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Debunking Market Myths

Financial theorist William Bernstein once said, "Investment wisdom begins with the realization that long-term results are the only ones that matter." Yet, while markets produce relatively consistent returns over the long run, their short-term volatility constantly works to sabotage the best attempts of investors to think that way. Replacing common market myths with historical truth helps cultivate the patience and discipline required to become a successful and wise long-term investor.

by Ben Carlson

Meet Bob. Bob is the world's worst market timer. What follows is Bob's tale of terrible market timing purchases in the stock market.

Bob began his career in 1970 at age 22. He was a diligent saver and planner. Bob mapped out his entire future savings in advance to plan for retirement. His plan was to save $2,000 a year during the 1970s and bump up that amount by $2,000 each decade until he could retire at age 65 by the end of 2013.

He started out by saving the $2,000 a year in his bank account until he had $6,000 to invest by the end of 1972. While Bob was a diligent saver, his investment skills left a lot to be desired. Bob's problem as an investor was that he only had the courage to put his money to work in the market after a huge run up.

All of his money went into an S&P 500 index fund at the end of 1972. The market proceeded to drop nearly 50 percent in the 1973 to 1974 bear market, so Bob put his money in at the peak of the market right before a crash—terrible timing on his part. Although he had terrible timing on his buy decision, Bob did have one saving grace. Once he was in the market, he never sold his fund shares. He held on for dear life because he was too nervous about being wrong on his sell decisions, too.

Remember this decision, because it's a big one.

Bob didn't feel comfortable about investing again until August 1987, after another huge bull market had taken hold. After 15 years of saving he now had $46,000 in additional funds to put to work. Again he invested in an S&P 500 index fund and again he top-ticked the market just before another crash. This time stocks lost more than 30 percent in short order right after Bob bought his index shares. Timing wasn't on Bob's side so he continued to keep his money invested just as he did before.

After the 1987 crash Bob didn't feel right about putting his future savings back into stocks until the tech bubble really ramped up by the end of 1999. He now had another $68,000 of savings to put to work. This time his purchase, at the end of December 1999, was just before a 50 percent-plus downturn that lasted until 2002. This buy decision left Bob with some more scars but he decided to make one more big purchase with his savings before he retired.

The final investment was made in October 2007, when he invested $64,000, which he had been saving since his last purchase in 2000. He rounded out his string of horrific market timing calls by buying right before (continued on page 147)

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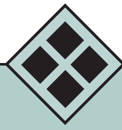
"FOR GOD HAS NOT GIVEN US THE SPIRIT OF FEAR BUT OF POWER, AND OF LOVE, AND OF A SOUND MIND."



EDITORIAL

Six Investing Facts to Consider when Risking Your Money in the Stock Market

Remember the Southern Corn Leaf Blight of 1970? No? Well, I wouldn't either except for the fact it changed my life…and perhaps yours as well.

"First reported in February in southern Florida, by mid-June the disease covered the entire state of Florida, lower Alabama, and most of Mississippi. Reproducing rapidly in the unusually warm and moist weather of 1970, its spores carried on the wind, the new disease began moving northward toward a full-scale invasion of America's vast corn empire."[1]

As the supply of corn was threatened, prices began to rise. I was blissfully unaware of the drama until my neighbor, a Merrill Lynch broker, helpfully filled me in with stories of the wonderful gains his clients were enjoying in corn futures. Did I want in? Yes, I did. And so began my immersion into the high-risk, high-reward world of commodities trading. As I explained in the *Sound Mind Investing Handbook*:

"For a time, commodities became my driving purpose.… I remember making and losing $10,000 [that would be about $60,000 in 2015 dollars!] in a single day of trading. I remember driving along the Pennsylvania Turnpike on a summer getaway with Susie and ruining the whole effect by stopping every 75 miles to call my broker back in Louisville. Every hour I stopped. Can you believe it? Susie couldn't. But she just didn't understand. I had left town still holding a heavy short position in frozen pork bellies and I had to be careful. (For you laymen, that means I had sold 200 tons of bacon I didn't own to a buyer I had never met for a price one of us would soon regret. Obviously, I was hoping it wouldn't be me.) I remember that I made more money in commodities than I ever made in stocks."

When we moved west for two years to volunteer our time with a Christian ministry, I left my commodity trading days behind—before re-entering the fray about 15 years later. My latter venture in the 1980s was not as profitable, except for six lessons I learned that have influenced the way we have designed SMI investing strategies you may be following:

• The Efficient Market Hypothesis (EMH), so popular on Wall Street and academia and the driver of the index-fund revolution in recent decades, was wrong. EMH asserts that all publicly available information is always fully reflected in stock prices, thus no one can expect to beat the market consistently. On the contrary, many famous investors and fund managers have a history of regularly outperforming the market. Beating the market is hard and rare, but it can be done.

• Emotions are stronger than reason. The markets can be volatile and irrational because investors often behave in emotional and irrational ways. Fear and greed are strong drivers of poor investing decisions. This means it's essential to develop—and consistently follow—a rules-based approach to decision-making. The rules provide boundaries that *serve to protect us from the markets and ourselves.*

• Price trends (that is, performance momentum) can last longer and go further than anyone expects. We see this at the extremes of bull and bear markets.

• Momentum is the well-documented tendency of leading performers to continue being leading performers, and poor performers to continue being poor performers. Momentum has been one of the most highly researched finance topics over the past 20 years. The research has shown that momentum investing works well within and across nearly all markets, and over a wide variety of time periods.[2]

• It's easier and more profitable to jump on a trend that's already in place than attempting to predict when and where the next trend will begin. Thus the market truism, "The trend is your friend." Follow it, don't fight it.

• Large losses undermine long-term success to a greater degree than is understood by the average investor (e.g., a 50% loss requires a 100% gain to get even). To control losses (and protect gains), you must have a robust selling discipline.

Building on these facts of investing life, SMI has consistently created strategies that are: (1) rules-driven, to provide a clear-cut and objective basis for decision-making, (2) trend following in nature (that is, not predictive or anticipatory); (3) momentum-based, seeking to invest only in the current leaders; and (4) governed by a firm selling discipline that tells us when to sell, take profits/losses, and move on. You'll recognize these traits in Upgrading, DAA, Sector Rotation and our other strategies.

AUSTIN PRYOR
FOUNDER/PUBLISHER

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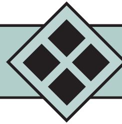
[1] tinyurl.com/npv2j5w [2] Dual Momentum Investing by Gary Antonacci

FEATURE  ARTICLE

Debunking Market Myths

(continued from front page)

another 50 percent-plus crash from the real-estate bubble. After the financial crisis he decided to continue to save his money in the bank (another $46,000) but kept his stock investments in the market until he retired at the end of 2013.

TABLE 1
BOB'S RETIREMENT SAVINGS SCHEDULE[1]

Decade	Annual Savings	Total Saved
1970-1979	$2,000	$20,000
1980-1989	$4,000	$40,000
1990-1999	$6,000	$60,000
2000-2009	$8,000	$80,000
2010-2013	$10,000	$40,000

[1]Bob retired at the end of 2013

TABLE 2
BOB'S MISTIMING OF MARKET PEAKS

Date Invested	Amount Invested	Subsequent Crash
12/1972	$6,000	–48%
08/1987	$46,000	–34%
12/1999	$68,000	–55%
10/2007	$64,000	–57%

To recap, Bob was a terrible market timer with his only stock market purchases being made at the market peaks just before extreme losses. Table 2 lists the purchase dates, the crashes that followed, and the amount invested at each date.

Luckily, while Bob couldn't time his buys, he never sold out of the market even once. He didn't sell after the bear market of 1973-1974, or the Black Monday crash in 1987, or the technology bust in 2000, or the financial crisis of 2007-2009. He never sold a single share.

So how did he do?

Even though he bought only at the very top of the market, Bob still ended up a millionaire with $1.1 million. How could that be you might ask?

First of all Bob was a diligent saver and planned out his savings in advance. He never wavered on his savings goals and increased the amount he saved over time. Second, he allowed his investments to compound through the decades by never selling out of the market over his 40-plus years of investing. He gave himself a really long runway. He did have to endure a huge psychological toll from seeing large losses and sticking with his long-term mindset, but I like to think Bob didn't pay much attention to his portfolio statements over the years. He just continued to save and kept his head down.

Obviously, it's difficult to believe that Bob would have had enough intestinal fortitude to hold his stocks without selling if he was that bad of a market timer. But the point is that with a long enough time horizon, even bad decisions can get smoothed out by compound interest. Now can you imagine if Bob had simply dollar-cost-averaged his money into the market over this same time frame instead of constantly making bad market-timing decisions? If he hadn't been so afraid to make purchases until he was confident in the market, he would have ended up with nearly $2.3 million. But then he wouldn't be considered "Bob, the world's worst market timer."

Bob is a prime example of the first myth about investing.

Myth 1: You have to time the market to earn respectable returns

Over the past 90 years or so, the U.S. stock market is up nearly 10% per year. That number includes periods of high market valuations and low valuations and rising and falling inflation, with short-term interest rates as high as 15% and as low as 0%. It includes many manias and panics, including the Great Depression, a recession roughly every five years, World War II, the tech bubble, and nearly one hundred 10% corrections.

Over a very long time horizon, a well-timed investment might not matter all that much in the grand scheme of things. Legendary mutual-fund manager Peter Lynch performed a study with Fidelity Investments that looked at the 30-year period from 1965 to 1995 and found that if you invested every single year at the lows in the market (the lowest day to be precise) you would have earned a return of 11.7% annually.

Had you been the unlucky sort, the Jackie Gleasons of the world as Lynch put it, and picked the high day every single year to put your money to work, your return would have been 10.6%. On the other hand if you would have kept it simple and put your money to work on the first day of the year and not tried to guess one way or the other, you would have earned 11.0% per year. The odds of consistently picking the best and worst days are minimal, but putting money into the markets on a periodic basis is something every investor can do. So much time and energy is put into trying to figure out the best time to invest when a simple dollar-cost-averaging (DCA) plan with a long time horizon is much less stressful and easier to implement.

There was another study done that looked at 237 market-timing newsletters. These newsletters send buy and sell signals to their paying customers. The results of the study found that the market-timing calls were right less than 25 percent of the time.

It's not so much that market timing is completely impossible to pull off. Investors have done it before. Not many, but a few have done it. It's just that it's brutal psychologically. If you're making a binary choice between being completely in the market or completely out of the market, it can be emotionally draining.

This is because timing the market requires two decisions—both a sale at a relatively high point and then a buy at a relatively lower point. Even if you're able to get half of that equation right (the sale), it will be extremely difficult to make yourself buy back in after stocks fall. Sitting in cash is the best feeling in the world when markets correct or crash. Talking yourself out of getting back in is much easier than pulling the trigger and going all-in again. Unless you have a systematic, rules-based process that gives you buy and sell signals that you can follow through thick and thin, it will be very difficult to force yourself to change positions when you should by using fundamentals or your gut instinct alone.

Of course, any long-term strategy can be emotionally draining at times. The trick is finding the one that balances your ability to sleep at night with a high probability of achieving your long-term financial aspirations.

Myth 2: You have to wait until things get better before you invest

"I'll just wait until things start to improve before I put my money back to work in the markets." I heard variations of this line of thinking by countless investors during the market crash of 2007-2009. The problem is that if you wait for things to get better you'll end up missing the majority of the gains when markets finally come back to life.

The stock market anticipates future events and discounts them today. It doesn't always get them correct, but that's never stopped investors from trying. Markets don't usually perform the best when the economic outlook goes from good to great. They actually show the best performance when things go from terrible to not-quite-so-terrible as before. And it's not the absolute level of improvement that matters—it's whether things are getting better or worse. If things are just getting less worse, investors perceive this as a positive because there's nowhere to go but up.

TABLE 3

UNEMPLOYMENT RATE AND MARKET RETURNS

Unemployment Rate	S&P 500 Annualized Returns	Frequency
> 9%	24.5%	8%
7% - 9%	15.1%	22%
5% - 7%	8.3%	46%
< 5%	3.9%	24%

Source: Federal Reserve

For example, since 1950 the average unemployment rate is just over 6 percent. When the unemployment rate has been below average, the S&P 500 is up 6 percent annually, much lower than the long-term average of almost 10 percent per year in that time. When the unemployment rate has been above average, the annual performance of stocks jumps to over 16 percent per year. An unfortunate truth of the stock market is that the best time to buy is when conditions are at their worst.

Breaking down this relationship even further, Table 3 shows the returns by different unemployment rates, the corresponding stock-market returns, and the frequency with which those rates were observed. When things seem the worst, it's actually the best time to invest. If you wait for things to get better, chances are the ship has already sailed.

Myth 3: If only you can time the next recession, you can time the stock market

Since 1928, the U.S. economy has been in a recession, on average, one out of every five years, or 20 percent of the time. In that time, the longest the economy has ever gone between recessions is 10 years, from 1991 to 2001. Recessions can be painful, but somehow every time we're in the midst of a strong economic recovery, people forget that they're a natural outcome in the ebb and flow of the business cycle. Table 4 shows how common recessions are in the United States.

TABLE 4

U.S. RECESSIONS SINCE 1929

Recessions	GDP Contraction
August 1929 - March 1933	-26.7%
May 1937 - June 1938	-18.2%
February 1945 - October 1945	-12.7%
November 1948 - October 1949	-1.7%
July 1953 - May 1954	-2.6%
August 1957 - April 1958	-3.7%
April 1960 - February 1961	-1.6%
December 1969 - November 1970	-0.6%
November 1973 - March 1975	-3.2%
January 1980 - July 1980	-2.2%
July 1981 - November 1982	-2.7%
July 1990 - March 1991	-1.4%
March 2001 - November 2001	-0.3%
December 2007 - June 2009	-4.3%

Source: Natl Bureau Economic Research

TABLE 5

STOCKS FALL 10%+ WITH NO RECESSION

Year(s)	Decline
1946-1947	-23.2%
1961-1962	-27.1%
1966	-22.3%
1967-1968	-12.5%
1971	-16.1%
1978	-12.8%
1983-1984	-15.6%
1987	-35.1%
1997	-13.3%
1998	-19.3%
2002	-31.5%
2010	-13.6%
2011	-16.8%

Source: *Stocks for the Long Run*

The stock market is cyclical just like the economy, so most would assume that large losses in the stock market should coincide with a contraction in GDP growth. If only it were that easy. According to Professor Jeremy Siegel, since World War II, there have been 13 instances where the Dow Jones Industrial Average fell at least 10% without the economy experiencing a recession (see Table 5). That means the market has fallen an average of 20% every five years or so *without* the economy going into a recession.

The stock market and the economy are rarely in sync with one another. Economic growth tells us very little about where the stock market is going next. Over a one-year period the relationship between GDP growth and stock market returns is next to nothing. Even looking out over a 10-year period there's not a close relationship between the two. Repeat the following mantra to yourself on a consistent basis: The stock market is not the economy, the stock market is not the economy. . . .

Myth 4: There's a precise pattern in historical market cycles

Famed value investor John Templeton once stated, "The investor who says, 'This time is different,' when in fact it's virtually a repeat of an earlier situation, has uttered among the four most costly words in the annals of investing." Many investors take this quote to mean that if they can only deconstruct the historical nature of the markets they can come up with the perfect formula to figure out how it should work in the future. The problem with this line of thinking is that past cycles are completely unique. You will find no rhyme or reason from one decade to the next. There's no single indicator or variable that's going to give investors an edge.

The one constant in the markets is the fact that they're cyclical. Nothing goes in one direction forever. As Oaktree's Howard Marks puts it, "Every once in a while, an up-or down-leg goes on for a long time and/or a great extreme and people start to say 'this time it's different.' They cite the changes in geopolitics, institutions, technology or behavior that have rendered the 'old rules' obsolete. They make investment decisions that extrapolate the recent trend. And then it turns out that the old rules do still apply, and the cycle resumes. In the end, trees don't grow to the sky, and few things go to zero. Rather, most phenomena turn out to be cyclical."

But Marks and Templeton aren't talking about finding reliable indicators to be able to predict future market movements. It's human nature that's the constant in the equation. As Jesse Livermore stated more than a century ago, "Another lesson I learned early is that there is nothing new in Wall Street. There can't be because speculation is as old as the hills. Whatever happens in the stock market today has happened before and will happen again." People will always fall for trappings of fear and greed.

Cycles are inevitable, but trying to perfectly time those cycles is the hard part because, although this time is never different from the standpoint of human nature, this time is *always* different in terms of the makeup of the market. Industries change. Information becomes redundant. Investors wise

up to historical anomalies and just when you think you've found the secret indicator that explains the perfect time to buy and sell securities, it stops working.

Myth 5: Stocks and bonds always move in different directions

Because stocks and bonds are found on different ends of the risk spectrum, many investors assume they should always be moving in opposite directions. So when stocks perform well, bonds should be performing poorly and vice versa. The usual argument is that something has to give when each are showing positive performance in the same period. This makes sense in theory, but not so much in reality when you consider that both stocks and bonds show positive gains over time. In fact, in nearly 60 percent of all annual periods going back to the 1930s, the S&P 500 and 10-year Treasuries have both had positive returns during the same year (see Table 6).

TABLE 6

POSITIVE ANNUAL RETURNS FOR STOCKS AND BONDS IN THE SAME YEAR

Decade	Both Positive
1930s	40%
1940s	70%
1950s	30%
1960s	60%
1970s	70%
1980s	70%
1990s	70%
2000s	50%
2010-2013	75%
1930-2013	57%

The relationship between stocks and bonds is anything but static, like nearly everything else in the financial markets. Over a very long time frame, these two distinct asset classes have a correlation that's more or less equal to zero—in layman's terms, this means the price movements between the two have no positive or negative relationship. Although the two are positive together most of the time, that doesn't mean that they move in lockstep with one another. Even this correlation changes over time. Sometimes they're both moving up together. Other times they're going in different directions while most of the time there's no discernible pattern.

The true diversification benefit of owning both stocks and bonds comes during the down years. Going back to 1928, there have only been three times that both stocks and bonds finished down in the same calendar year (1931, 1941, and 1969).

Myth 6: Investing in the stock market is like gambling at a casino

"The stock market is rigged. It's like rolling the dice at a casino. I might as well just buy a lottery ticket." This is how many people felt about investing in stocks following the 2007-2009 crash. In reality, it's our emotions that are rigged against us, not the markets. While the Great Recession was an extraordinarily painful period of economic and financial ruin for many people, as investors you have to expect to deal with those types of gut-wrenching markets a few times throughout your life. Harry Truman once said, "The only thing new in the world is the history you don't know." Replace "the world" with "finance" and this explains the reaction of the majority of stock market investors during a panic.

Knowing your financial history provides not only the knowledge necessary to remain calm during market downturns, but also helps to show that the markets have always been cyclical. Yes, they can be a roller coaster, but the trend is still in favor of progress. If anything, investors learned in 2008 that they over-estimated their tolerance for risk.

The one thing you should never be as an investor is surprised by how far the markets travel in either direction. The reasons will always be different for the rise and fall, but the magnitude of gains and losses should never catch you off guard. The reason for this is simple—people control the stock market and those people sometimes get together to make irrational decisions all at the same time. The feelings produced by bull and bear markets rarely change: nervous, excited, scared, happy, euphoric, confused, perplexed, frustrated, angry, envious, delighted, and of course fearful and greedy.

Most investment books show a long-term chart of the stock market to prove how great an investment in stocks can be over the *very* long run. If nothing else, this chart shows the power of human ingenuity and innovation over the past 100 years or so. It tells us nothing about where stocks are going, but it does tell us where the markets have been.

But to disprove the assumption that the market acts as something of a dirty pit boss at the casino, I've always been more interested in the historical growth in dividends on the S&P 500. [Editor's note: Which, when charted over the long-term, looks very similar to the upward direction of the long-term stock market chart.] Dividends represent actual cash paid out to shareholders—real, tangible money. Casinos don't make dividend payments to their customers. You can't fake cash payments. In fact, dividends rarely rise or fall as much as the stock market does. Between September 1929 and June of 1932, the stock market fell 81% as measured by the inflation-adjusted S&P index. But in that time inflation-adjusted dividends only fell 11%. When the market fell 54% from January of 1973 to December of 1974, real dividends fell only 6%.

The long-term increase in the stock market is entirely the result of the increase in long-term dividends and earnings growth of the companies that make up the market. How much investors are willing to pay for those earnings and dividends will change constantly. Much of these fluctuations have to do with speculation, but most of them have to do with the fact that investors are constantly projecting out the recent past into an uncertain future. That doesn't mean the odds are stacked against individual investors; just the ones who are unable to control their emotions.

Key takeaways from market history

• Historical data is littered with caveats, counterintuitive results, and no easy answers over the short-to intermediate-term. Over the long term, the markets are much more consistent, but it requires a great deal of patience and discipline to remain a long-term investor when short-term instincts take over.

• The long-term average market performance is made up of many periods that are anything but average. Plan on experiencing uneven results, frustrating periods, volatility, and the occasional crash.

• Financial market history can be useful in defining and managing risk, but it will never be able to tell you how to make the perfect move at the perfect time. ◆

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LEVEL 1 ONE

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

DO YOU NEED UMBRELLA LIABILITY INSURANCE?

Start investigating the subject of "umbrella" liability insurance and it won't be long before you hear this phrase: "It's only a couple hundred dollars per year for $1 million of coverage." While it may sound like you get a lot for little cost, you first need to understand exactly what umbrella insurance is—and whether you even need it—before concluding such insurance is "a bargain."

What does it shield you from?

Auto and homeowner's insurance policies typically contain multiple coverages. First, both provide damage protection. If you wreck your car or your house burns down, such insurance will pay to fix the damage. Assuming the underwriting process was done correctly, auto and homeowner's policies should cover the full value of those respective assets.

Second, such policies provide a degree of liability coverage. However, unlike insuring against damages where value is relatively easy to ascertain, liability risks are more difficult to measure—and can potentially be much greater. Often, liability protection offered by auto and homeowner policies proves to be insufficient.

That's where an umbrella liability insurance policy, also known as an "excess-liability" policy, comes in. It kicks in at whatever point the liability coverage of your auto or homeowner's (or renter's) policy ends.[1]

Here's a simple illustration of how an umbrella liability policy helps supplement your existing coverage. Joe has a $300,000 limit on bodily injury liability in his auto insurance. He is at fault in an accident which results in total medical bills of $500,000 for the person he hit. His auto policy will cover the first $300,000. Without the umbrella policy, Joe would likely be sued for the remaining $200,000. Instead, his umbrella liability policy covers those bills.

First, understand your current coverage

Vehicle owners are required by law to carry insurance that provides two forms of liability coverage. If you are found to be at fault in an accident, *property damage* liability coverage will help pay to repair the other person's property. If the other person is injured, *bodily injury* liability will help pay his or her medical bills.

While both types of liability coverage are required in most states, mandatory coverage amounts vary by state, and can be fairly low. In Kentucky, for example, the law requires property damage liability coverage of only $10,000 and bodily injury liability coverage of just $25,000 per person and $50,000 per accident. Many drivers opt for higher coverage amounts, but there are limits as to how much coverage is available. Even at higher coverage levels, you run the risk of being sued for more, and that's when umbrella coverage can be helpful.

Homeowner's insurance policies provide two types of liability coverage as well. *Personal liability* covers claims or lawsuits related to any injuries or property damage someone may experience because of an accident on your property, or because of an accident elsewhere caused by you (or a family member who lives with you). Protection levels typically range from $100,000 to $300,000. *Medical payments to others* covers medical costs for someone injured on your property. Medical payments coverage can provide as little as $1,000 to $5,000 of protection per person. An umbrella policy can provide additional payments in such cases.

Inclusions and exclusions

Here are some added risks to weigh. If you have teenage drivers or you regularly give rides to other adults or other people's children, you have increased risks that may warrant increased insurance protection.

When it comes to your home, stairways and slippery sidewalks are common sources of injury. Add a swimming pool, trampoline, swing set, or a pet that could hurt someone (e.g., Pete the pit bull could be a problem; Georgie the goldfish, not so much), and your risk levels go up quite a bit.

If you own rental property, an umbrella policy will typically help pay for injuries or property damage sustained by a tenant. Such insurance also protects you in case you're sued for libel, slander, and more.

As for what umbrella policies do *not* cover, typical exclusions are: damage you caused intentionally, issues arising from business pursuits, and anything related to aircraft, jet skis, and other types of recreational vehicles.

Umbrella policies typically are sold only by companies that already provide your auto or homeowner's insurance, and most such companies require you to carry certain levels of liability coverage on those policies before they'll sell you an excess-liability policy.

Umbrella policy math

A starting point for evaluating whether you need an umbrella liability policy is to estimate the value of your assets and compare it to the liability coverage you have through your auto and homeowner's policies. The greater the gap, the more an umbrella policy probably makes sense. It's worth noting that some settlements and judgments in liability cases can go after your future earnings as well as your current assets.

Money magazine suggests basing the amount of umbrella coverage on your assets because in a liability lawsuit, attorneys tend to aim for the amount of your available assets but often will settle for a comparable insurance amount. That line of thinking is the reason why some financial planners recommend insuring for *(continued on page 157)*

[1] Liability insurance may also cover you from some types of claims that may be excluded from your other coverage.

LEVEL 2 TWO

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

LESSONS FROM UPGRADING'S LONG-TERM PERFORMANCE HISTORY

In his August editorial, *Are Your Investing Expectations Reasonable?*, Austin discussed how the perceived reliability of a given strategy is colored by each investor's initial experience with that strategy. If you start using an approach just as that strategy is starting a hot streak, you'll likely develop a strong positive perception of it. The opposite is true if the strategy struggles soon after you start using it. Intuitively we know every strategy is going to have ups and downs, but our first impressions of a strategy's value are hard to overcome.

As part of that August discussion, Austin suggested adopting a 10-year time frame for evaluating the effectiveness of an investing strategy. This allows you to consider the strategy's returns over the course of one or more full market cycles, enabling you to see how the strategy performs during different types of market environments. For example, you wouldn't want to draw any conclusions about SMI's Dynamic Asset Allocation strategy without seeing it operate over the course of a full bear market, given its tendency to earn excess returns (relative to the market) during such periods.

Upgrading's 10-year returns: Consistent superiority

The August editorial attempted to suggest "reasonable expectations" for the various SMI strategies, in part by reporting each strategy's most recent 10-year performance. While helpful overall, we think this approach may have cast an unfairly negative light on our Stock Upgrading strategy. So for the benefit of newer readers who weren't around to experience Upgrading's "glory days," it's worthwhile to revisit this topic in more depth.

Where the August editorial only focused on a strategy's *most recent* 10-year performance figure, Table 1 shows a *series* of 10-year returns for Stock Upgrading. Each figure represents the actual annualized performance of the 10 years ended with each calendar year. So while the table shows that the 10 years ended 12/2014 boasted only a 0.2% annual advantage for Upgrading, it also shows that each of the other nine measured periods finished with 10-year returns in excess of what the market earned. By looking at it this way, we're effectively looking back 20 years instead of just 10, as the first period listed spans the years 1996-2005.

TABLE 1

10-Year Periods	U.S. Market	Stock Upgrading
1996-2005	9.2%	13.7%
1997-2006	8.7%	13.5%
1998-2007	6.3%	12.5%
1999-2008	-0.6%	6.1%
2000-2009	-0.3%	6.3%
2001-2010	2.5%	8.4%
2002-2011	3.8%	7.3%
2003-2012	7.9%	10.4%
2004-2013	8.0%	9.4%
2005-2014	8.0%	8.2%

Upgrading has clearly improved on the market's returns over the past 20 years. The degree of Upgrading's superiority has ebbed and flowed, from 4.5% annually over the first 10-year period shown, to a peak of 6.7% in the period ended in 2008, which corresponded with Upgrading beating the market for nine consecutive years (1999-2007).

What to make of the troubling trend?

That said, it doesn't take a math wizard to recognize that Upgrading's margin of victory over the market has been in decline since that high point of 2008. The 10 years ended in 2014 showed a scant 0.2% advantage. While that 0.2% per year adds up more than you might think (it was worth an extra $5,100 on a $100,000 initial investment), the trend is troubling.

The problem with needing a 10-year history to adequately evaluate an investing approach is that we quickly run out of data points for most of our current SMI strategies. However, in Upgrading's case, we can look back a bit further via the NoLoad FundX newsletter's history. We've noted before that they were the originators of the Upgrading concept, a form of momentum investing, back in the 1970s. While we implement the strategy somewhat differently than they do, the trend and performance of the two approaches is close enough to be useful in this case.

Indeed, being able to go back in time an additional 15 years is quite helpful, as it reveals that the recent decline in the effectiveness of momentum investing is not unprecedented and can be seen in NoLoad FundX's past returns. That prior history shows significant winning and losing streaks. For example, after beating the market seven straight years from 1980-1986, their version of Upgrading trailed the market in eight of the next 11 years.

Translating FundX's annual performance into the same type of trailing 10-year returns we looked at earlier, we see a trend very similar to what we noted in Table 1. During the first half of the 1990s, FundX's trailing 10-year returns declined from a healthy margin over the market to a slim margin, just as ours have recently. More surprisingly, from 1996-1998 their 10-year trailing performance *lagged* the market three years in a row.

What happened next? FundX's Upgrading rebounded and crushed the market over the next decade, beating it *10 straight years*! This was the stretch when SMI's Upgrading strategy was coming online and growing in popularity. Then, just as suddenly, Upgrading cooled off again, and NoLoad FundX's version of it has now trailed the market the past seven years in a row.

Conclusions

First, it's worth reiterating that SMI's version of Upgrading is different from NoLoad FundX's. SMI's Upgrading has beaten the market in three of the past six calendar years and has yet (continued on page 157)

LEVEL 3 THREE

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

RECENT MARKET CORRECTION EXPOSES ETF VULNERABILITIES

For most investors, the August stock market correction was an uncomfortable, if short-lived, reminder of how volatile stocks can be. For advisor Ted Feight, a financial planner in Lansing, Michigan, the impact was much deeper.

According to *The Wall Street Journal*, Feight had orders in place to sell his clients' exchange-traded funds (ETFs) if their prices fell 15% from their peak 2015 prices. Surprisingly, when the stock market opened roughly 6% lower on the morning of August 24, nearly every ETF he had was sold. Even more alarmingly, some of those sales occurred at losses of *as much as 31%* on the day, despite the stock market indexes only falling 6%-9% at their lows.

August 24 wasn't the first time ETFs have been in the spotlight for behaving strangely. Many will recall the infamous May 6, 2010 "flash crash" when roughly 20% of all ETFs experienced trades at prices more than 50% below their eventual closing price for the day, with most of the craziness happening within a narrow 20-minute period. Some ETFs traded for as low as a penny, others at ten cents. Importantly, while most of those extreme flash-crash trades ultimately were cancelled, none of the trades from August 24 has been.

To understand how these events were possible, it's necessary to look under the hood at how ETFs are constructed and what drives their trading. In doing so, we'll discover distinct vulnerabilities, but also ways investors can protect themselves and use ETFs safely.

Structural weakness

ETFs aren't particularly complicated securities. Like a traditional mutual fund, an ETF is merely a basket of other securities (typically stocks or bonds). A traditional mutual fund is priced only once per day *after* the market closes. This allows time for all of the securities in the fund to be properly valued, resulting in an accurate daily valuation of the fund based solely on the assets the mutual fund owns.

Unlike a traditional mutual fund, however, ETFs are priced continually *while the market is open*, trading like a stock. This requires a pricing mechanism for ETFs that is considerably more complicated, given that both the ETF itself, as well as all of the individual holdings in the ETF, are continuously being traded and priced by the market.

To keep this explanation simple, suffice it to say that there is a market mechanism built into the structure of ETFs that normally keeps the valuation of the ETF itself closely in line with its underlying holdings. But the market's "bid/ask" system (i.e., the constantly changing prices at which buyers and sellers offer to exchange shares) is the primary mechanism by which the price of each individual ETF trade is determined. And this price can, when the market is under unusual stress, become wildly uncoupled from the actual value of the ETF's underlying holdings.

Unintended consequences

Ironically, one of the responses to the flash crash in 2010 was the introduction of new "circuit breaker" rules that temporarily halt trading in individual stocks and ETFs when their trading becomes too volatile. Designed to allow traders to pause and assess the true value of what they're trading, these new circuit breakers became a new source of problems for ETFs during the morning of August 24.

The reason these brief time-outs were so problematic is that in order for the ETF arbitrage system to work, traders need to have a clear understanding of the current value of each holding within an ETF, so the aggregate value can be compared to the price at which the ETF is currently trading. When the circuit breakers in individual securities started triggering on August 24, that visibility into the true value of the ETF's underlying holdings disappeared, as many of these components suddenly had no current price at a time when the market was continuing to swiftly decline. Further adding to the confusion, the ETFs themselves were being halted by the circuit breakers, leading to both sides of the equation—the ETF itself as well as the underlying basket of holdings—yielding unknown valuations.

Faced with this type of uncertainty, most buy and sell orders disappeared, with traders afraid of offering any type of price in such an opaque environment. Those market-makers (who facilitate the trading in these vehicles by offering both buy and sell orders) who offered any prices at all did what they always do when liquidity is lacking: they temporarily widened the spread between the prices at which they were offering to buy and sell, sometimes dramatically.

ETF liquidity: a blessing and a curse

Many investors are likely unaware that ETFs have their origin in an even earlier market "flash crash"—Black Monday, October 19, 1987. On that day, some mutual-fund investors stood by helplessly waiting to sell until the end of the day when their funds would be priced. But by the time that horrible day ended, the market was down 22.6%. Three years later, the first ETF was born, the idea being to create a mutual fund, "only better" in that it could be traded throughout the day so investors wouldn't be trapped.

In reality, the greater liquidity that ETFs offer is both a blessing and a curse. To gain the potential benefit of being able to buy and sell throughout the day, an ETF investor has to deal with the downside of *(continued on page 158)*

LEVEL 4 FOUR

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

SHOULD SOCIAL SECURITY IMPACT YOUR ASSET ALLOCATION?

You know the asset-allocation drill. At the intersection of your age and risk tolerance is the optimal mix of stocks and bonds for your portfolio. This seems clear enough for the assets already in your portfolio. But what happens if you add future income streams—such as Social Security or a company pension—into the mix?

Since those are "guaranteed" payments, some advisers suggest doing the math to estimate their present value. Further, since such benefits are "safe" income streams, these advisers recommend treating their present value as part of the bond or fixed-rate portion of one's portfolio, thereby enabling more of the rest of the portfolio to be tilted toward equities. Is that a good idea?

The argument in favor

The idea of treating Social Security as a portfolio asset has the support of a number of financial luminaries, including Vanguard founder Jack Bogle. In an interview with Morningstar, Bogle used the example of someone who is 60 or 65 years old, has a $100,000 portfolio, and a future stream of Social-Security benefits he valued at $300,000.

"I don't see why you would not put all ($100,000) in stocks at that stage of your life. That would be 25% then in equities and 75%, in effect, in fixed income with an inflation hedge (via Social Security). It's a good investment."

How did he come up with a value of $300,000 for this person's Social-Security benefits? There are several formulas for running the numbers. *The simplest way to get a rough estimate is to take the first year's benefit and multiply it by one's life expectancy.*[1] For example, for a 62-year-old with a $10,000 per-year benefit and a 22-year life expectancy, the present value is $220,000.

Some advocates of treating Social Security as a bond-type asset argue that *not* doing so would require a smaller stock position that would "miss out on the bigger gains" they *assume* would be generated by a larger stock allocation. Others tout the "extra" years of retirement income one could earn via the hoped-for higher returns from stock gains. On paper, it looks quite appealing—until you take a closer look through the lens of real life.

The argument against

Those who oppose treating Social Security as an asset point out that there's something many retirees value more than the possibility of greater retirement income: peace of mind. They use the same equations used by advocates of the strategy to emphasize the problems with the approach.

• **Added risk.** Consider Charley, a 67-year-old with a nest egg of $900,000 who is receiving $30,000 per year in Social-Security benefits. Using the aforementioned present-value formula and assuming Charley's life expectancy is 20 years, he would arrive at a value of his Social-Security benefits today of $600,000.

Let's assume Charley is using the 50/50 stock/bond allocation recommended by SMI for "Explorers" in their early retirement years.[2] If Charley leaves Social Security out of the equation, he would invest $450,000 of his $900,000 portfolio in stocks and $450,000 in bonds. However, if including Social Security in the mix, Charley's total portfolio amount rises from $900,000 to $1,500,000. Considering the $600,000 Social-Security "asset" as part of the bond allocation leads to Charley investing only $150,000 in bonds and the remaining $750,000 of his current portfolio in stocks.

During the next market downturn, how do you suppose Charley will feel about his $750,000 equity position?

• **Fuzzy math.** Money in your current investment portfolio is a known quantity. However, the value of your future Social-Security benefits isn't as easy to calculate. You could use a more sophisticated formula by factoring in an annual inflation adjustment, or not. You could peg the present value to the value of an asset (like an annuity) that could generate a stream of income similar to your Social-Security benefit, but what rate of return would you assume? And with so many different Social-Security "claiming strategies" available to married couples,[3] on which one should you base your estimate?

• **Inheritance risk.** If you hope to leave money to your heirs, treating Social Security as an asset may add complexity and uncertainty. After all, *it isn't an asset you can leave behind.* And, taking more risk with your current portfolio increases the risk of leaving your heirs with less.

Tilting toward safety

A more conservative way to view Social Security or a company pension is as a source of income that reduces the pressure on your retirement portfolio to cover your living expenses. Your monthly expenses minus your "guaranteed" income equals the amount your portfolio has to provide. If your monthly expenses are $7,500 and Social Security provides $2,500, your portfolio needs to deliver $5,000 each month.

Of course, you don't have to take an all-or-nothing approach. You could think of your Social Security as a *small* additional portion of your bond allocation and take a *slightly* more equity-focused approach with the rest of your portfolio. *However, the Sound Mind Investing asset-allocation model already tilts toward the aggressive side of the spectrum, in part because we don't include these retirement payments*. Because of the added risk it entails—at a time of life when you can least afford risk financially or emotionally—we recommend not treating Social Security or a company pension as a portfolio asset. ◆

[1]For your estimated benefit, go to www.ssa.gov/myaccount. Your life expectancy may be calculated at tinyurl.com/34prn3L. [2]SMI members have access to our asset-allocation methodology at tinyurl.com/nf6ejxs. [3]See June2015:p84, May2014:p73, and May2013:p73.

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. Three 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

RECOMMENDED FUNDS FOR SMI'S JUST-THE-BASICS STRATEGY

Data through 8/31/2015	Portfolio Invested In	MOM	Performance YTD	1Mo	3Mo	6Mo	12Mo	3Yr Avg	Rel Risk	Expense Ratio	Stock/Bond Mix 100/0	80/20	60/40	40/60	Ticker Symbol
Total International Stock ETF	Foreign stocks	-30.7	-2.8%	-7.4%	-10.5%	-8.4%	-11.8%	5.8%	1.24	0.14%	20%	16%	12%	8%	VXUS
Extended Market Index ETF	Small company stocks	-12.6	-1.5%	-5.9%	-6.7%	-5.3%	-0.5%	15.7%	1.22	0.10%	40%	32%	24%	16%	VXF
S&P 500 Index ETF	Large company stocks	-10.9	-2.9%	-6.1%	-6.0%	-5.3%	0.4%	14.2%	1.01	0.05%	40%	32%	24%	16%	VOO
Total Bond Mkt Index ETF	Medium-term bonds	0.1	0.3%	-0.3%	-0.5%	-0.8%	1.3%	1.3%	1.06	0.07%	None	20%	40%	60%	BND

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 June2012:p89.

RECOMMENDED FUNDS FOR SMI'S FUND UPGRADING STRATEGY

Risk	Data through 8/31/2015[1]	Date Added	Scottrade Avail[2]	Fidelity Avail[2]	Schwab Avail[2]	MOM[3]	Performance YTD	1Mo	3Mo	6Mo	12Mo	3Yr Avg	Relative Risk[4]	Exp Ratio	Number Holdings	Redemp Fee?[5]	Ticker Symbol
Category 5 Foreign	1. Fidelity Intl Small Cap	07/15	Yes	NTF	Yes	-0.1	8.1%	-4.5%	-3.8%	2.1%	1.6%	13.6%	1.02	1.30	165	2% 90days	FSCOX
	2. Fidelity Overseas	03/15	Yes	NTF	Yes	-3.6	7.2%	-5.5%	-5.3%	-1.1%	2.8%	12.9%	1.11	1.02	166	1%30days	FOSFX
	3. Marsico International Opp	12/14	NTF	NTF	NTF	-12.6	0.7%	-7.0%	-7.7%	-4.7%	-0.1%	8.4%	1.19	1.60	38	None	MIOFX
Category 4 Small/Growth	2. Fidelity Small Cap Gro	09/15	Yes	NTF	Yes	12.9	8.3%	-5.9%	-2.6%	2.5%	13.0%	18.1%	1.39	0.91	149	1.5% 90days	FCPGX
	1. Driehaus Micro Cap Gr	07/15	NTF	NTF	NTF	30.0	10.1%	-7.1%	-1.6%	6.6%	25.0%	25.9%	1.98	1.59	120	2% 60days	DMCRX
	3. Nicholas Fund	08/14	NTF	Yes	NTF	1.4	2.3%	-6.3%	-5.1%	-2.3%	8.9%	21.1%	1.06	0.72	46	None	NICSX
Category 3 Small/Value	1. Hennessy Cornerstone 30	08/15	NTF	NTF	NTF	14.9	9.5%	-4.4%	0.1%	5.5%	9.3%	19.0%	1.35	1.17	32	None	HFMDX
	2. FAM Small Cap	09/15	NTF	NTF	NTF	-2.8	-3.3%	-3.6%	-2.5%	-4.1%	3.8%	15.3%	1.37	1.42	30	None	FAMFX
	3. Vanguard Mid Cap Index	12/14	ETF	ETF	ETF	-8.2	-1.0%	-5.2%	-5.7%	-4.7%	2.2%	16.9%	1.09	0.09	372	None	VO[8]
Category 2 Large/Growth	1. Polen Growth	09/15	NTF	NTF	NTF	20.6	6.8%	-4.7%	0.8%	2.5%	17.3%	15.4%	1.02	1.25	24	2% 60days	POLRX
	2. TCW Select Equities	09/15	NTF	NTF	NTF	10.4	5.5%	-6.8%	1.3%	1.1%	8.0%	14.6%	1.27	1.13	32	None	TGCNX[12]
	3. Harbor Capital Appr Inv	07/15	NTF	NTF	NTF	2.1	5.1%	-7.0%	-3.0%	-1.6%	6.6%	17.0%	1.20	1.03	70	None	HCAIX
Category 1 Large/Value	1. Lazard US Equity Concen	02/15	NTF	NTF	NTF	-0.4	0.2%	-6.0%	-4.7%	-3.1%	7.5%	17.1%	1.01	1.25	21	1% 30days	LEVOX
	2. Clipper Fund	08/15	NTF	NTF	NTF	-2.9	1.7%	-5.4%	-3.7%	-1.5%	2.3%	15.4%	1.04	0.74	24	None	CFIMX
	3. T. Rowe Price Div Growth	01/15	Yes	Yes	Yes	-8.6	-2.6%	-5.7%	-5.8%	-5.3%	2.6%	13.7%	0.97	0.65	111	None	PRDGX
Bond Categories	Vanguard GNMA Fund[6]	09/15	Yes	Yes	Yes	2.2	0.7%	-0.1%	-0.3%	0.2%	2.3%	1.6%	0.96	0.21	4.6[7]	None	VFIIX[11]
	Vanguard I-T Bond Index	01/15	ETF	ETF	ETF	0.5	0.9%	-0.2%	-0.6%	-0.7%	1.9%	1.8%	1.47	0.10	6.5[7]	None	BIV[9]
	Vanguard S-T Bond Index	07/12	ETF	ETF	ETF	1.6	0.9%	-0.1%	-0.1%	0.5%	1.2%	0.9%	0.39	0.10	2.7[7]	None	BSV[10]

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-September, 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 July2014: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 the fund was 1.4 times (40%) more

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.

Strategy	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015[1]	Avg[2]	Worst 12[2]	Rel Risk[2]
Dynamic Asset Allocation	7.1%	4.0%	10.4%	22.4%	19.3%	8.6%	25.7%	10.1%	1.3%	17.6%	20.3%	1.4%	13.9%	16.2%	13.0%	-2.6%	12.5%	-13.7%	0.60
Wilshire 5000	-10.9%	-11.0%	-20.9%	31.6%	12.5%	6.4%	15.8%	5.6%	-37.2%	28.3%	17.2%	1.0%	16.1%	33.1%	12.7%	1.7%	4.7%	-43.3%	1.00

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.

Strategy	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015[1]	Avg[2]	Worst 12[2]	Rel Risk[2]
Sector Rotation	39.2%	3.7%	-13.1%	54.4%	12.6%	46.1%	-1.9%	28.1%	-31.5%	30.5%	9.1%	-3.2%	23.3%	65.7%	49.9%	4.4%	15.2%	-38.6%	1.85
Wilshire 5000	-10.9%	-11.0%	-20.9%	31.6%	12.5%	6.4%	15.8%	5.6%	-37.2%	28.3%	17.2%	1.0%	16.1%	33.1%	12.7%	1.7%	4.7%	-43.3%	1.00

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.

Strategy	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015[1]	Avg[2]	Worst 12[2]	Rel Risk[2]
Inflation Hedges	7.5%	1.8%	18.7%	47.3%	23.3%	32.0%	30.3%	22.4%	-41.4%	48.1%	28.4%	-7.0%	11.1%	-7.2%	-0.3%	-5.0%	11.8%	-51.0%	1.31
Wilshire 5000	-10.9%	-11.0%	-20.9%	31.6%	12.5%	6.4%	15.8%	5.6%	-37.2%	28.3%	17.2%	1.0%	16.1%	33.1%	12.7%	1.7%	4.7%	-43.3%	1.00

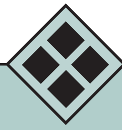
ENHANCED JUST-THE-BASICS

• **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.

Strategy	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015[1]	Avg[2]	Worst 12[2]	Rel Risk[2]
Enhanced Just-the-Basics	-13.2%	-4.0%	-18.6%	37.6%	18.3%	20.1%	22.3%	23.6%	-44.7%	30.7%	16.1%	-5.2%	16.1%	30.2%	6.7%	3.2%	6.5%	-49.9%	1.14
Just-the-Basics	-11.6%	-12.3%	-19.6%	35.7%	15.6%	9.0%	17.2%	7.1%	-39.3%	33.9%	20.0%	-3.4%	17.6%	31.2%	7.5%	3.5%	5.0%	-45.4%	1.09

volatile than the market. See June2015:p88. **[5] Redemption Fees:** Depending on how long you hold this fund, a redemption fee may be charged by the fund when selling (for example, a fee of 1% if you sell within six months of purchase). This is not the same as the short-term trading fees charged by brokers on fund sales that take place before the broker's minimum holding period. Fees change often and vary from broker to broker, so be sure to check with your broker for the most current information. See our broker review (Feb2012:Cover) for more details. **[6] Rotating Fund:** This bond recommendation changes periodically based on SMI's Upgrading methodology. The Short-Term and Intermediate-Term Index recommendations shown below that fund are fixed and don't change from month to month. See January2015:p7 for more information. **[7] Duration:** For bond funds, this column shows the average duration of the bonds in the portfolio in years. Typically, the longer the duration, the greater the risk/reward. See Jun2012:p88. **[8]** Those preferring a traditional mutual-fund option can buy VIMAX where available, otherwise VIMSX. See Dec2014:p190 for details. **[9]** Those preferring a traditional mutual-fund option can buy VBILX where available, otherwise VBIIX. **[10]** Those preferring a traditional mutual-fund option can buy VBIRX where available, otherwise VBISX. **[11]** If available, those investing at least $50,000 should buy the Admiral share (VFIJX) instead. **[12]** A different share class (TGCEX) carries a transaction fee but has lower expenses. See Sept2015:p141 for details.

[1]January-June 2015 [2]The 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.



MONEYTALK

SHARING SMI IS NOW EASIER (AND MORE BENEFICIAL!)

SMI has never spent heavily on advertising. We keep our membership prices low by avoiding the temptation to advertise during the Super Bowl.

All kidding aside, we've found that our best "advertising" is word of mouth—the recommendations that satisfied subscribers make to their family and friends. Recently, our in-house web wunderkinds, Jon Renner and Steven Peercy, created four new and simple ways for you to help spread the word about SMI.

When you're logged in to the SMI website, clicking on your name in the top right corner of any page will display a new "Share SMI" area on the right side of the page. From there, it's now incredibly easy to let other people know about us via Facebook, Twitter, or email. We've filled in a default message for each of those options, but after you click on the "Share" buttons, or in the case of email, the "Send" button, you'll be able to edit what's written before it's actually shared or sent.

Here's the really cool part: at the end of whatever message you send is a link that's automatically customized to identify you as the sender. So if the person you contact ends up subscribing to SMI through that link, we'll know they came to us through you, and we'll thank you by extending your membership with a free month. *There's no limit to the number of free months you can earn.* If 10 of your friends or family members sign up, that's 10 free months for you.

This personalized referral link is also displayed below the Share and Send buttons on your membership screen, so you can copy and share it however you'd like.

And, of course, you can always share specific articles (to Facebook, Twitter, etc.) via the buttons at the top and bottom of each individual article page. So as you're reading SMI, if something strikes you as particularly helpful, we'd love it if you'd use those buttons to share it with those in your circle of influence. (To those who are worried about sharing locked articles by accident—we're locking relatively few articles these days, and we note those articles that are locked by placing a small icon and the words "Members only" next to the comments link and author's name at the top of the article.)

Please make use of these new referral options. We really do count on word of mouth "marketing," and greatly appreciate your willingness to introduce others to SMI! ◆

SIGHTING: BUILT FOR ACTION
by James Osborne, CFP

We humans are doers. We want to move, to make, to accomplish, to act. We do not take kindly to sitting idly by. We do not enjoy being bored and most of us struggle to sit quietly alone. We are just not very good at doing nothing. This is especially true as investors.

You get your statement and look at the numbers and it just tickles your nerves a little bit. "Should I do something?" it asks. "What's not working?" it wants to know. "Have I made a mistake?" "What should I do?" "How do I fix it?" They are quiet questions, but there they are, lingering in the back of our minds. We only get one chance at this investing thing, and we're terrified that we'll get it wrong. We'll miss out on opportunities or hire the wrong advisor or buy at the wrong time or have to listen to our brother-in-law at Thanksgiving talk about how he nailed it *again* this year.

Hopefully we have the other voice too. The calm, rational one that reminds us that we have a plan. A pretty well thought out plan. A plan that involves boring years and periods where returns don't meet our expectations. This voice should remind us that we knew about that going in. It doesn't necessarily make it easier to remember that, but it ought to handcuff us. Even though we simply *hate* to do nothing, we should. We are not built for it. We are built for action! If it looks broken, fix it! The problem is that what "looks broken" to us is based on our desperate need for immediate gratification and split-second feedback about our decisions. But split-second feedback makes us absolutely terrible investors. In the moment, we can't take the long view, so we need to listen to our past selves about why we made the plans we did and how we already know what to do in these situations. Generally: nothing.

— As written for Bason Asset Management on September 16. For the full article, go to www.tinyurl.com/qadeg5l. ◆

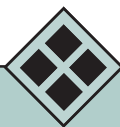
SIGHTING: IT'S NOT EASY
by Howard Marks, Chairman of Oaktree Capital Management

Especially during downdrafts, many investors impute intelligence to the market and look to it to tell them what's going on and what to do about it. This is one of the biggest mistakes you can make. As Ben Graham pointed out, the day-to-day market isn't a fundamental analyst; it's a barometer of investor sentiment. You just can't take it too seriously.

Market participants have limited insight into what's really happening in terms of fundamentals, and any intelligence that could be behind their buys and sells is obscured by their emotional swings. It would be wrong to interpret the recent worldwide drop as meaning the market "knows" tough times lay ahead. Rather, China came out with some negative news and people panicked, especially Chinese investors who had bought stocks on margin and perhaps were experiencing their first serious market correction. Their selling prompted investors in the U.S. and elsewhere to sell also, believing that the market decline in China signaled serious implications for the Chinese economy and others.

The analysis of fundamentals and valuation should dictate an investor's behavior, not the actions of others. If you let the investing herd—which determines market movements—tell you what to do, how can you expect to outperform?

In good times—perhaps emulating Warren Buffett—investors talk about how much they'd like to see the stocks they own decline in price, since it would allow them to add to positions at lower levels. But when prices collapse, the chance to average down is usually a lot less welcome...and a lot harder to act on.



MONEYTALK

Coping with a declining market seems easy ahead of time, since emotions aren't in play and investors know what they should do. It's only when prices start falling in earnest, as they have recently, that it turns out to be harder than expected.

— Howard Marks' investing memo of September 9. Read more at www.oaktreecapital.com/memo.aspx. ◆

SIGHTING: AN INVESTING LESSON FROM THE 9/11 TRAGEDY
by Mark Hulbert

Dumping stocks during a panic is never a good idea.

Consider an impetuous investor who unloaded his shares in the wake of the 9/11 attack. At the stock market's low five trading sessions later, the Dow Jones Industrial Average had fallen 17.5% from the close Sept. 10. Yet the stock market quickly recovered. The Dow Industrials, by early November, was trading higher than where it had been the day before the attacks.

A lucky break in otherwise dark times?

The plunge-and-quick-rebound pattern is very much in line with historical precedents, according to a study of 51 major geopolitical crises since the beginning of the last century compiled by Ned Davis Research.

What's the clear investment lesson to draw? If you sell into a panic, you are likely to get the worst possible price.
If extreme market turbulence is intolerable, you should act now to reduce your equity exposure rather than to wait until it's too late. Your risk level should be set at whatever level you would be comfortable holding through a crisis.

— Appeared on *MarketWatch*, September 15. For the full article, go to tinyurl.com/ormnevs. ◆

LEVEL 1 / CONTINUED FROM PAGE 150:
DO YOU NEED UMBRELLA LIABILITY INSURANCE?

roughly the amount of your net worth, though many of those will recommend adding an extra $1 million of coverage for peace of mind, given the relatively low incremental cost of additional coverage.

That said, some of your assets *may* already be protected from lawsuits. Workplace retirement plan and IRA assets would *most likely* be protected. Your state's homestead exemption *may* protect your home, or at least *some* of its value. Another measure you could take to protect your home is to title it, "tenancy by the entirety" if that's an option in your state. That means your home couldn't be sold unless both you and your spouse agree to the sale.

For many people, relying on words and phrases such as "may," "most likely," and "some" doesn't seem like a good plan. If you have significant assets that could be at risk if you were to be sued for some sort of liability issue, an umbrella policy is likely worth the relatively small premiums. As with insurance generally, you hope you'll never use the policy. But even if you never make a claim, an umbrella policy is likely to yield a benefit nonetheless: the peace of mind that comes from knowing these types of unforeseen liability situations are covered. ◆

LEVEL 2 / CONTINUED FROM PAGE 151:
LESSONS FROM UPGRADING'S LONG-TERM PERFORMANCE HISTORY

to have a 10-year trailing period that lagged the market. But it's comforting to see that while momentum investing has had such lagging periods in the past, they did *not* signal the end of the strategy's effectiveness. In fact, they immediately preceded the best stretch of relative performance the strategy has ever had!

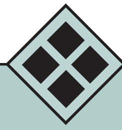
Second, the longer history demonstrates that Upgrading's performance has been more "streaky" than we believed during the 1999-2007 period when our initial impressions of the strategy were being formed. At that time, Upgrading seemed equally adept at handling all sorts of different types of market environments. In reality, hindsight indicates this was simply one of Upgrading's periodic winning streaks. The longer view shows Upgrading's 10-year performance advantage ebbing and flowing over time, although it's worth noting that even during its current low tide, SMI Upgrading has still performed as well or better than indexing, which is what many investors would use as an alternative.

In light of this information, some will wonder if it's worth the effort required to follow a strategy such as Upgrading. An article by Mark Hulbert in the *Wall Street Journal* last summer suggests the answer. Hulbert profiled NoLoad FundX as one of only three newsletters beating the S&P 500's total return (including dividends) over the prior 34 years (when Hulbert first began tracking the performance of investment newsletters). That article pointed out that each of the three winners (out of a total of 36) lagged behind the S&P 500 in more than half of the five-year periods since 1980.

In other words, beating the market over an extended period of time is hard and unusual! Most mutual funds can't do it, most investment newsletters can't do it, and most advisors can't do it either. That's why so many have given up trying, and opted to concede the race to index funds. So it's encouraging to know that, of the handful of strategies that *have been able to do it*, one is an Upgrading approach quite similar to the one SMI follows. Yet obtaining those superior long-term results has required *sticking with the strategy through the types of performance streaks that we see in the 10-year data.*

This makes clear that the type of up and down performance Upgrading has experienced since 2008 isn't all that unusual, and it doesn't indicate anything has fundamentally changed or "broken" with the system. Nor does it indicate Upgrading's usefulness has passed.

What it probably *does* mean is that Upgrading is going to be an easier strategy to stick with emotionally if you blend it with other strategies in a diversified portfolio. Not surprisingly, we think that a portfolio that includes exposure to Dynamic Asset Allocation, Upgrading, and Sector Rotation is likely to produce the best investing experience for most readers, not just in terms of absolute performance, but in terms of easing the emotional ups and downs they have to endure to make that long-term performance a reality. ◆



MONEYTALK

LEVEL 3 / CONTINUED FROM PAGE 152:

RECENT MARKET CORRECTION EXPOSES ETF VULNERABILITIES

occasional crazy exchange events such as we've been describing. Thankfully, there are ways to limit our exposure to such damaging events by the way we structure our ETF orders.

Traders vs. investors

First, it's important to note that these ETF anomalies have been short-lived, only 20-30 minutes, with only those who happened to trade within those very narrow windows of time affected. While it's extremely disconcerting to see major ETFs that have been used in SMI's core strategies impacted by these events, the reality is that investors were damaged only if they happened to place a trade during a specific 20-30 minutes period on May 6, 2010 or August 24, 2015. Longer-term investors who *owned these securities but didn't trade them during that brief window were unaffected*, as the trading prices of the ETFs were quickly restored to reflect the value of their underlying holdings.

Most SMI investors interact with ETFs only through Just-the-Basics, the Dynamic Asset Allocation strategy, or the bond holdings of the Fund Upgrading strategy (with occasional stock ETFs being recommended in Stock Upgrading). In any of these cases, the ETFs are traded infrequently, so the chances of an SMI member happening to trade during one of these temporary market anomalies is quite small—unless the member abandons our system and trades during a panic, in which case those odds increase significantly.

Order types matter

That said, it's still troubling to know the possibility exists of getting such horrible pricing on an ETF order. Thankfully, knowing the difference between various order types can effectively insulate you from the possibility of being a victim in this type of unusual market situation. An article in our June 2014 issue offers a primer on the various types of orders.[1] We highly recommend reading it if you're unfamiliar with this topic. But here's a quick overview of order types:

• **Market orders**. The simplest type of order is called a *market* order. This type of order says "just give me the next price for the security" and executes at that price. In normal market conditions, and with liquid securities, this is usually sufficient. This is because the market normally prices buyer (bid) and seller (ask) offers very closely together. For example, most of the individual S&P 500 stocks as well as liquid, high-volume ETFs such as the SPDR S&P 500 (SPY) used in our Dynamic Asset Allocation strategy will normally have bid-ask "spreads" of only a penny per share. To oversimplify just a bit, if the last trade in SPY happened at $200.35 and new market buy and sell orders were input, both the buyer and the seller would expect a price within one cent of that last price (note that prices can change fast, so it's rarely that simple, but that's the general idea).

Market orders have the upside of being simple and executing quickly. The downside is that the price is not guaranteed, which can lead to the strange behavior of these flash crash episodes. If you panicked when the market fell 6% at its opening on August 24 and placed a market order to sell the iShares Core S&P 500 ETF (IVV), the problems described earlier in this article and the resultant lack of any bids (buy orders) in the system might have resulted in your market order filling at a price as much as 26% below it's opening price (despite that price being roughly 20% lower than its fair value based on its underlying holdings). Ouch!

The takeaway here is that market orders may be fine during normal market conditions. But on a volatile day, it's usually smarter to use a limit order.

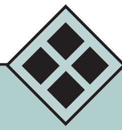
• **Limit orders.** This type of order will only accept a price at least as good as what you specify. If you enter a buy order with a limit price of $20, you know you won't pay more than $20, period. The advantage is that you will never pay more than you want; the disadvantage is that your order might never be filled.

It's easier to see the advantages of limit orders when you approach them from the sell side. Say you've just gotten word from SMI that you're to sell your SPY holdings today. The current price is $200.35 and you want to get out without fooling around trying to fine-tune the price, but it's a volatile day and you don't want to be exposed to "flash crash" possibilities either. The first thing you can do is to pause a moment to watch the bid/ask prices when you enter your order. Most brokers display them, changing in real time, on either the order screen or on an available quote page. Taking this brief extra moment will give you a quick idea of how much volatility there is in the current trading of the security. Armed with that knowledge, you can enter an intelligent limit order to sell SPY. If the price is bouncing around within a relatively narrow range, you might set the limit price at $200.00. As long as the next bid (buy order) in the system is above $200.00, you'll get that market price (not your $200.00 limit price, but the next bid price in the system as long as it's higher than $200.00). If the trading is more volatile, you might enter a lower limit price, perhaps $199.00.

With a limit order you know that you'll at least get the price you specified, or you'll continue to own the ETF. It won't ever get sold at a price that surprises you in a negative way. You might have to adjust your limit order to a lower price if it doesn't get filled quickly, but that's a far better outcome than selling at a price 20% lower than you expected.

• **Stop orders.** Please read the full June 2014 article before considering the use of a "stop" order. Such orders are placed in advance in an effort to put a "floor" under one's holdings. This is the type of order that tripped up Mr. Feight, the planner whose story opened this article. *Stop orders turn into market orders when the security reaches the price you specify*. But, as Mr. Feight learned, setting a stop price is no guarantee that you'll get that price. When his stop levels were reached in the middle of the August 24 chaos, they turned into market orders that, in some cases, were not executed until buyers were found at levels 15%+ lower.

[1] June2014:p88



MONEYTALK

Because of this potential danger, we strongly recommend avoiding using stop orders with ETFs, unless they are "stop-limit" orders that allow you to specify a minimum selling price. Thankfully, none of SMI's strategies calls for using stop orders, so if you're following our instructions, they won't come into play.

Conclusion

We've now seen multiple instances of ETFs behaving badly during extremely volatile market conditions. These probably won't be the last instances of such behavior either, as there appears to be a structural component to these episodes that will be difficult to fix. During a crisis, liquidity usually drops, sometimes precipitously. Because ETF pricing depends on liquidity to an even greater degree than regular stock pricing, ETFs will likely remain vulnerable to temporary dislocations in price, even if the circuit-breaker rules get tweaked and cleaned up in the aftermath of this most recent episode.

That's not to say ETFs should be avoided, just that special care needs to be taken with them, particularly if they're being traded during volatile market conditions. Using limit orders will go a long way toward ensuring a good result from your ETF trading, and generally won't add much hassle as long as you don't set your limit prices too tight (that is, too close to the price at which the ETF is then trading). Even more importantly, if you're a long-term investor rather than a trader, you'll probably never be selling during this type of market in the first place. ◆

MARKET NOTES, QUOTES, AND ANECDOTES

The Fed punts again on raising interest rates

• "…in light of the heightened uncertainties abroad and the slightly softer expected path for inflation, the committee judged it appropriate to wait for more evidence, including some further improvement in the labor market, to bolster its confidence that inflation will rise to 2% in the medium term." – Fed Chair Janet Yellen, after the Fed's Open Market Committee meeting on 9/17/15, explaining why it decided not to raise short-term interest rates. For more, see tinyurl.com/pbqmfrb.

• "The Fed continues to stick to its guns that it wants inflation to hit its 2% target. And yet it is clear to so many people that the inflation metrics the government issues just don't reflect life in the supermarket for most people. The effect of rising prices is obvious in most things I spend money on....It's clear that not even the Fed thinks the stated unemployment rate is worth much. Economists know the official 5.1% rate from the government doesn't reflect what it used to before the financial crisis. Then it would be an indication of a strong labor market. Now, not so much because millions of people have simply given up looking for work." – *Forbes* Contributor Simon Constable, on 9/18/15, questioning the metrics the Fed is using in its decision-making. For more, see tinyurl.com/pvwvodd.

• "There had been warning signs that the economy was not as strong as it initially seemed. Just the same, there had been growing confidence the U.S. economy was on strong footing and that not even China or a Fed interest-rate hike could stop that upward trajectory. In essence, the Fed's recent statements cast considerable doubt over that line of thinking. Instead, the central bank gave some credence to the idea that the current economic expansion may be closer to the end of its run, rather than in the middle. And that got the market worried." – Stephen Gandel, for *Fortune* on 9/18/15, on the market's decline following the Fed's decision not to raise rates. For more, see tinyurl.com/o8vghav.

• "I'm sorry to the retirees that have saved their whole lives. I'm sorry to the generation of young people that don't know what the benefits of saving [are]. I'm sorry to the free markets that best allocate capital. I'm sorry to pension funds that can't grow assets to match their liabilities. I'm sorry to the successful companies that are competing against those that are only still alive because of cheap credit. I'm sorry to those industries that have seen a pile of capital (aka, energy sector) enter their industry and have been or will see the consequences of too much capacity. I'm sorry to investors who continue to be bullied into making decisions they wouldn't have made otherwise. I'm sorry for the bubbles that continue to be blown. Again, I'm sorry to those who don't want to hear this." – Peter Boockvar for The Lindsey Group, an economic advisory firm, in a note to clients on 9/17/15, expressing his frustration with the Fed's decision. For more, see tinyurl.com/pw6673q.

Sizing up a possible bear market

• "The lessons of the long bull market are, in truth, lessons for the next bear market. Although the common investment dream is to be brilliant enough to dodge the bear, for most investors the real opportunity lies instead in being positioned to catch the next bull. Six years ago, too many people listened to what might go wrong, rather than think about what could go right." – John Rekenthaler for Morningstar on the importance of not overreacting to the market's recent downturn. For more, see tinyurl.com/nv98m48.

• "Bearishness has reached an extreme not seen at least since the top of the Internet bubble in early 2000. Yet this is a bullish omen, according to the inverse logic of contrarian analysis: Extreme levels of bearishness indicate that there is a very robust 'wall of worry' for the market to climb." - *MarketWatch* Columnist Mark Hulbert, 9/25/15, on how contrarians view current market sentiment. For more, see tinyurl.com/nrwvbcy. ◆

PERIODICALS POSTAGE
PAID AT LOUISVILLE, KENTUCKY

Dated Investment Material
Please Do Not Delay!

PERFORMANCE DATA

SOUND MIND INVESTING MODEL PORTFOLIOS • DATA THROUGH AUGUST 31, 2015

BASIC STRATEGIES

	Year to Date	1 Month	3 Months	12 Months	3 Yrs Annual	5 Yrs Annual	10 Yrs Annual	15 Yrs Annual
U.S. Stock Market [1]	-2.7%	-6.0%	-6.0%	0.3%	14.4%	15.8%	7.4%	4.3%
Just-the-Basics [2]	-2.4%	-6.3%	-7.2%	-2.3%	13.2%	14.1%	7.2%	4.5%
Stock Upgrading [3]	-1.0%	-6.1%	-6.0%	-1.9%	13.6%	13.1%	7.4%	7.5%
U.S. Bond Market [4]	0.3%	-0.3%	-0.5%	1.2%	1.3%	2.7%	4.3%	5.0%
Bond Upgrading [5]	-1.6%	-0.5%	-1.1%	0.5%	3.7%	4.7%	7.1%	7.4%

PREMIUM STRATEGIES

	Year to Date	1 Month	3 Months	12 Months	3 Yrs Annual	5 Yrs Annual	10 Yrs Annual	15 Yrs Annual
DAA [6]	-7.7%	-6.6%	-8.3%	-3.3%	7.3%	8.9%	11.4%	11.6%
Sector Rotation [7]	-4.5%	-10.9%	-6.1%	4.4%	34.5%	28.4%	12.8%	13.8%
50-40-10 Blend [8]	-4.7%	-6.9%	-7.1%	-1.7%	12.7%	12.6%	10.4%	10.6%
Inflation Hedges [9]	-14.1%	-2.5%	-14.2%	-27.3%	-6.0%	-0.2%	4.9%	10.1%
Enhanced Just Basics [10]	-4.3%	-7.1%	-8.8%	-4.6%	11.3%	12.4%	7.1%	5.9%

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 (VXUS). • [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 Barclay's 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] The results prior to November 2003 are hypothetical, calculated from backtesting the strategy following a mechanical rules-based system. • [8] For a portfolio allocated 50% to DAA, 40% to Stock Upgrading, and 10% to Sector Rotation. See the May 2014 cover article for details. The results prior to January 2013 are hypothetical, calculated from backtesting the strategy following a mechanical rules-based system. • [9] Based on our OIH 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. • [10] 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.

THE SOUND MIND INVESTING MUTUAL FUND (SMIFX)

Current Returns as of 8/31/2015	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	Annual since Inception
SMIFX	-3.26%	-6.68%	-6.83%	-3.84%	12.30%	11.49%	6.09% [1]
Wilshire 5000	-2.71%	-5.95%	-5.99%	0.32%	14.42%	15.84%	7.09%
S&P 500	-2.88%	-6.03%	-5.92%	0.48%	14.31%	15.87%	6.90%

Quarterly Returns as of 6/30/2015	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	Annual since Inception
SMIFX	2.09%	-1.69%	-0.49%	2.25%	15.25%	13.31%	6.80% [1]
Wilshire 5000	1.67%	-1.75%	0.07%	7.09%	17.45%	17.33%	7.71%
S&P 500	1.23%	-1.94%	0.28%	7.42%	17.31%	17.34%	7.49%

[1] Annualized 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. • 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. • 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. • 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. • The Sound Mind Investing Funds are distributed by Unified Financial Securities (member FINRA).

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