SMI’s 2015 Broker Review: Choosing the Broker That’s Right for You

Since our last broker review three years ago, several brokerage companies have altered their policies, and many SMI readers have blended strategies such as Dynamic Asset Allocation and Sector Rotation with their Upgrading portfolios. Read on for a review of the current state of the broker landscape through the lens of SMI’s primary investing strategies.

by Matt Bell and Mark Biller

New SMI members have two important choices to make: which strategy (or strategies) to implement, and which broker to use. As you’ll soon see, the first choice will help determine the second.

Several important changes have occurred in the broker landscape since our last comprehensive broker review in early 2012. Notably, Vanguard has become a more hospitable place for those following Fund Upgrading. The company has increased the number of no-transaction fee (NTF) funds it provides access to. In addition, Vanguard has shortened the period it requires an investor to hold such funds to avoid being charged a fee (and it has reduced those fees in many cases).

Still, our top three recommended brokers remain the same: Fidelity, Scottrade, and Schwab. Vanguard and TD Ameritrade are commendable options for some. Vanguard holds particular appeal for those using our indexing-focused Just-the-Basics strategy, while TD Ameritrade is still utilized by many SMI readers who were grandfathered into a free-trade arrangement years ago. There are other fine brokers around, and we looked at several others including Siebert, Firstrade, and E*TRADE. But for the specific needs of SMI readers, we believe our recommended three are the best options at this time.

Industry background

The discount-brokerage business is only 30 years old, yet because of the opportunities (and pressures) of the Internet, the industry has undergone dramatic changes and shifts of power. Within that short time frame we’ve seen industry leaders lose their way and recover it, as well as a whole new generation of entrants rise up (many of which were soon gobbled up by larger competitors). Through it all, change has been the only constant. Competition for assets and accounts has produced intense innovation, and has driven prices down to levels once considered unimaginable. Brokerage customers have been the big winners—more and better services have been added at continually declining prices.

Compare today’s competitive environment to 30 years ago. In the mid-1980s, mutual-fund investors essentially had two options: Go with a traditional broker and gain access to a wide variety of pricey load funds, or avoid loads by opening an account directly with a specific no-load mutual-fund company that offered a sharply limited fund lineup. In other words, it was fund variety at high cost or extremely limited choices at low cost.

That changed when Charles Schwab invented... (continued on page 115)
Are Your Investing Expectations Reasonable?

Investing self-discipline requires holding on to reasonable beliefs in spite of your changing moods. When your strategy suddenly seems unproductive, it is self-discipline that holds you on course and keeps you anchored.

Every investor, from time to time, has his or her emotions rise up when short-term events go against them. When your intellect and emotions sit down at the negotiating table, the intellect is usually the first to blink.

To combat this, SMI preaches the importance of developing a long-term mindset. For many, thinking long-term is easier said than done. Perhaps this perspective will help. The nearby chart shows the natural ebb and flow of any successful investing strategy. The long-term trend is up, but there are periods of rising and falling prices along the way.

As time passes, new investors come along and adopt the strategy. Some, solely by happenstance, invest at advantageous times (points 1-3). Others just happen to invest as an unfavorable period begins or is underway (points 4-6). Each group’s view of the reliability of the strategy is colored by the timing of their individual entry points. Some see it positively due to their initial profits, others view it with growing doubt due to their initial losses. None of this has anything to do with the validity or long-term success of the strategy itself.

Not over-reacting to short-term events is one of the greatest challenges facing the average investor. Make sure your expectations are geared to your long-term results (I suggest you use at least a 10-year time frame) rather than the inevitable short-term ups and downs. Based on the histories of SMI’s various strategies, here are some “reasonable expectations” you might adopt:

- **Just-the-Basics.** JtB should generate returns at least equal to those of the overall U.S. stock market on an average annualized basis over a 10-year period. Most recent 10 years (as found on back cover): Beat the market by 0.1% per year.

- **Stock Upgrading.** More often than not, this strategy will generate returns better than those of the U.S. stock market on a yearly basis, and outperform on an average annualized basis over a 10-year period. Most recent 10 years: Beat the market by 0.2% per year. (Underperformance in 2011 and 2014 has diminished what was once an impressive 10-year comparison for Upgrading; more on this next month.)

- **Bond Upgrading.** More often than not, this approach will generate returns better than those of the U.S. bond market on a yearly basis, and outperform over a 10-year period. Most recent 10 years: Beat the bond market by 2.7% per year.

- **Dynamic Asset Allocation (DAA).** Yearly returns may not consistently be better than those of the overall U.S. stock market, but by minimizing losses during bear markets, DAA should generate returns better than those of the stock market over a 10-year period. Most recent 10 years: Beat market by 4.0% per year.

- **Sector Rotation.** By concentrating in single industries, SR likely will significantly outperform the U.S. stock market over a 10-year period, accepting higher risk of loss on an annual basis in the process. Last 10 years: Beat the market by 7.5% per year.

- **50-40-10.** By blending three SMI strategies, 50-40-10 is likely to outperform the U.S. stock market over a 10-year period. This should occur with less volatility on an annual basis. Most recent 10 years: Beat the market by 3.4% per year.

- **Optional Inflation Hedges.** Designed for periods of rising inflationary concerns. Only in that environment would we expect this strategy to outperform the U.S. stock market in any given year. Most recent 10 years: Trailing the market by 1.2% per year.

- **Enhanced Just-the-Basics.** By adding an Upgrading element to our indexing strategy, EJtB should generate returns better than those of Just-the-Basics over a 10-year period. Most recent 10 years: Beat Just-the-Basics by 0.4% per year.

We’ve redesigned our back page so you can have updated performance information each month on all our basic and premium strategies. The point of doing that, however, is not to focus attention on the most recent month(s) as investors tend to do, but more importantly to help our members keep a long-term perspective by regularly updating the 10- and 15-year numbers.

Looking at past histories with records of success is a good defense against present discouragement leading to emotional—and generally counter-productive—decisions.

**NECESSARY CAUTIONS**

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**POSTMASTER**

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— See May2014:Cover and May2015:p70 for more on the 50-40-10 strategy.
SMI’s 2015 Broker Review

(continued from front page)

The “mutual-fund supermarket” (and Fidelity quickly followed with its own discount-broker model). The fund-supermarket approach offered investors the best of both worlds: a broad range of fund choices at a fraction of the full-service brokerage price. Not surprisingly, SMI has recommended both Schwab and Fidelity since our first issue back in 1990. These two continue to be the leaders of the discount-broker pack, both in terms of the size of their operations and customer experiences they offer.

But the rest of the broker marketplace didn’t stand still. As the bull market of the 1990s unfolded, Schwab and Fidelity found themselves pushed by a crowd of new competitors. The primary appeal of these challengers was simple: lower fees than the two big guys. It wasn’t long before TD Waterhouse (which became TD Ameritrade) and Scottrade showed up on SMI’s radar screen, because of their lower overall costs for smaller accounts and more lenient policies in a few key areas of particular interest to Upgraders. These upstarts took over the “low cost” position that Schwab and Fidelity once owned in the brokerage food chain. Vanguard’s excellence at low-cost indexing has provided them a niche appeal for SMI members as well.

Choosing the “right” broker

One of the first questions an investor grapples with is “Where should I open my account?” While Fidelity offers the most flexibility to follow any of SMI’s strategies, the best home for your account will be dictated largely by which investing strategy you intend to pursue.

Just-the-Basics followers will want no-fee access to the Vanguard index funds. No problem—a regular mutual fund account with Vanguard fills the bill. Someone exclusively following the Enhanced Just-the-Basics strategy—a premium membership strategy that requires quarterly housekeeping and relies on Fidelity funds—would likewise gravitate toward a Fidelity account. For those following Fund Upgrading, several brokers offer the right funds at reasonable prices. Those following Dynamic Asset Allocation (DAA), which requires the use of exchange-traded funds (ETFs), will find their needs met at most brokers, albeit with slightly varying commission costs.

Other factors in choosing the right broker include:

• **Customer service and website design.** There is a strong element of “you get what you pay for” when it comes to discount brokers. Generally speaking, the cheaper the broker’s fees, the less service you can expect. If having ready access to a customer service rep (via phone, email, or online chat) is important to you, you’re likely to be disappointed with the low-cost brokers. We suspect it’s worth it to most investors to pay a little more to have access to competent help when a clarification is needed or a problem arises. But like everything else, it’s up to you to decide.

• **Maintenance fees for smaller accounts.** Some brokerages (Fidelity, Vanguard) still discourage smaller accounts by charging fees on accounts below a certain dollar threshold. Thankfully, these “nuisance” fees have become increasingly rare and usually can be avoided by accepting conditions such as agreeing to receive statements and other documents electronically.

What follows is a look at which brokers work best for each of the SMI strategies.

Just-the-Basics

The needs of those following Just-the-Basics are...basic. You want access to the recommended ETFs/funds (of which there are only four) or adequate alternatives. While you would prefer that you not be charged any fees to buy or sell, this matters less than with SMI’s other strategies due to the fact that there is no selling of funds throughout the year.

Still, the go-to broker for SMI members following this strategy is Vanguard since the strategy uses Vanguard funds exclusively. Whether using the ETF or traditional mutual fund classes, Vanguard accounts can trade them all for free. Just-the-Basics can be implemented at virtually any broker due to the inexpensive cost of buying the recommended ETFs, but if you’re choosing a broker specifically to implement JtB, Vanguard is the obvious choice.

Fund Upgrading

Those following Fund Upgrading need more from a broker than those following any other SMI strategy. Here are the critical criteria:

• **Selection of no-transaction-fee (NTF) funds (more is better).** These are funds you can buy and sell within your account without paying any commissions or transaction fees. You want a broker that offers an abundance of NTF funds. (While no transaction fees are charged directly to the investor, investors pay indirectly via higher expense ratios because fund companies have to pay the brokers to make their funds available.)

• **NTF holding periods (shorter is better).** To discourage overly active trading, most brokers require you to hold NTF-fund shares for a certain number of days to qualify for the no-transaction-fee price break. If you sell your holdings too quickly, you’re penalized with a “short-term redemption fee.”

The most common holding period is 90 days. However, some brokers still require a deal-breaking (for Fund Upgrading) 180 days. On the other hand, Fidelity and Vanguard feature 60-day holding periods.

How often you will have to pay a short-term redemption fee depends on your trading patterns. If you use dollar-cost averaging (investing month-by-month in funds you already hold), you are likely to incur these fees (more on this shortly). But if you typically make a single purchase of each fund and don’t add additional money, you rarely will pay a trading fee if you use a broker with a 90-day or shorter holding period. That’s because SMI almost never sells recommended funds within three months. In fact, the average recommended fund is held about nine months. However, a not-insignificant number are sold within six months. When that happens, you’ll pay for that transaction if your broker has a 180-day requirement.

• **Short-term redemption fees (lower is better).** If you ever do have to pay a short-term trading fee, you’ll want that fee to be as low as possible. Fortunately, some brokers have reduced their fees since our last broker review, but the fees
still range from $17-$50. (Note that these fees go to the broker, and are above and beyond any “early-redemption” fee the fund itself might mandate. Broker short-term redemption fees are listed in the table below; any fund-specific short-term redemption fees for our recommended funds are listed on the “Basic Strategies” page of each monthly issue of SMI.)

The dollar amount of a broker’s short-term redemption fee is of particular importance to those who try to combine Upgrading with dollar-cost-averaging. The reason is that fund companies apply the fee based on when you made various purchases of fund shares. For example, suppose you bought a fund in February and sold it in November. The shares purchased originally would be well beyond any 90-day holding period. But if you had invested additional money each month along the way, then selling all of your shares in November would trigger a short-term redemption fee, based on the shares purchased in the three months prior to your “sell” date. (The ability to avoid these types of short-term redemption fees is one reason many investors who want to combine dollar-cost-averaging with Upgrading choose to invest via the SMI mutual funds. See www.smifund.com.)

- **Transaction fees on non-NTF fund purchases (lower is better).** Any fund labeled “Yes” in the list of recommended funds on the SMI website or on the “Basic Strategies” page of the print newsletter is available through the particular broker listed, but the broker will charge a transaction fee when you buy that fund—and in most cases, another when you sell it. (Fidelity and Schwab are unique in charging a transaction fee only when you buy; it costs nothing to sell.)

If you are using Fund Upgrading, keep this important point in mind: When we recommend that a fund be sold, it’s basic to our Upgrading strategy that you (1) do so immediately, and (2) normally replace it with the highest-ranked fund available at your broker (as explained in An Upgrading Overview: Easy as 1-2-3). However, we commonly hear from readers who continue to hold a fund an extra two or three months after we said to sell it because they want to avoid paying a short-term trading fee. Or, they bought the third-ranked fund in a certain risk category because the two top-ranked funds required transaction fees.

Usually this preoccupation with avoiding fees doesn’t pay off. In our experience, you’re better off simply accepting the fact that paying some fees is inevitable in following the Upgrading strategy. That said, choosing a broker with Upgrading-friendly policies and fees will help you avoid the temptation to hold funds longer than you should or to buy funds other than the top recommended funds.

### Dynamic Asset Allocation

Those following Dynamic Asset Allocation (DAA) need access to only six ETFs, which are available at each of the brokers reviewed. The only difference is the commission charged. At Fidelity, Schwab, and TD Ameritrade, five of the six ETFs (or a close alternative) can be purchased without paying a commission. At Scottrade, the commission is just $7 per trade.

### Sector Rotation

This high-risk/high-reward optional add-on strategy (we recommend devoting no more than 20 percent of your stock allocation to it) can be implemented at each broker listed in the table below. However, since the Sector Rotation fund universe contains many Fidelity funds, having a Fidelity account offers an edge by offering those funds on a no-action-fee basis. In fact, nine of the last 10 funds used in SR were available from Fidelity on an NTF basis.

**The lay of the land in 2015**

Here’s a look at each broker’s strengths and weaknesses:

- **Fidelity** was once difficult to recommend because of the 180-day holding period it once required to avoid paying a short-term redemption fee for its NTF funds. What a difference a few years make! Now, Fidelity is the most SMI-friendly broker in the business, earning “Excellent” ratings across all of our actively managed strategies.

Today, Fidelity requires only a 60-day holding period for NTF funds. While that nearly erases any chance of an SMI member ever incurring a short-term redemption fee, in the unlikely event that it does happen, Fidelity has reduced its fee since our last broker review from $75 to $49.95. Fidelity’s fee for purchasing non-NTF funds also has been reduced to $49.95 for most funds, although some still require a fee of $75. This fee is charged only on the purchase of non-NTF funds; there is no fee for selling such funds.

Importantly for those following Fund Upgrading, Fidelity also offers the best availability of the strategy’s recommended funds and, among those, it offers the highest number with no transaction fee. Over the past three years, of the 89 funds we recommended, only one was unavailable at Fidelity. Of those that were available there, 57 were available with no transaction fee. (See the nearby table to compare fund availability among the leading brokers.)

For those following Dynamic Asset Allocation, five of the six ETFs can be traded via Fidelity with no commission (one is the actual DAA recommended ETF, the

### SUITABILITY OF SMI STRATEGIES AT LEADING DISCOUNT BROKERS

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Fidelity</th>
<th>Scottrade</th>
<th>Schwab</th>
<th>TDA</th>
<th>Vanguard</th>
</tr>
</thead>
<tbody>
<tr>
<td>Just-the-Basics</td>
<td>Good</td>
<td>Good</td>
<td>Good</td>
<td>Good</td>
<td>Excellent</td>
</tr>
<tr>
<td>Fund Upgrading</td>
<td>Excellent</td>
<td>Excellent</td>
<td>Good</td>
<td>Poor</td>
<td>Good</td>
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<tr>
<td>Sector Rotation</td>
<td>Excellent</td>
<td>Good</td>
<td>Excellent</td>
<td>Excellent</td>
<td>Excellent</td>
</tr>
<tr>
<td>NTF Fund Selection</td>
<td>Excellent</td>
<td>Good</td>
<td>Good</td>
<td>Fair</td>
<td>Fair</td>
</tr>
<tr>
<td>NTF Fund Holding Period</td>
<td>60 days</td>
<td>90 days</td>
<td>90 days</td>
<td>180 days</td>
<td>60 days</td>
</tr>
<tr>
<td>NTF Fund 5-7 Redemption Fee</td>
<td>$49.95</td>
<td>$17</td>
<td>$49.95</td>
<td>$49.99</td>
<td>$50</td>
</tr>
<tr>
<td>Non-NTF Fund Purchase Fee</td>
<td>$49.95-$575</td>
<td>$17</td>
<td>$76</td>
<td>$49.99</td>
<td>$8-$355</td>
</tr>
<tr>
<td>Non-NTF Fund Sell Fee</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$49.99</td>
<td>$8-$355</td>
</tr>
<tr>
<td>Commission for Non-NTF ETFs</td>
<td>$7.95</td>
<td>$7.00</td>
<td>$8.95</td>
<td>$9.99</td>
<td>$73</td>
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<td>Minimum to Open Account</td>
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<td>$2,500</td>
<td>$1,000/$1001</td>
<td>$0</td>
<td>$3,000</td>
</tr>
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<td>Small Portfolio Suitability</td>
<td>Fair</td>
<td>Fair</td>
<td>Good</td>
<td>Excellent</td>
<td>Good</td>
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</tbody>
</table>

1The lower amount requires a commitment to contribute that much per month. 2$35 if account balance is less than $50,000; $20 if balance is $50,000-$1 million; $8 if balance is $1 million or more. 3$7 for first 20 trades, then $20, if account balance is less than $50,000; $7 if balance is $50,000-$500,000, $2 if balance is $500,000-$1 million; free if balance is greater than $1 million.
four others are reasonable alternatives).

Of the last 10 recommended Sector Rotation funds, all were available at Fidelity—nine of them on an NTF basis.

Also working in Fidelity’s favor are top-flight customer service, helpful retirement-planning calculators, and excellent mobile apps.

- **Scottrade** continues to fill the low-cost niche among our top-three recommended brokers, offering solid availability of funds used in Fund Upgrading (many on an NTF basis), a reasonable 90-day holding period to avoid short-term trading fees on NTF funds, and low commissions for buying and selling the ETFs used in Dynamic Asset Allocation (though none of the ETFs trade for free). The broker did increase its minimum required amount to open a new account from $500 to $2,500 since our last broker review, but that shouldn’t impact too many SMI members.

- **Schwab** was once our top recommended broker, and still is listed among our top three. However, this is more a function of the reality that many SMI readers already have accounts there than the idea that it is among the best options for new accounts. Schwab has become significantly stingier in recent years when it comes to a few notable features of particular interest to SMI members.

Many fund investors are unaware of what allows them to receive the great deal of buying and selling many funds with no transaction fees. Simply put, funds that desire this NTF standing pay the broker a percentage of all the assets invested in the fund through accounts at that broker. So, for example, if the Smith Fund is NTF at Schwab, the fund’s manager pays Schwab 0.40% of all the assets invested in the Smith Fund through Schwab accounts. Given that many funds charge a management fee of 1% or less, Schwab’s fee obviously lays claim to a considerable piece of a fund’s profit. (While many have pointed the finger at a greedy mutual-fund industry as the reason why mutual-fund fees haven’t declined more as assets have risen, an often overlooked aspect is that discount brokers have largely absorbed the fee savings that might have otherwise been passed on to investors. Most funds can’t survive without the access and exposure provided by the discount brokers’ mutual-fund platforms.)

Among the discount brokers, Schwab has always charged the highest fees to NTF fund companies. In 2011, they took this a step further by starting to charge a percentage fee on transaction-fee funds as well. (These are the funds marked “Yes” on on the “Basic Strategies” page of the print newsletter.) This change resulted in huge fee increases for many funds. While many funds felt they had no choice but to absorb this fee increase, some decided not to play ball. As a result, more funds started showing up as unavailable at Schwab (five of the 89 funds recommended for use in Fund Upgrading over the past three years were unavailable at Schwab). Just recently, SMI has learned that Schwab’s general policy is to not add any new funds to their transaction-fee fund platform, in essence offering funds the choice to list as NTF (with the corresponding huge increase in fees paid to Schwab) or not have the funds available there. This has been the reason the new SMI Bond Fund (SMIUX) is still unavailable there, much to the disappointment of many SMI readers with Schwab accounts. Given that fund availability is of key importance to those using Fund Upgrading, these are significant strikes against Schwab.

Another issue at Schwab is the company’s $76 fee for buying non-NTF funds. While it does not charge for selling such funds, this is still the highest cost for using non-NTF funds among our top three brokers.

Many readers who already have Schwab accounts may decide to stay put because Schwab still offers a lot to its customers. But with pricing that is higher than Fidelity’s at this point and an inferior fund lineup, we can’t see any reason for a new account to favor Schwab over Fidelity.

- **Vanguard** has made the greatest improvement over the past three years. Most significantly, shortening its required holding period for NTF funds in order to avoid early redemption fees—from an industry-worst 180 days to an industry-best (along with Fidelity) 60 days—was a huge step in the right direction. Its number of NTF funds has grown as well. However, as the table shows, its fund availability still isn’t quite up to par with the other leading brokers. Over the past three years, seven of the funds recommended for use in Fund Upgrading were unavailable at Vanguard.

For now, Vanguard holds the greatest appeal for followers of Just-the-Basics, and to a lesser extent, DAA. However, Vanguard’s arrow is pointing up, and we won’t be surprised if it earns a stronger overall recommendation in the future.

- **TD Ameritrade** gained many SMI accounts in 2008-2009 through its participation in a novel arrangement that provided free trades to customers in exchange for a low annual fee. Unfortunately, TDA closed that program to new accounts at the end of 2009 (though it grandfathered existing accounts already in the program, explaining why many SMI readers continue to have accounts there.) This illustrates the principle we have always promoted regarding brokers: find the best deal currently available given your specific needs, then be ready to move your account elsewhere if either the broker’s terms or your needs change.

Originally added to SMI as a recommended broker several years ago on the basis of its low costs and great fund selection, TDA’s standard fees and policies have gradually become less and less appealing. The biggest strike against TDA is its NTF holding period of 180 days.

TDA is a good choice for those just starting out with investing since it has no opening balance requirement and provides commission-free access to five of the six ETFs used in DAA (two of the recommended funds and three adequate alternatives). Just-the-Basics also can be implemented at TDA with NTF funds (two of the recommended funds and two adequate alternatives).

However, given that its other fees are relatively high, there isn’t any compelling reason for most SMI members to choose TDA over our other recommended brokers. Members who have a regular (i.e., non-Omnium) TDA account may want to consider moving to a more attractive recommended broker. (If you switch from TDA (continued on page 125)}
Strengthening Your Foundation

Wise money management begins with a strong financial foundation. In this column, we cover topics such as how to manage cash flow, apply strategies for getting debt-free, make wise purchasing decisions, build savings, choose appropriate insurance protection, navigate marital financial issues, and many more.

“By wisdom a house is built, and through understanding it is established.” Proverbs 24:3

WHERE DOES ALL YOUR MONEY GO?
by Matt Bell

Does the word “budget” still make you cringe? For many, the word conjures up images of a ball and chain strapped to their ankle, a heavy weight putting a drag on their finances and fun. But people who use a budget usually find it freeing. It provides peace of mind, guiding their use of money in a way that enables them to live generously, save and invest adequately for future needs, and enjoy financial margin.

This article is the second of a three-part series. Last month, we looked at the first step involved in using a budget: planning. Now let’s take a closer look at the second key step: tracking.

Knowin’ where it’s goin’

Once you have a plan for how much you intend to give, save, invest, and spend on everything from food to clothing, you need a system for seeing what’s really going on with your cash flow. We’ll introduce you to different tracking tools in this article. The best one? The one you will actually use!

First is a paper and pencil system. Along with the Cash Flow Plan form on the SMI web site, you’ll find a Cash Flow Tracker form. Take the goals from your Plan and write them across the top of the Tracker form. Every time you spend money, whether you use cash, write a check, use a debit or credit card, or pay a bill online, write it down in the appropriate column.

The reason there aren’t 30 or 31 rows is that you won’t spend money in every category every day of the month (at least, we hope not!).

Keep your Cash Flow Plan and Tracker forms in a place where you’ll see them, such as your kitchen counter or a bedroom dresser. That way you’ll be reminded to record the day’s spending. After you do, cross off the date at the bottom of the form as a reminder that you captured the day’s spending.

Use one form for each month, totaling up the spending for each category, and using last month’s totals to keep track of year-to-date totals.

The most visual, hands-on system

Another way to track your cash flow is to use the envelope system. With this system, some of your bills will be paid out of your checking account, such as your rent or mortgage, utility bills, insurance premiums, and others. For other more discretionary categories, such as food, clothing, and entertainment, withdraw (in cash) each category’s monthly budgeted amount. Put the designated cash for each category in a separate, clearly-labeled envelope.

For example, if you get paid once a month, take the month’s budgeted amount for groceries and put that cash into an envelope marked “Groceries.” When you go to the store, bring that envelope with you, pay for your groceries with that cash, and put the change back in the envelope. If you get paid twice a month, on payday take half of the monthly budgeted amount and put it in the envelope.

The envelope system is a hands-on, visual tracking tool. You can easily see how much you have left for a particular category at any point in time, which can help you stay on track.

If you’re new to budgeting, we recommend starting with either the paper and pencil system or the envelope system. Use one of these approaches for at least six months before considering moving on to an electronic budget tool.

Adding some automation

There are two types of electronic budget tools available today—software and online tools. They have some benefits in common, but also key differences. Quicken is the leading budget software program, and Mint.com is arguably the leading online budget tool, but others exist as well.

One of the strongest benefits of electronic budget tools is they do a lot of the tracking for you. When linked to your bank and credit-card accounts, these tools can automatically capture transactions you make by check, credit card, debit card, and online bill-pay, as well as online transfers and deposits. The only transactions you have to enter manually are cash transactions.

Electronic tools can even categorize your transactions. If you do your grocery shopping at Bob’s Finer Foods, for example, these budgeting tools can be set up to automatically categorize such transactions as “Groceries.”

With such tools, you can easily see how you’re doing in any category at any time. It’s great to be able to pull up the status of your online budget on your smart phone while in the parking lot of a store before going in to shop.

Worried about security? The leading electronic budget tools use what’s called bank-level security, which is the same type of security your bank uses when you check your account online. Of course, if you’re not comfortable with that, go with the paper and pencil or envelope system instead.

Quicken can generate a variety of detailed reports, so if you’re especially analytical, you might want to go that route. Mint is more streamlined.

In the Bell household, we used to use Quicken, but switched to Mint years ago. What steered us away from budget software was the fact that it tethered you to one computer, plus you have to pay for it. With Mint, you can access your budget anywhere you can get on the Internet, plus Mint is free.

How can you best make use of the information you track? That’ll be our focus next month.
Developing Your Investing Plan

Investing decisions are best made as part of a comprehensive personalized plan. In this column, we focus on topics that will help you implement an investment strategy that takes into account your personal goals, attitude toward risk-taking, and current season of life. We explain investing essentials, discuss SMI’s core investing strategies, and help you decide which is best for your situation.

“The plans of the diligent lead to profit as surely as haste leads to poverty.” Proverbs 21:5

Understanding the Important Difference Between “Yield” and “Total Return”

Yield and total return are concepts SMI has historically discussed in relation to bonds or other savings vehicles. But because our Dynamic Asset Allocation (DAA) strategy recently presented a scenario involving these factors that confused a number of readers, it is an opportune time to revisit these subjects in a wider context.

There’s some math in this article. If you aren’t math savvy, you’ll be glad to know that it’s not essential you understand these two terms in order to make investments when following SMI’s strategies. They come into play primarily when you attempt to measure the results from your investments.

Let’s start with a quick review of the basics before widening the lens. To learn whether a particular savings-type or bond investment has been successful, ask two questions: First, how much interest income did you earn while waiting to get your money back? Second, did you get all of your original investment back, more than you put in, or less?

The income you received while your money was tied up is called the yield. It’s always expressed in “annualized” terms (i.e., what the investment pays over one year). Example: If you invested $1,000 in a 10-year bond and it paid $30 a year in interest, it yielded 3.0% per year ($30 ÷ $1,000).

With a bond (or bond fund), however, the yield is only one aspect of how well the investment performs. Let’s say interest rates fall after you made your $1,000 investment. When rates fall, bond prices rise. As a result, you may have been able to sell your still-unmatured bond after three years for a profit—say for $1,050. This would give you a $50 capital gain. When you combine your yield and your gain, the result is your total return.

In our example, you invested $1,000 and received back $1,140 over three years ($90 in interest income plus the $50 gain). To gauge your total return in annual percentage terms, you need to figure out what rate of growth would turn $1,000 into $1,140 in three years. A financial calculator that performs time-value-of-money computations will show that it takes a 4.46% annual rate of return to do that. In other words, if you could invest $1,000 at 4.46% for three years (compounded annually), you would have about $1,140 at the end of that time.

How did you get from a yield of 3.0% to a total return of 4.46%—almost 1.5 times better than the stated yield? By selling your bond investment for a $50 gain. The 3.0% yield you received as you went along plus the $50 gain at the end combined to produce a 4.46% annualized total return, significantly better than the promised yield alone.

But suppose interest rates had risen and the bond’s price had gone down by $50 and you sold at a loss? That would have created a much different result. After three years, you would have $1,040 to show for your $1,000 investment ($90 in interest income minus a $50 loss). While you thought you were earning 3.0% a year, it turns out you were actually netting, on average, just 1.32% per year. So yield tells only part of the story. Total return is what you’re really interested in.

This information helps you understand why not all savings vehicles are interchangeable. Some fixed-income investments—e.g., insured savings accounts, CDs, and money-market funds/accounts—do not fluctuate in value. You’ll always be repaid what you put in, plus any interest you earned; there is never a loss of your original capital to worry about. However, other fixed-income investments, such as bond funds, do fluctuate in value. When you eventually sell, you’re likely to get back more or less than you put in. In some situations, you could lose more on the sale than you received in interest. The unhappy result would be a negative total return.

So for your emergency money, it’s better to stick with money-market funds or bank money-market accounts that aren’t subject to daily changes in value. For your accumulation fund, it’s OK to go for the higher returns available from bond funds. But to minimize the risk of negative returns, be sure to match your expected investment time frame to the right kind of fund.

For example, if you know you won’t need your savings for two-to-three years, consider a short-term bond fund. The bonds held by such funds offer higher yields than shorter-term instruments, and those higher yields typically compensate for any temporary minor losses in value due to changes in interest rates.

For periods of three years or longer, you might look into mortgage-backed bond funds. These funds, often referred to as GNMA (Ginnie Mae) funds, invest in mortgage-backed securities issued by the Government National Mortgage Association. Ginnie Maes are even more sensitive to interest-rate changes than are short-term bonds, so a longer holding period is crucial. In the past, the higher yields of Ginnie Maes have more than offset (eventually) short-term losses caused by rising interest rates.

Moving from the savings arena into the investing sphere

Thankfully, it’s just a short jump to apply these same concepts to investments that fluctuate more significantly in value. For instance, when our DAA strategy calls for owning long-term bonds, the application of yield and total return is exactly the same as just described for short-term bond funds. The difference is simply a matter of degree—long-term bonds will respond more dramatically.
BROADENING YOUR PORTFOLIO

This column goes beyond the investing essentials taught in Level 2, introducing you to a wider range of investment securities and markets. By further diversifying your holdings, you can create a more efficient, less volatile portfolio. We also comment quarterly on the performance of the various markets, and on how SMI’s fund recommendations and strategies have fared.

“Divide your portion to seven, or even to eight, for you do not know what misfortune may occur on the earth.” Ecclesiastes 11:2

SECOND QUARTER REVIEW OF SMI’S INVESTING STRATEGIES

As has been the case in recent years, interest rates were the primary driver of the financial markets in the second quarter. Investors continued to focus heavily on each utterance by the Federal Reserve, trying to determine when the seemingly inevitable first interest-rate hike will come.

As 2015 began, the consensus opinion was that the rate-hiking process would begin by June. However, a run of softer than expected economic data during the first half of the year pushed those plans back, and the June Fed meeting came and went without any change. Investors quickly shifted their attention to the upcoming September and December meetings as the next likely points for rate hikes to begin.

So while interest rates didn’t overtly affect the stock market this quarter, the anticipation of rate hikes later this year didn’t help. Neither did a rekindling of the Greek/Euro tensions. Stocks didn’t overreact to these external threats, but these factors did serve to restrain investor enthusiasm, and the stock market finished the quarter essentially flat (though still up slightly for 2015 as a whole).

New monthly performance table

We’ve made a change to how the performance of the SMI strategies is being reported. In the past, we’ve included a detailed performance table once each quarter in these quarterly report articles. Starting this month, we’ve created a new performance table that will appear on the back cover of each monthly issue (it’s also available on the SMI website). This new table includes nearly all of the information the old table used to report quarterly, but expands it to include all of SMI’s strategies and will be updated more frequently.

We hope making this information available every month won’t cause readers to become more short-term oriented. But as we’ve added more strategies, and with more SMI readers mixing and matching these strategies within their portfolios, it seems appropriate to provide updated performance information more often.

Referring to that table may be helpful as you read the rest of this article.

Just-the-Basics (JtB) & Stock Upgrading

When the overall stock market is flat, there’s a reasonable chance these two strategies are going to follow suit. That was the case in the second quarter, as the market, JtB, and Upgrading all performed within a tiny range of +/- 0.1%. For the first half of 2015, JtB is up 3.5% and Upgrading is up 3.4%, both roughly double the +1.7% gain of the overall stock market (Wilshire 5000).

While stocks have been fairly dull this year, the “story” has been the surprising resurgence of foreign stocks, and to a lesser extent small-company stocks. This is evident in the year-to-date numbers of SMI’s risk categories (table below) as well as the performance of the major market indices. The Dow Jones Industrials (a group of 30 extremely large companies) was down -0.1% through mid-year, the S&P 500 (the largest 500 stocks) gained 1.1%, and the Wilshire 5000 index (the widest measure of the whole market, with smaller stocks representing as much as 25%) was up even more at +1.7%. Adding smaller stocks clearly has helped the broader indexes, and including small and foreign stocks in SMI portfolios has benefitted both JtB and Upgrading as well so far this year.

Bond Upgrading

Despite the Federal Reserve holding short-term interest rates steady, longer-term rates did rise during the second quarter in anticipation of the eventual Fed move.

(The Federal Reserve directly controls only very short-term interest rates. The bond markets set longer-term rates as bond investors “vote” with their dollars. Strong buying sends prices up and interest rates down, and vice versa.)

The 10-year Treasury bond began the second quarter yielding 1.94% and rose as high as 2.50% by mid-June. The 30-year Treasury rose even further, from 2.54% to as high as 3.25%. These rather dramatic moves explain the poor performance of the bond market during the second quarter, and consequently investments in SMI’s bond-upgrading portfolio as well. With all three holdings down for the quarter, the year-to-date numbers moved from a +2.2% gain after the first quarter to a negative -1.5% for the entire six-month period.

Dynamic Asset Allocation (DAA)

This was probably the most challenging quarter DAA investors have endured since DAA launched in January 2013. Long-term bonds and real estate were hurt by rising interest rates, and while both were replaced by the end of the quarter, those holdings weighed on DAA’s returns. DAA lost -5.3% during the second quarter and is down -2.6% for the year so far.

Those losses aren’t terrible, but they’re particularly acute for readers who are new to the strategy this year and experienced significant losses in bonds and real estate right away. Giving back a portion of earlier gains is often part of the deal with trend-following strategies, but when

(continued on page 126)
Looking Toward Retirement

As you move through your 50s, 60s, and beyond, you face a new set of financial decisions related to reducing your investment risk and generating income from your portfolio. In this column, we address such topics, as well as those pertaining to Social Security, long-term health care, advanced giving strategies, estate planning, and other matters of importance to those nearing and in retirement.

“There is precious treasure and oil in the dwelling of the wise.” Proverbs 21:20a

HOW WELL DO TARGET-DATE FUNDS PERFORM IN A DOWNTURN?

Target-date mutual funds (TDFs) have grown rapidly to become among the most popular investments held in workplace retirement plans—such as 401(k), 403(b), and 457 plans. With millions of people holding this type of investment, and with the bull market now past its sixth birthday, here is an important question: how well are such investments performing in 2008 (the biggest downturn in modern history)? That’s not to say we think a 100% loss of the group) and its seemingly modest stock allocation in table 1. It appears that the company has changed its allocation formulas since the recession. A 2009 Chicago Tribune article about heavy losses experienced by target-date funds in 2008 noted that T. Rowe Price’s target-date funds were initially designed to have a 55% stock allocation by the time they reached their target years. However, as the first table shows, its 2015 fund has a much lower 42.1% stock allocation today.

Many companies have made similar changes, although it’s noteworthy how aggressive Fidelity’s target-date funds continue to be. The lesson here is that it’s not enough to just review your TDF’s 2008 performance; you need to also check its current allocations in case its approach has changed.

DAA in your 401(k)?

Historically, we have not been overly directive in recommending one SMI strategy over another. We’ve simply explained how they work, noted their pros and cons, and let SMI members choose for themselves. However, when launching our new web site at the start of 2015, we made a conscious decision to include this statement in our Start Here section: “Because it combines simplicity, a strong track record, and protection during bear markets, DAA is currently our recommended approach for newer members wanting to get started with a single strategy.”

That’s not to say we think a 100% DAA portfolio is necessarily the optimal approach—we continue to believe that blending multiple SMI strategies is advisable for most readers (see our May 2014 cover article on the merits of a “50-40-10” approach). But if someone were going to choose only one strategy, as many new readers might, we

<table>
<thead>
<tr>
<th>Target Date</th>
<th>Fidelity Version</th>
<th>Vanguard Version</th>
<th>Price Version</th>
</tr>
</thead>
<tbody>
<tr>
<td>2030</td>
<td>86.7%</td>
<td>74.6%</td>
<td>63.2%</td>
</tr>
<tr>
<td>2025</td>
<td>73.2%</td>
<td>67.3%</td>
<td>56.4%</td>
</tr>
<tr>
<td>2020</td>
<td>64.5%</td>
<td>59.8%</td>
<td>49.5%</td>
</tr>
<tr>
<td>2015</td>
<td>58.3%</td>
<td>49.8%</td>
<td>42.1%</td>
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<td>2010</td>
<td>50.6%</td>
<td>35.6%</td>
<td>36.4%</td>
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</table>

<table>
<thead>
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<th>Target Date</th>
<th>Fidelity Version</th>
<th>Vanguard Version</th>
<th>Price Version</th>
</tr>
</thead>
<tbody>
<tr>
<td>2030</td>
<td>-36.9%</td>
<td>-32.9%</td>
<td>-41.4%</td>
</tr>
<tr>
<td>2025</td>
<td>-33.7%</td>
<td>-30.0%</td>
<td>-39.8%</td>
</tr>
<tr>
<td>2020</td>
<td>-32.1%</td>
<td>-27.0%</td>
<td>-37.4%</td>
</tr>
<tr>
<td>2015</td>
<td>-27.2%</td>
<td>-24.1%</td>
<td>-34.4%</td>
</tr>
<tr>
<td>2010</td>
<td>-23.3%</td>
<td>-20.7%</td>
<td>-30.8%</td>
</tr>
</tbody>
</table>

(continued on page 126)
**Basic Strategies**

The fund recommendations shown for Upgrading accountholders are based primarily on their most recent “momentum” scores at mid-month (not the earlier end-of-month scores shown on this page), but consistency of performance and the portfolio manager’s philosophy and number of years at the helm are also important. Four recommendations are made in each risk category so that you can select the one(s) most in accord with your preferences and broker availability.

“Plans fail for lack of counsel, but with many advisers they succeed.” Proverbs 15:22

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**RECOMMENDED FUNDS FOR SMI’S JUST-THE-BASICS STRATEGY**

<table>
<thead>
<tr>
<th>Portfolio</th>
<th>Invested In</th>
<th>MOM</th>
<th>YTD</th>
<th>1Mo</th>
<th>3Mo</th>
<th>6Mo</th>
<th>12Mo</th>
<th>Avg</th>
<th>Rel</th>
<th>Risk</th>
<th>Expense</th>
<th>Stock/Bond Mix</th>
<th>Symbol</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total International Stock ETF</td>
<td>Foreign stocks</td>
<td>1.8</td>
<td>5.5%</td>
<td>-2.7%</td>
<td>1.0%</td>
<td>5.5%</td>
<td>4.8%</td>
<td>9.8%</td>
<td>1.27</td>
<td>0.14%</td>
<td>20%</td>
<td>16%</td>
<td>12%</td>
</tr>
<tr>
<td>Extended Market Index ETF</td>
<td>Small company stocks</td>
<td>10.6</td>
<td>4.8%</td>
<td>-0.7%</td>
<td>-0.5%</td>
<td>4.8%</td>
<td>6.3%</td>
<td>19.3%</td>
<td>1.28</td>
<td>0.10%</td>
<td>40%</td>
<td>32%</td>
<td>24%</td>
</tr>
<tr>
<td>S&amp;P 500 Index ETF</td>
<td>Large company stocks</td>
<td>8.8</td>
<td>1.2%</td>
<td>-2.0%</td>
<td>0.3%</td>
<td>1.2%</td>
<td>7.4%</td>
<td>17.3%</td>
<td>1.01</td>
<td>0.05%</td>
<td>40%</td>
<td>32%</td>
<td>24%</td>
</tr>
<tr>
<td>Total Bond Mkt Index ETF</td>
<td>Medium-term bonds</td>
<td>-0.7</td>
<td>-0.3%</td>
<td>0.1%</td>
<td>0.1%</td>
<td>-0.3%</td>
<td>1.6%</td>
<td>-1.6%</td>
<td>1.05</td>
<td>0.07%</td>
<td>0%</td>
<td>20%</td>
<td>40%</td>
</tr>
</tbody>
</table>

**VANGUARD JUST-THE-BASICS FOOTNOTES:** Just-the-Basics is an indexing strategy that requires just minutes a year to assure that your returns are in line with those of the overall market. You won’t “beat the market” using this simple strategy, but neither will you fall badly behind. Your JtB portfolio should be allocated among as many as four Vanguard funds (as shown above) depending on your stock/bond mix. For more on Just-the-Basics, see June 2012:p89.

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**SOUND MIND PORTFOLIOS**

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**RECOMMENDED FUNDS FOR SMI’S FUND UPGRADING STRATEGY**

<table>
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<tr>
<th>Risk</th>
<th>Data through 6/30/2015</th>
<th>Date Added</th>
<th>Scottrade</th>
<th>Fidelity</th>
<th>Schwab</th>
<th>Vanguard</th>
<th>MOM</th>
<th>YTD</th>
<th>1Mo</th>
<th>3Mo</th>
<th>6Mo</th>
<th>12Mo</th>
<th>Avg</th>
<th>Rel</th>
<th>Risk</th>
<th>Expense</th>
<th>Stock/Bond Mix</th>
<th>Symbol</th>
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</thead>
<tbody>
<tr>
<td>1. Fidelity Intl Small Cap</td>
<td>07/15</td>
<td>NTF</td>
<td>Yes</td>
<td>12.4%</td>
<td>-0.1%</td>
<td>4.9%</td>
<td>12.0%</td>
<td>3.6%</td>
<td>16.7%</td>
<td>1.09</td>
<td>1.30</td>
<td>165</td>
<td>2%</td>
<td>90 days</td>
<td>FSCOX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Fidelity Overseas</td>
<td>03/15</td>
<td>Yes</td>
<td>NTF</td>
<td>17.5%</td>
<td>11.0%</td>
<td>-1.9%</td>
<td>3.6%</td>
<td>11.0%</td>
<td>2.9%</td>
<td>16.1%</td>
<td>1.15</td>
<td>1.02</td>
<td>170</td>
<td>1%</td>
<td>30 days</td>
<td>FOSFX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Marsico International Opp</td>
<td>12/14</td>
<td>NTF</td>
<td>NTF</td>
<td>10.8%</td>
<td>6.3%</td>
<td>-2.7%</td>
<td>0.6%</td>
<td>6.3%</td>
<td>3.9%</td>
<td>11.3%</td>
<td>1.21</td>
<td>1.60</td>
<td>41</td>
<td>None</td>
<td>MIOFX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Driehaus Micro Cap Gr</td>
<td>07/15</td>
<td>NTF</td>
<td>NTF</td>
<td>58.6%</td>
<td>18.2%</td>
<td>5.6%</td>
<td>10.7%</td>
<td>18.2%</td>
<td>29.6%</td>
<td>31.7%</td>
<td>2.15</td>
<td>1.59</td>
<td>119</td>
<td>2%</td>
<td>60 days</td>
<td>DMCRX</td>
<td></td>
<td></td>
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<tr>
<td>5. Janus Venture T</td>
<td>01/15</td>
<td>Closed</td>
<td>Closed</td>
<td>24.3%</td>
<td>6.8%</td>
<td>1.1%</td>
<td>2.2%</td>
<td>6.8%</td>
<td>15.3%</td>
<td>20.3%</td>
<td>1.36</td>
<td>0.93</td>
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<td>JAVTX</td>
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<td>6. Nicholas Fund</td>
<td>08/14</td>
<td>NTF</td>
<td>Yes</td>
<td>24.1%</td>
<td>6.5%</td>
<td>-1.3%</td>
<td>1.7%</td>
<td>6.5%</td>
<td>15.9%</td>
<td>24.9%</td>
<td>1.06</td>
<td>0.73</td>
<td>44</td>
<td>None</td>
<td>NICSX</td>
<td></td>
<td></td>
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<tr>
<td>1. Hennessy Cornerstone 30</td>
<td>08/15</td>
<td>NTF</td>
<td>NTF</td>
<td>27.2%</td>
<td>11.2%</td>
<td>1.6%</td>
<td>3.5%</td>
<td>11.2%</td>
<td>12.5%</td>
<td>21.8%</td>
<td>1.45</td>
<td>1.17</td>
<td>32</td>
<td>None</td>
<td>HFDNX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Vanguard Mid Cap Index</td>
<td>12/14</td>
<td>ETF</td>
<td>ETF</td>
<td>ETF</td>
<td>10.5%</td>
<td>3.1%</td>
<td>-1.7%</td>
<td>-1.2%</td>
<td>3.1%</td>
<td>8.6%</td>
<td>19.7%</td>
<td>1.14</td>
<td>0.90</td>
<td>370</td>
<td>None</td>
<td>VO</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Vanguard Strategic Equity</td>
<td>06/14</td>
<td>Yes</td>
<td>Yes</td>
<td>11.0%</td>
<td>4.0%</td>
<td>-1.9%</td>
<td>-1.1%</td>
<td>4.0%</td>
<td>8.1%</td>
<td>22.7%</td>
<td>1.16</td>
<td>0.27</td>
<td>442</td>
<td>None</td>
<td>VSEQX</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Harbor Capital Appr Inv</td>
<td>07/15</td>
<td>NTF</td>
<td>NTF</td>
<td>25.0%</td>
<td>8.4%</td>
<td>0.1%</td>
<td>2.8%</td>
<td>8.4%</td>
<td>13.9%</td>
<td>19.2%</td>
<td>1.22</td>
<td>0.66</td>
<td>68</td>
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<td>HCAIX</td>
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<tr>
<td>5. Fidelity OTC</td>
<td>12/14</td>
<td>Yes</td>
<td>NTF</td>
<td>18.5%</td>
<td>4.6%</td>
<td>-2.8%</td>
<td>-0.2%</td>
<td>4.6%</td>
<td>14.1%</td>
<td>23.0%</td>
<td>1.48</td>
<td>0.77</td>
<td>196</td>
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<td>FOPCX</td>
<td></td>
<td></td>
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<tr>
<td>6. Powershares QQQ ETF</td>
<td>09/14</td>
<td>ETF</td>
<td>ETF</td>
<td>ETF</td>
<td>21.1%</td>
<td>4.2%</td>
<td>-2.5%</td>
<td>1.6%</td>
<td>4.2%</td>
<td>15.2%</td>
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<td>None</td>
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<td></td>
</tr>
<tr>
<td>1. Clipper Fund</td>
<td>08/15</td>
<td>NTF</td>
<td>NTF</td>
<td>10.8%</td>
<td>3.7%</td>
<td>-1.7%</td>
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<td>0.74</td>
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<tr>
<td>2. Lazard US Equity Concen</td>
<td>02/15</td>
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<td>NTF</td>
<td>16.7%</td>
<td>3.6%</td>
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<td>3.6%</td>
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<td>1%</td>
<td>30 days</td>
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<tr>
<td>3. T. Rowe Price Div Growth</td>
<td>01/15</td>
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<td>Yes</td>
<td>8.9%</td>
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<td>1.4%</td>
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<td>Yes</td>
<td>3.1%</td>
<td>1.9%</td>
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<td>-0.2%</td>
<td>1.9%</td>
<td>1.5%</td>
<td>6.1%</td>
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<td>0.23</td>
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<td>5. Vanguard I-T Bond Index</td>
<td>01/15</td>
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<td>ETF</td>
<td>ETF</td>
<td>0.5%</td>
<td>0.2%</td>
<td>-1.4%</td>
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<td>0.2%</td>
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<td>0.10</td>
<td>27</td>
<td>None</td>
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**Upgrading Footnotes:** For tips on how to launch your Upgrading strategy, go to the Start Here tab on our website’s homepage. [1] **Fund Recommendations:** The funds in each risk category are selected (and ranked 1 through 3) primarily based on their momentum scores in late-July, not the performance data shown on this report. When an owned fund is removed from this page (not when it merely shifts out of the #1 ranking), you should immediately sell that fund and invest the proceeds in the highest-ranked fund in the same risk category that is available at your broker. The fund ranked third is the one which currently appears most likely to be replaced next month. A telephone symbol (☎) next to a fund’s name indicates that fund is a new recommendation. See the fund writeups in “MoneyTalk” for more information. [2] **Fund Availability:** NTF means the fund can be bought and sold free of transaction fees as long as you stay within the trading limitations imposed by Scottrade (800-619-7283), Fidelity (800-343-3548), and Schwab (800-435-4000). Policies change frequently, so be sure to verify their accuracy. ETFs trade like stocks and are typically available at all brokers for a modest commission. [3] **Momentum** is a measure of a fund’s performance over the past year and is our primary performance evaluation tool. For more, see July 2014:p103. [4] **Relative Risk:** A 1.0 reading indicates the fund has had the same volatility as the market in general over the past three years. For example, a fund with a relative risk score of 1.4 would mean...
Premium Strategies

The strategies on this page are available to those with an SMI Premium web membership. They can be used in combination with — or in place of — our Just-the Basics and Upgrading portfolios. These strategies have special characteristics that could make them desirable depending upon your individual goals, risk tolerance, and tax bracket. You can learn more about each strategy in the Premium section of the SMI website.

“If any of you lacks wisdom, he should ask God who gives generously to all . . . and it will be given to him.” James 1:5

DYNAMIC ASSET ALLOCATION

• Overview: This is a stand-alone strategy that can be used alongside (or in place of) SMI’s basic strategies. It involves rotating among six assets classes—U.S. stocks, foreign stocks, gold, real estate, bonds, and cash. Only three are held at any one time. Who should consider this strategy: Anyone, especially investors focused on loss avoidance and preservation of capital. • Pros: Excellent downside protection, reflected in very low relative-risk score and worst-case result. Great long-term track record. • Cons: Can lag in up years. Emotionally challenging in making trades promptly and concentrating entire portfolio in only three asset classes.

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<td>7.1%</td>
<td>4.0%</td>
<td>10.4%</td>
<td>22.4%</td>
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<td>8.6%</td>
<td>25.7%</td>
<td>10.1%</td>
<td>1.3%</td>
<td>17.6%</td>
<td>20.3%</td>
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<tr>
<td>Wilshire 5000</td>
<td>-10.9%</td>
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<td>-20.9%</td>
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<td>33.1%</td>
<td>12.7%</td>
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SECTOR ROTATION

• Overview: The sector-fund recommendations in this strategy are designed to be used in combination with Upgrading up to a maximum of 20% of the stock allocation. These are special-purpose stock funds that invest in a very narrow slice of the economy. Only one fund, selected using the momentum and upgrading concepts, is held at a time. Who should consider this strategy: Experienced investors willing to concentrate an investment in a single sector of the economy. • Pros: Very attractive long-term returns. • Cons: Much greater month-to-month volatility and relative risk with dramatic short-term loss potential.

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<td>12.6%</td>
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<td>28.1%</td>
<td>-31.5%</td>
<td>30.5%</td>
<td>9.1%</td>
<td>-3.2%</td>
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<td>16.1%</td>
<td>33.1%</td>
<td>12.7%</td>
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INFLATION HEDGES

• Overview: These mutual fund recommendations are designed to be used in combination with Upgrading up to a maximum of 20% of the stock allocation. Who should consider this strategy: Those who are concerned that federal budget deficits projected for the coming decade are likely to be inflationary. We expect Upgrading to do a reasonably good job in an inflationary environment, but these investments offer additional protection against a declining U.S. dollar by diversifying further among gold, real estate, energy, and emerging markets. • Pros: Very attractive long-term returns. • Cons: Much greater month-to-month volatility and relative risk.

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<td>-41.4%</td>
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<td>-7.0%</td>
<td>11.1%</td>
<td>-7.2%</td>
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<tr>
<td>Wilshire 5000</td>
<td>-10.9%</td>
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<td>-20.9%</td>
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<td>12.5%</td>
<td>6.4%</td>
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<td>28.3%</td>
<td>17.2%</td>
<td>1.0%</td>
<td>16.1%</td>
<td>33.1%</td>
<td>12.7%</td>
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ENHANCED JUST-THE-BASICS

• Overview: This is a stand-alone strategy to be used in place of our regular Just-the-Basics portfolios. • Who should consider this strategy: Those currently using Just-the-Basics who are willing to do more frequent maintenance (quarterly rather than annually) and are willing to take slightly higher risks while seeking higher returns. • Pros: Higher long-term returns than Just-the-Basics. • Cons: Greater month-to-month volatility and relative risk. Requires a quarterly review of your portfolio (made relatively easy by using SMI’s online Personal Portfolio Tracker) to see which, if any, of your holdings should be replaced.

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<td>20.1%</td>
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<td>17.6%</td>
<td>31.2%</td>
<td>7.5%</td>
<td>3.5%</td>
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1 January-June 2015 2The three data points on the far right in each of the four tables are for the Jan2000-Dec2014 period. “Avg” represents the average annualized return from 2000-2014. “Worst12” represents the worst investor experience over 168 rolling 12-month periods from 2000-2014.
STOCK UPGRAADING — NEW FUND RECOMMENDATIONS

[When more than one fund in the same risk category is replaced, you should evaluate which of the newly recommended funds is the best fit for your portfolio. Those seeking the simplest method for picking new funds can simply refer to our 1-3 rankings on the “Recommended Funds” page, selecting the highest ranked fund(s) available through your brokerage. • Funds are selected with the hope they will be held for at least 12 months in order to qualify for long-term capital gains tax treatment. Nevertheless, changes are suggested when a recommended fund’s performance violates certain mechanical guidelines. Our guidelines provide objective criteria for making the decision as to when to “upgrade” to a better performing fund. When these guidelines are violated, the fund is recommended for sale even if the twelve-month holding period has not yet been met. However, a “$” symbol following the name of the fund being sold lets you know that we still think well of the fund and its management and you might elect to continue holding the fund for a month or two to achieve a tax benefit or save on transaction or redemption fees. Be aware, however, that from 2006-2010, the performance “cost” of retaining such funds has been roughly 0.5% per month. For more details, see Oct2011:p153.]

◆ In the Small/Value group, Ariel Fund (ARGFX, 11/2014) is being replaced.5 We’ve recommended Ariel enough times over the years to have recognized its typical profile: great performer during bull markets, not so good during bear markets. Sure enough, Ariel has generated above average returns over the past eight+ months, earning 7.8% through the end of June (compared to 4.3% for the average fund in our small/value group). While no one is calling an end to the bull market just yet, it’s not a huge surprise that as the stock market has cooled off in 2015 this fund has had an increasingly difficult time holding onto its top-quartile perch. It hasn’t fallen far below the quartile, sitting at the 34th percentile as the last week of July began. But that’s down from the 12th percentile at the end of June, so we’re heading for the door with our gains intact.

• Hennessy Cornerstone Mid Cap 30 (HFMDX) is being added.3 Recommending Hennessy funds is always fun because it provides an opportunity to point out how much traditional investment analysis firms (like Morningstar) hate funds like Hennessy — and how foolish that makes the traditional firms look when these funds succeed.

The reason for the animosity is Hennessy’s strategy, like SMI’s, is purely quantitative—that is, decisions are solely based on hard data. Hennessy’s strategies are totally different from ours, but have in common the key trait that they select investments based purely on numbers-driven rules. This drives Morningstar crazy, as they can’t stand the idea that there’s no human “wisdom” balancing out what the numbers are saying.

For example, consider what Morningstar was saying about this particular Hennessy fund five years ago:

“Hennessy Focus 30’s returns are enticing, but a closer inspection reveals a house of cards. Evaluated solely on performance, this fund looks impressive. Over the trailing five years, its 5% annualized gain tops 85% of mid-blend rivals. But investors should never choose a fund based on past performance alone, and on closer inspection, this offering has a number of fundamental flaws. Chief among them is lead manager Neil Hennessy’s blind faith in the past. The fund relies on a few simple value and momentum screens, based on a strategy that, owing to promising back-tested results, he purchased the rights to in late 2000. These seductive, ‘what could have been’ returns may be an easy sell, but they give investors a false, rear-view sense of security, suggesting that what has worked in the past will continue to work going forward. Financial markets have an uncanny ability to arbitrage away what has worked in the past, however. When hordes of capital flow to successful strategies, mispriced stocks don’t typically remain mispriced for long...”

“House of cards?” “Blind faith?” “Seductive...easy sell” — please Morningstar, tell us what you really think! The author makes his best case for dismissing the impressive returns the fund had generated over the previous five years. So it must be really irritating that it has gone on to be the top-performing mid-cap blend fund in Morningstar’s database over the succeeding five years!

Okay, enough picking on Morningstar. We realized long ago, and hopefully you have too, that much of the traditional financial media views the world through a fundamentally different lens than we do. Funds like this Hennessy recommendation, and frankly firms like SMI, will never win their praise because our simple focus on what works seems too simplistic and not sophisticated enough. So be it—as long as the mainstream continues to disbelieve in our quantitative approaches, those approaches are more likely to continue working.

In fairness, SMI has hit rough sailing before when recommending Hennessy funds within Upgrading. Sometimes, what was working when a particular batch of stocks was selected stops working before Hennessy is ready to shuffle the fund’s portfolio. These funds only choose new investments once per year and their selection criteria is pretty straightforward. But the approach has worked really well most of the time, so understanding that occasionally these funds can get out of synch with the market, we’re comfortable investing based on their system’s recently superior performance (and the fact that they’ve been able to repeat it many times over many years). This fund’s screens are designed to identify undervalued stocks with above-average growth potential, which certainly passes the common sense test. And the screens are typically re-run in the Fall, so it would seem that now is a good time to be buying.

◆ In the Large/Value group, Fidelity Mid Cap Value (FSMVX, 4/2013) is being replaced.5 When we first recommended this fund more than two years ago, the move was purely about size. At the time, smaller stocks were handily outperforming larger ones, so the addition of a couple “mid-size” funds into our large-category recommendations was a way of benefitting from that “smaller is better” dynamic. Of course, we knew that dynamic would eventually shift, writing:

For more on this fund, visit www.morningstar.com.
“Whether that will be a week, a month, a year from now…nobody knows. But when it does, the Upgrading system will lead us back into the “purer” large-category funds as their performance improves relative to the medium-sized alternatives. We can relax and follow the system, knowing that it has significant size and management-style flexibility already built into it.”

Now, two years later, that time has finally come. Fidelity Mid Cap Value did a great job for us, gaining 42.8% through the end of June. That’s significantly better than the 34.2% gain of the average fund in SMI’s large/value group over the same period. The fund still ranked highly as recently as the end of June, but has drifted significantly lower throughout July. So with it starting the final week of July in the 34th percentile, we’re turning the reigns over to a pure large-company fund once again.

• Clipper (CFIMX) is being added.1 Long-time readers may remember owning Clipper long ago, as it was a key contributor to Upgrading’s superior performance during the 2000-2002 bear market. Alas, today’s Clipper has little in common with that earlier version. The fund’s managers stumbled in the years that followed and wound up selling the fund. It is now managed by Christopher Davis of the Davis (and “Selected”) mutual-fund families, who, like his father and grandfather (both named Shelby Davis) is a well-known value investor. The fund utilizes a very concentrated (only 24 holdings), deep-value approach to stock picking. While performance hasn’t been great since Davis took over in 2006, it has improved markedly since Davis replaced his former co-manager at the beginning of 2014. That’s a lot of history and backstory, but really all Upgraders need to know is the fund has climbed to near the top of the large/value rankings, so we’re jumping aboard. ◆

STATUS REPORT OF FORMERLY RECOMMENDED FUNDS

Beginning in April, SMI’s Stock Upgrading strategy shifted from providing four official fund recommendations in each stock category to listing only three. (See April, page 55, for details.) This means each risk category had one official recommendation removed. This column provides status reports on those formerly recommended funds, so readers who already own them will know when they have fallen out of their category’s top quartile and should be sold. These updates are provided to track the progress of the funds for which we’ve not already issued sell recommendations.

• Foreign (Cat 5) — Litman Gregory Masters International (MNILX/MSILX, 3/2015): This fund has slipped into the 40th percentile range of its peer group. As such, we’re issuing our formal sell signal, meaning we won’t continue to track it. As we’ve mentioned before in regard to this fund, however, there is a wrinkle complicating this sell decision: the fund charges a 2% redemption fee on purchases sold within 180 days. Given the fund was recommended in the March issue (potentially meaning it was bought in late February), most SMI readers would have to hold it until the September issue (late August, at the earliest) in order to avoid the steep redemption fee.

So while we’re officially putting it on the sell list, it probably isn’t a bad idea to wait until the end of August if you were among those who bought it when it was first recommended. The chances of any new fund you choose outperforming this one by more than 2% over the next month aren’t high. However, if you bought it later than the initial recommendation date, it might be worthwhile to go ahead and sell rather than waiting several more months.

• Small/Growth (Cat 4) — PRIMECAP Odyssey Aggressive Growth (POAGX, 11/2012): We’ve given this fund a fair amount of wiggle room given its long-term superior performance and the fact that it has continued to bob along around the quartile cutoff. But with it entering the last week in July at the 40th percentile of its category, we’re pulling the plug and recommending that it be sold. Those who bought it back in November of 2012 are well over two-and-a-half years into this holding and it’s been an exceptional ride. The fund was up 98.4% through the end of June, significantly ahead of the 57.8% gain of the average fund in SMI’s small/growth risk category.

When a fund performs so well for so long, it’s easy to “fall in love” with it, making it potentially difficult to ever sell. Upgrading’s mechanical selling discipline steers us around that pitfall, allowing us to ride a hot fund indefinitely while still providing the final impetus to sell when its performance eventually declines. ◆

COVER ARTICLE / CONTINUED FROM PAGE 117:
SMI’S 2015 BROKER REVIEW
to another broker, TDA will charge a $75 fee for an “outbound full-account transfer.”)

Summing up

Fidelity is our top choice for most SMI members, with Scottrade and Schwab still earning their places among our top three. But as noted earlier, your personal needs and investing approach will largely dictate the “best” broker for you. While changing brokers isn’t fun, it’s a relatively easy process. So if your broker doesn’t measure up, consider a move to a more SMI-friendly firm. ◆

LEVEL 2 / CONTINUED FROM PAGE 119:
UNDERSTANDING THE IMPORTANT DIFFERENCE BETWEEN “YIELD” AND “TOTAL RETURN”

for better or worse, to changes in interest rates. Whereas a short-term bond fund’s total return will normally be comprised primarily of its income (yield) with a small capital gain/loss component, the primary driver of a long-term bond fund’s total return will often be the capital gain/loss element by itself. When interest rates are on the move, this capital-gain piece can easily overwhelm the income earned by long-term bonds.

While bonds and savings vehicles are the most obvious

1For more on this fund, visit www.morningstar.com.
investments to focus on when discussing yields and total returns, other investments are also affected by this same dynamic. For example, some stocks pay dividends, and this “dividend yield” factors into the total-return calculation in the same way that a bond’s yield from interest income does.

When DAA recently sold its Real Estate holding (VNQ), some readers were perplexed at the reported returns. In most of these cases, the confusion stemmed from simply looking at the price at which they had bought VNQ and comparing it to the price they sold for. This approach computed a significantly smaller gain than SMI was reporting. The missing variable in the equation was the significant amount of income that had been paid out to VNQ shareholders during the 16 months it was owned.

Here’s how the specific numbers broke down. Using the final month-end prices from when VNQ was first recommended and then later sold, readers would have bought at around $70.73/share and sold at around $74.69/share. That represents a 5.6% gain, which was only about half as much as the 11.6% gain SMI reported in the sell announcement on June 30. No wonder some readers were confused!

In this particular case, the $3.96 change in price (the capital gain) was actually overshadowed by the $4.193/share in income distributions an investor would have received from VNQ during the prior 16 months. Only by adding the capital-gain and income-distribution amounts together (and then dividing by the starting price) would an investor arrive at the correct total return.

Three of DAA’s asset classes (Bonds, Cash, Real Estate) derive a substantial proportion of their total returns from periodic income distributions, so it’s helpful to understand how both yield and capital gain/loss work together to generate total return. Years ago, the same used to be true of many stock investments, though in recent decades yield has largely been an afterthought for growth-oriented stock investors.

The easiest way for investors to deal with this potentially confusing situation is simply to rely on data sources that report total returns in the first place. SMI typically reports all performance numbers in total return terms, as does our primary data source, Morningstar. Most brokerages should also report total returns (although not all do and the way returns are reported at some brokers can be confusing). The main thing to avoid is looking only at the beginning and ending prices and forgetting to account for income distributions. Now that you know to be on the lookout for the two factors that can affect your total return, you should be able to navigate these potentially confusing waters with ease. ◆

**LEVEL 3 / CONTINUED FROM PAGE 120:**

**SECOND QUARTER REVIEW OF SMI’S INVESTING STRATEGIES**

You’re new, it’s harder to have early losses because there were no previous gains! For those in that position, take encouragement from Austin’s editorial this month, as well as DAA’s longer-term track record (see the aforementioned table on the back page). Mild losses along the way are bound to happen, but avoiding the big losses is what DAA excels at. A disappointing first few months doesn’t negate any of the reasons you chose to use this strategy in the first place.

**Sector Rotation (SR)**

Sector Rotation rebounded from a small first-quarter loss to generate an outstanding +8.2% gain in the second quarter. We made a change to the SR recommendation as the second quarter began and it paid off right away. SR has now returned +23.6% over the past 12 months.

**50/40/10**

This oddly titled portfolio refers to the specific blend of SMI strategies—50% DAA, 40% Upgrading, 10% Sector Rotation—examined in detail in our May 2014 cover article, *Higher Returns With Less Risk: The Best Combinations of SMI’s Most Popular Strategies*. That article found this combination of strategies has worked synergistically in the past to boost returns while simultaneously reducing risk—a great combination. It accomplished this by adding the high upside of SR and the volatility-dampening properties of DAA to an Upgrading base. (We report the results of this portfolio as if the Upgrading portion is invested 100% in stocks—no bonds. But if your risk temperament and season of life call for you to blend stocks and bonds in the Upgrading portion of this portfolio, then by all means do so.)

In the first quarter, we saw the benefits of blending these approaches, as SR fell while DAA and Upgrading rose. During the second quarter, we again saw the benefits of diversifying among these three strategies, although in a different way—it was SR’s strong gain helping to offset an unusually weak quarter by DAA.

The performance of the three strategies will vary at times, but a portfolio diversified among them will smooth out some of those wrinkles along the way. Whether you’re using this specific 50/40/10 blend or a different allocation combination tailored to your specific risk tolerance and situation, we think many SMI readers can benefit from combining them in some fashion. ◆

**LEVEL 4 / CONTINUED FROM PAGE 121:**

**HOW WELL DO TARGET-DATE FUNDS PERFORM IN A DOWNTURN?**

wanted to make it clear that at this (seemingly) late stage of the bull market, we believe DAA is the best choice.

While no one can accurately predict what will happen next in the stock market, the age of the current bull market gives us reason to remind investors that such markets don’t last forever and, at the very least, to encourage them to give careful thought to their investing time frame, risk tolerance, and comfort with their current approach.

Given that one of the most popular uses of TDFs is in 401(k) plans, it raises the question of whether DAA can be
implemented as an alternative in those accounts. If you have access to a “brokerage window” via your retirement plan, it probably can. However, in some cases, such investors are prevented from investing in exchange-traded funds (ETFs), which are used exclusively in DAA. Still, with a little extra effort, you should be able to come close to replicating DAA with traditional mutual funds.

Even 401(k) investors without access to a brokerage window may be able to implement DAA. For example, one SMI member recently sent a list of the 30 mutual funds he has access to in his workplace plan. After entering all of the funds into the Personal Portfolio Tracker, along with the six ETFs used in DAA, it showed that he has access to funds that match up well with five of the six DAA choices. If DAA ever became for the use of the one asset class where this reader doesn’t have a good match, he could use his workplace plan to invest in two of the recommended DAA-like funds and invest in the third (the one for which he has no close substitute) using his IRA.

Obviously, the DAA path isn’t as easy as plopping your money into a target-date fund. However, if you are using a target-date fund in your workplace plan, this may be a good time to at least familiarize yourself with its current stock allocation along with its timetable for reducing risk by shifting money into safer fixed-income investments. Make sure you’re comfortable with the fund’s allocation strategy. This may also be a good time to explore how easily DAA could be implemented in your workplace plan. ◆

**MARKET NOTES, QUOTES, AND ANECDOTES**

**Signals, noise, and the risks that matter**

- “When you’re constantly looking for a catalyst to explain every single move in the markets, you start to see signals and correlations that just don’t exist. Much of the time we won’t know exactly why the markets moved a certain way until much later. Sometimes even with the benefit of perfect hindsight, investors still can’t agree on the specifics of the cause and effect. But to some the ‘why’ in the markets will always seem easy after the fact, so they keep searching for the answers.” —Ben Carlson, author of AWealthofCommonSense.com blog, in a 6/30/15 post on the futile search for a market narrative.

- “Now, consider the stock market’s signals and noises. Its performance gets measured every moment of every day, down to a tenth of a point. That’s a lot of noise, and we often confuse it for a signal. The most common example has to be down days versus up days. If the market goes up, the non-rational part of our brain hears the noise of that higher number and thinks, ‘Oh, that’s a signal to buy.’ If the market goes down, the same area urges us to ‘Sell, sell, sell.’

  But what if—and maybe this is a silly idea—we didn’t do anything? Or, what if we at least didn’t do anything that wasn’t based on a plan? What if we ignored the noise and instead focused on signals that related to us personally?” —Carl Richards, “Sketch Guy” blogger at the NY Times, in a 7/13/15 post on the importance of managing investments based on a personal financial plan, not the day’s financial headlines. For more, see tinyurl.com/njguc5.

- “There are two forms of risk that really matter. One is whether you understand a given investment as well as you think you do. The other is whether you’ve correctly anticipated how you’ll react if your analysis turns out to be wrong.” —Wall Street Journal columnist Jason Zweig on why standard measures of investment risk matter less than the risk of an investor getting in his or her own way.

**Something to sell**

- “The rout in gold prices is telling us that the world is changing. Gold is usually sought when inflation starts to heat up. When the economy first emerged from the Great Recession, gold rose in price, figuring that inflation would eventually rise...It did not work out quite this way. Instead of heating up, inflation actually cooled off. When gold buyers caught on, they dumped the precious metal...The current plunge has brought gold prices down to levels not seen since the last recession.” —Irwin Kellner, chief economist for MarketWatch, writing on 7/28/15 on gold’s recent fall to its lowest level in almost six years. For more, see tinyurl.com/nyxz3y5.

**Lost luster**

- “The rout in gold prices is telling us that the world is changing. Gold is usually sought when inflation starts to heat up. When the economy first emerged from the Great Recession, gold rose in price, figuring that inflation would eventually rise...It did not work out quite this way. Instead of heating up, inflation actually cooled off. When gold buyers caught on, they dumped the precious metal...The current plunge has brought gold prices down to levels not seen since the last recession.” —Irwin Kellner, chief economist for MarketWatch, writing on 7/28/15 on gold’s recent fall to its lowest level in almost six years. For more, see tinyurl.com/nyxz3y5.
### PERFORMANCE DATA

**SOUND MIND INVESTING MODEL PORTFOLIOS • DATA THROUGH JUNE 30, 2015**

<table>
<thead>
<tr>
<th>BASIC STRATEGIES</th>
<th>Year to Date</th>
<th>1 Month</th>
<th>3 Months</th>
<th>12 Months</th>
<th>3 Yrs Annual</th>
<th>5 Yrs Annual</th>
<th>10 Yrs Annual</th>
<th>15 Yrs Annual</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Stock Market</td>
<td>1.7%</td>
<td>-1.8%</td>
<td>0.1%</td>
<td>7.1%</td>
<td>17.5%</td>
<td>17.3%</td>
<td>8.2%</td>
<td>4.9%</td>
</tr>
<tr>
<td>Just-the-Basics</td>
<td>3.5%</td>
<td>-1.6%</td>
<td>0.1%</td>
<td>4.6%</td>
<td>16.7%</td>
<td>16.0%</td>
<td>8.3%</td>
<td>5.2%</td>
</tr>
<tr>
<td>Stock Upgrading</td>
<td>3.4%</td>
<td>-1.8%</td>
<td>-0.1%</td>
<td>3.3%</td>
<td>16.5%</td>
<td>14.6%</td>
<td>8.4%</td>
<td>8.2%</td>
</tr>
<tr>
<td>U.S. Bond Market</td>
<td>-0.1%</td>
<td>-1.1%</td>
<td>-1.8%</td>
<td>1.9%</td>
<td>18.0%</td>
<td>14.7%</td>
<td>8.4%</td>
<td>8.2%</td>
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<tr>
<td>Bond Upgrading</td>
<td>-1.5%</td>
<td>-1.1%</td>
<td>-3.6%</td>
<td>2.9%</td>
<td>4.5%</td>
<td>5.4%</td>
<td>7.1%</td>
<td>7.6%</td>
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</table>

<table>
<thead>
<tr>
<th>PREMIUM STRATEGIES</th>
<th>Year to Date</th>
<th>1 Month</th>
<th>3 Months</th>
<th>12 Months</th>
<th>3 Yrs Annual</th>
<th>5 Yrs Annual</th>
<th>10 Yrs Annual</th>
<th>15 Yrs Annual</th>
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</thead>
<tbody>
<tr>
<td>DAA</td>
<td>-2.6%</td>
<td>-3.3%</td>
<td>-5.3%</td>
<td>3.1%</td>
<td>10.3%</td>
<td>11.2%</td>
<td>12.2%</td>
<td>12.2%</td>
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<tr>
<td>Sector Rotation</td>
<td>4.4%</td>
<td>2.6%</td>
<td>8.2%</td>
<td>23.6%</td>
<td>40.2%</td>
<td>31.2%</td>
<td>15.7%</td>
<td>15.8%</td>
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<tr>
<td>50-40-10 Blend</td>
<td>0.5%</td>
<td>-2.1%</td>
<td>-1.9%</td>
<td>5.5%</td>
<td>16.0%</td>
<td>14.7%</td>
<td>11.6%</td>
<td>11.5%</td>
</tr>
<tr>
<td>Inflation Hedges</td>
<td>-5.0%</td>
<td>-5.1%</td>
<td>-3.8%</td>
<td>-1.8%</td>
<td>-1.2%</td>
<td>3.2%</td>
<td>7.0%</td>
<td>11.1%</td>
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<tr>
<td>Enhanced Just Basics</td>
<td>3.2%</td>
<td>-1.7%</td>
<td>-0.1%</td>
<td>3.8%</td>
<td>15.4%</td>
<td>14.2%</td>
<td>8.7%</td>
<td>6.9%</td>
</tr>
</tbody>
</table>

**Notes:** Transaction costs and redemption fees—which vary by broker and fund—are not included. *1 Based on the float-adjusted Wilshire 5000 Total Return Index, the broadest measure of the U.S. stock market. *2 Calculated assuming account rebalancing at the beginning of each year with 40% of the stock allocation invested in the Vanguard S&P 500 (VOO), 40% in Extended Market (VXF), and 20% in Total International Stock (VLI). *3 For a 100% stock portfolio, assuming the portfolio allocation for each risk category was divided evenly among all the recommended funds. *4 Based on Barclays U.S. Aggregate Bond Index, the broadest measure of the U.S. bond market. *5 For a 100% bond portfolio, assuming 25% of the portfolio was invested in Vanguard I-T Bond Index (BIV), 25% in Vanguard S-T Bond Index (BSV), and 50% in the rotating recommended bond fund. The results prior to January 2015 are hypothetical, calculated from backtesting the strategy following a mechanical rules-based system. *6 The results prior to January 2013 are hypothetical, calculated from backtesting the strategy following a mechanical rules-based system. *7 Based on our OWh recommendations. The results prior to January 2010 are hypothetical, calculated from backtesting the strategy following a mechanical rules-based system. See the January 2010 issue for details. *8 This is a refinement of our Just-the-Basics strategy, most useful for Fidelity investors. The results prior to January 2008 are hypothetical, calculated from backtesting the strategy following a mechanical rules-based system.

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**THE SOUND MIND INVESTING MUTUAL FUND (SMIFX)**

<table>
<thead>
<tr>
<th>Current Returns as of 6/30/2015</th>
<th>Year to Date</th>
<th>1 Month</th>
<th>3 Months</th>
<th>12 Months</th>
<th>3 Yrs Annual</th>
<th>5 Yrs Annual</th>
<th>Annual since Inception</th>
</tr>
</thead>
<tbody>
<tr>
<td>SMIFX</td>
<td>2.09%</td>
<td>-1.69%</td>
<td>-0.49%</td>
<td>2.25%</td>
<td>15.25%</td>
<td>13.31%</td>
<td>6.80%</td>
</tr>
<tr>
<td>Wilshire 5000</td>
<td>1.67%</td>
<td>-1.75%</td>
<td>0.07%</td>
<td>7.09%</td>
<td>17.45%</td>
<td>17.33%</td>
<td>7.71%</td>
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<tr>
<td>S&amp;P 500</td>
<td>1.23%</td>
<td>-1.94%</td>
<td>0.28%</td>
<td>7.42%</td>
<td>17.31%</td>
<td>17.34%</td>
<td>7.49%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Quarterly Returns as of 6/30/2015</th>
<th>Year to Date</th>
<th>1 Month</th>
<th>3 Months</th>
<th>12 Months</th>
<th>3 Yrs Annual</th>
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<td>17.31%</td>
<td>17.34%</td>
<td>7.49%</td>
</tr>
</tbody>
</table>

1Annualized return since SMIFX inception date of December 2, 2005. Total/Gross expense ratio: 2.03% as of 2/28/2015 (includes expenses of underlying funds) Net expense ratio: 1.11% as of 2/28/2015 (excludes expenses of underlying funds)

**Notes:** The performance data quoted represents past performance, and past performance is not a guarantee of future results. Investment return and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted. *1 You should carefully consider the investment objectives, risks, fees, charges and expenses of the Funds before investing. The prospectus contains this and other information about the Funds. To obtain a prospectus or performance information current to the nearest month end, call 1-877-764-3863 or visit www.smifund.com. Read the prospectus carefully before investing. *2 Because the SMI Funds invest in other mutual funds, they will bear their share of the fees and expenses of the underlying funds in addition to the fees and expenses payable directly to the SMI Funds. As a result, you’ll pay higher total expenses than you would investing in the underlying funds directly. *3 Returns shown include reinvestment of dividends and capital gains. The Wilshire 5000 Index represents the broadest index for the U.S. equity market. The S&P 500 Index is an unmanaged index commonly used to measure the performance of U.S. stocks. You cannot invest directly in an index. *4 The Sound Mind Investing Funds are distributed by Unified Financial Securities (member FINRA).

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