fiduciary review.

In December of 2012, I wrote in this space about the dangers and potential misuse of target date funds. The eight DOL tips address many of the issues mentioned in that article. I have put together a table summarizing the tips and our suggested solutions for compliance below:

DOL Tip	Solution
Establish a process for comparing and selecting TDF's	Your process for comparing and selecting TDF's should be based on what your plan hopes to achieve with the TDF's and integrate the same aspects of fund criteria that are involved in selecting the non-TDF's for your fund menu. Have your investment fiduciary review each component with you, as TDF family comparison is often a case of comparing apples-to-oranges.
Establish a process for the periodic review of selected TDF's	Incorporate the TDF's into your quarterly fiduciary investment review and have specific documented parameters for measuring them.
Understand the fund's investments – the allocation in different classes (stocks, bonds, cash), individual investments and how these will change over time	As part of your review, determine if the fund's glide path (the gradual reduction in stock exposure over time) fits the needs of your plan and its participants. Learn the differences of "to" and "through" funds and incorporate that into your decision making process.
Review the fund's fees and investment expenses	As with every other fund in your plan, you should know the costs associated with TDF's. This should be a standard review component.
Inquire about whether a custom or non-proprietary target date fund would be a better fit for your plan	Most retirement plan platforms/vendors are trying to drive assets to TDF's that they offer/manage, which invariably is a compilation of their funds, both good and bad. This tip may impact how you select the proper platform. Does your platform allow you to use someone else's TDF's? If Fidelity is your platform, can you use Vanguard TDF's? Should you have custom target date funds? Document your questions and document the answers. Most good platforms allow use of any TDF family and also allow for custom TDF development
Develop effective employee communications	Hold employee education seminars and meetings regarding TDF's. Make your investment fiduciary available to discuss them.
Take advantage of available sources of information to evaluate the TDF and recommendations you received regarding the TDF selection	Listen to your independent investment fiduciary. You are paying them for an opinion in an area where you may not have expertise. Several court cases have highlighted the liability of the investment committee that ignores consulting advice. Document.
Document the process	A well-documented process is the best defense against lawsuits and audits.

If you have any questions regarding TDF selection for your plan, please contact the Independent Investment Fiduciaries at IMCG.

PLANNING CONCEPTS — TRACY ROGERS

Long-Term Care Insurance – A Primer & Review…

Unlike 10-15 years ago, multiple types of long-term care insurances are available to today's consumer. Many of these policies have come to market due to the consolidation of the industry and rising premium costs. These hybrid polices are gaining in popularity with the consumer and advisors because stand-alone polices are expensive, accrue no cash value, premiums may increase and underwriting can be difficult. The following provides a brief summary of some of the different insurance vehicles that offer long term care insurance coverage.

Individual or Group Long-Term Care Policies

These policies represent the majority of the long-term care policies sold today. They are designed to cover virtually all long-term care services and are usually purchased with monthly, quarterly, semiannual or annual premiums paid for the life of the insured. With some insurance companies, abbreviated payment schedules are available with policies fully paid up after 20 years, 10 years or one year, depending on the terms of the policy. This type of long-term care insurance policy is similar to the typical individual or group health insurance policy and tries to cover as many care alternatives as possible.

Rider to A Cash Value Life Insurance Policy

This type of policy actually uses two types of coverage within one policy, with the premium split to pay for both life and long term care insurance coverage. The long-term care rider differs from the "accelerated death benefit," a popular feature of many life insurance policies. An accelerated death benefit pays part of the life insurance, death benefit for terminal illness or for doctor-certified terminal long-term care while the insured is living. Since long-term care typically cannot be certified as care for a terminal patient, the accelerated death benefit does not apply to most long term care situations.

Either/Or Feature In A Life Insurance Policy

If you purchase a life insurance policy with an either/or feature, it works like this: If the insured dies, a death benefit is paid, just like a regular life insurance policy, however, if the insured needs long-term care before death, specified benefits are paid instead of life insurance. If all benefits are paid before death, the policy expires. Any benefits specified for long-term care that are not used prior to death are provided as a reduced death benefit. What you are buying is a policy with the potential to cover both contingencies, long-term care and death, although the amount of the death benefit will be reduced by the amount of any long-term care benefit used. This type of policy can be purchased with periodic premiums over the life of the insured or with a single premium of $50,000 or more.

The primary advantage of this type of policy is that the insured is guaranteed a benefit. One disadvantage is that many people who purchase long-term care insurance don't need life insurance. Because the policy covers both the mortality risk of death and the morbidity risk of long-term care, premiums are much higher than an equivalent stand-alone long-term care policy. Another disadvantage is that the underwriting standards for life insurance are stricter than standards for long term care insurance. Many who qualify for long-term care insurance would be denied life insurance coverage.

Integrated Into A Single Premium Deferred Annuity

This usually requires a single, lump sum payment of $50,000 or more. Part of the earnings on the annuity is used to fund the long term care morbidity risk, which reduces the actual earnings credited to the annuity. Thus an annuity that would normally earn 6% might only yield 4% when combined with long-term care insurance. However, some polices with this rider can double your initial benefit, thus creating $100,000 available for long-term care in this example. One advantage of this approach is that long-term care premiums are paid with tax deferred earnings and since they are expensed inside the annuity premiums, the premiums become tax free. A second apparent advantage is the perception that no money is spent on a long-term care policy if the long-term care benefit is never used. In fact the annuity lump sum even grows larger. Of course, money is actually spent because part of the annuity earnings is being used to cover the long-term care premium. Therefore, the lump sum grows larger but not as fast as it would if some of its earnings were not being used to pay the long term care premium. A significant disadvantage is that the money is tied up in the annuity. Removing money would terminate the long-term care coverage, perhaps just before you need it. At death, proceeds would go to a named beneficiary. Few people have $50,000 that they are willing to tie up for an extended period of time. In most cases, it is better to fund a stand-alone long-term care policy with the earnings from a separate investment account.

In a recent Cost of Care Survey for 2013 tabulated by Genworth Financial, the median annual rate for home health aides was $50,000. For assisted living facilities the average was $54,000 annually. For nursing home care the average cost was $104,025. These expenditures would be devastating to the majority of retirees. With options for coverage ever changing, it may be prudent to revisit a plan for long term care, so feel free to contact us if you'd like to discuss these concepts in more detail.

IMCG News

Fred Williams – Once again this year Mr. Williams attended the Morningstar Ibbotson Conference in late February. Ibbotson's analyst's symposium continues the tradition of bringing academic theory to industry practice, with thought leadership on asset allocation, investment research, economic analysis and portfolio strategy - this year's gathering featured a presentation by founder Roger Ibbotson, who spoke on the advantages of lower volatility/lower beta (i.e. lower risk) actually outperforming higher volatility/higher beta equity selections.

Jeannine Plourde – After 7 years of being an integral part of the firm's Client Development & Support Group, Jeannine has decided to retire and live carefree. She and her husband, Ray, hope to travel and expand their common interests in a much deserved retirement. Not only will the firm miss her but we know the clients she has interacted with over the years will also join us in saying "Thank you for all the service and entertainment you've brought to IMCG. Enjoy your retirement!"

Tom Donaldson – IMCG's Senior Advisor to the Investment Policy Committee recently returned from and energy conference in Canada. The Oil and Gas Investments Bulletin conference was held in Toronto, focused on new North American developments, and featured 12 energy companies in all phases of exploration and production in both the oil and gas and service industries.

Steve Eddy – Recently presented at a Maine Employee Benefits panel entitled "Target Date Funds (TDFs) – Peeling the Layers of the Onion". Steve addressed the fiduciary and disclosure issues surrounding these products being offered in qualified plans, as well as the cost and investment overlap concerns that are inherent to these currently "in vogue" mutual fund products.

Anne-Marie Palmer – We welcome aboard our newest Client Service Associate in the Client Development & Support Group, Anne-Marie Palmer. Anne-Marie joined us in May from the City of Westbrook's offices, with extensive experience in client support, along with administrative and operational services. She is taking on responsibilities for coordinating our new client relationship management software processes that greatly enhance how we maintain client data and confidentiality. She is the proud mother of three girls and one granddaughter, Aubrey. Anne-Marie is the Treasurer of the Westbrook Food Pantry and is already coming up with ideas on how to improve their services through an outreach financial advisement program.

Missy Lyon – Joined IMCG last month as a Portfolio Manager Associate, with a focus on coordinating our comprehensive portfolio and wealth management processes, as well as using her experience to help guide the firm's compliance structure. Missy has been in the financial services industry for over 25 years, most recently at Charles Schwab in Portland, has her B.A. degree from U.C. Santa Barbara and has worked on her M.B.A. at California State in Sacramento. Missy volunteers with the Girl Scouts, where she focuses on retention of older girls and financial literacy programming and is a past volunteer with the Sacramento Zoological Society Board of Directors, the Greely High School Principal's Advisory Committee and Treasurer for the Greely Field Hockey Boosters. She currently resides in North Yarmouth and has a daughter heading off to college this fall.

CLIENT NOTABLES:

Occasionally we like to highlight the achievements and accolades of our clients since they more than often contribute to the fabric of our community – the richness of which is one of the reasons we live in Maine. Again this year in its July issue Maine Magazine published its list of "50 Mainers Shaping Our State", highlighting "people who have changed our world, improved our lives, and broadened our horizons."

Dr. Dorothy Foote, who is CEO and Head of School at Wayfinder Schools, a private alternative high school with locations in Camden, New Gloucester and Machias, was noted for her work with Maine's young adults at risk of non-completion of high school. Dot's story can be found on page 140 of the current paper issue, or in the 13th slot of their online version at: http://wayfinderschools.org/wp-content/uploads/MM_July2014_50People.pdf

SAVE THE DATES:

We're in the midst of that time of year when a variety of non-profit organizations begin their fundraising efforts. Although by no means complete, the events below are but a sampling of the organizations that our firm, employees, colleagues and clients are involved with:

- ***Greg Francoeur Memorial Golf Tournament*** **–** The 11th annual event to benefit the scholarship fund managed by the Maine Community Foundation which provides support to students enrolled at Carrabassett Valley Academy who would not be able to take advantage of educational and training opportunities without financial assistance. Contact Gary Francoeur at garyfrancoeur@comcast.net for more information about the event to be held Friday morning July 11th at the Val Halla Golf Club in Cumberland, Maine.

- ***The Center for Grieving Children*** – Is holding its Swing "Fore" the Center benefit golf tournament Tuesday September 16th at The Purpoodock Club in Cape Elizabeth starting at noon. Additional information and registration can be found on their web site www.cgcmaine.org .

- ***Wayfinder Schools*** *(formerly The Community Schools at Opportunity Farm and Camden)* - Will host their annual "Farm to Sea" Auction on Thursday, October 9th in the Eastland Grand Ballroom at the new Westin Portland Harborview 6 p.m. to 9:30 p.m. All of the funds will support the School's mission of providing diplomas for adolescents at risk of non-completion of high school through their Residential and Passages Programs with campuses in Camden, New Gloucester and Machias. For more information, go to www.wayfinderschools.org where auction information will be posted and updated throughout the coming months.

Lastly, stay tuned in the early 4th quarter for some exciting announcements that have been in the works for more than a year as our firm continues to grow and prepare for the future!