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Is This a Good Market? Please Don't Ask!

Peter Lynch became an investing legend managing Fidelity's Magellan Fund during the 1980s, chalking up average gains of +28.5% per year for the entire decade. His 1989 book, *One Up on Wall Street*, became an instant classic. In this excerpt, he explains (with a good dose of wit) why he recommends focusing on the quality of specific stocks (or mutual funds) rather than looking at "the market" as a whole. The illustrations he cites may be dated, but Lynch's insights offer wisdom for newer investors and valuable reminders for the more experienced.

by Peter Lynch

During every question-and-answer period after I give a speech, somebody stands up and asks me if we're in a good market or a bad market. For every person who wonders if Goodyear Tire is a solid company, or well-priced at current levels, four other people want to know if the bull is alive and kicking, or if the bear has shown its grizzly face. I always tell them the only thing I know about predicting markets is that every time I get promoted, the market goes down. As soon as those words are launched from my lips, somebody else stands up and asks me when I'm due for another promotion.

Obviously you don't have to be able to predict the stock market to make money in stocks, or else I wouldn't have made any money. I've sat right here at my quote machine through some of the most terrible drops, and I couldn't have figured them out beforehand if my life had depended on it. In the middle of the summer of 1987, I didn't warn anybody, and least of all myself, about the imminent 1,000-point decline.

I wasn't the only one who failed to issue a warning. In fact, if ignorance loves company, then I was very comfortably surrounded by a large and impressive mob of famous seers, prognosticators, and other experts who failed to see it, too. "If you must forecast," an intelligent forecaster once said, "forecast often."

Nobody called to inform me of an immediate collapse in October '87, and if all the people who claimed to have predicted it beforehand had sold out their shares, then the market would have dropped the 1,000 points much earlier due to these great crowds of informed sellers.

Every year I talk to the executives of a thousand companies, and I can't avoid hearing from the various gold bugs, interest-rate disciples, Federal Reserve watchers, and fiscal mystics quoted in the newspapers. Thousands of experts study overbought indicators, oversold indicators, head-and-shoulder patterns, put-call ratios, the Fed's policy on money supply, foreign investment, the movement of the constellations through the heavens, and the moss on oak trees, and they can't predict markets with any useful consistency.

Nobody sent up any warning flares before the 1973-74 stock-market debacle, either. Back in graduate school I learned the market goes up 9% a year, and since then it's never gone up 9% in a year, and I've yet to find a reliable source to inform me how much it will go up, (continued on page 3)

IN THIS ISSUE

EDITORIAL

Watching, Waiting, Planning, Working

"The end times are at hand and you want me to set up a *plan*?"

Years ago, we sent out several thousand letters to Christians who we thought might have an interest in a resource such as SMI, one that could help them set up a personalized financial plan based on biblical principles. To many, this was welcome news—we added about a hundred new subscribers.

To others, such as the man who returned our order card with the above message (written with a bold red marker for emphasis!), it was an unnecessary distraction. His comment was a vivid reminder there are many Christians who are so focused on the reality of Christ's return that planning, saving, and investing for the future seem pointless.

I would like nothing better than to see their expectation of Jesus' imminent return come to pass! World events, and the extensive evidence of God's Spirit moving in new ways around the globe gathering millions into the Body of Christ, suggest that possibility. But until the Lord *does* return, we are not given an either/or choice. Should we be living in anticipation as we "eagerly wait for our Lord Jesus Christ to be revealed"?[1] Yes. Should we have plans that will enable us to "be rich in good deeds, and be generous and willing to share."?[2] Yes.

The Bible leaves no doubt that God expects us to plan:

• "The plans of the diligent lead to profit as surely as haste leads to poverty" (Proverbs 21:5).

• "A prudent man foresees the difficulties ahead and prepares for them; the simpleton goes blindly on and suffers the consequences" (Proverbs 22:3 LB).

But it also makes clear that we're to ask the Lord to guide us in the process and trust Him with the results:

• "Commit to the Lord whatever you do, and he will establish your plans" (Proverbs 16:3).

• "Many are the plans in a person's heart, but it is the Lord's purpose that prevails" (Proverbs 19:21).

Planning is an essential ingredient in managing your finances well. Pastor and author John MacArthur discusses the lessons of the Parable of the Talents[3] in these terms:

• **The responsibility we receive.** The servants are professing believers. The talents represent a wide range of spiritual opportunities, privileges, and resources, including natural abilities, spiritual gifts, material things, ministry responsibilities, and other blessings God has given us as stewards. Their duty was to *manage* the master's wealth, not merely hold it for him until he returned.

• **The reaction we have.** Two were faithful, embracing the responsibility they had been given. These two represent genuine believers whose supreme desire is to serve God. The trading done by these servants involved investment of the master's resources. The verb tenses used in the parable suggest they were trading the whole time of the master's absence; they did not merely make one successful trade and then sit idle the rest of the time.

• **The reckoning we will face.** Upon the master's sudden and unexpected return, all three stewards were summoned to give account. The unfaithful servant, by hiding his master's talent in the ground, guaranteed that those resources would never earn a return. His behavior was "wicked" and "lazy."[4] Because the two faithful servants' had made the most of an opportunity to serve him, the master rewarded them with *more* opportunity to serve, and this new opportunity was of the most joyous kind: "Come and share your master's happiness."[5]

The good steward *looks forward to the return of the Master*, but also *follows His instructions to "Put this money to work until I come back."*[6] The Scriptures tell us to plan, save, invest, and give generously, and as we do, God has promised "to make all grace abound to you, so that in all things at all times, having all that you need, you will abound in every good work."[7]

So, yes, may the church pray *"Maranatha!* Come, Lord Jesus!"[8] But in 2017, while we may wait and long for His appearing,[9] "let us not become weary in "doing good, for at the proper time we will reap a harvest if we do not give up."[10]

Austin

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NECESSARY CAUTIONS
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[1] 1 Corinthians 1:7b [2] 1 Timothy 6:18 [3] This section was adapted from Chapter 9 of The Second Coming by John F. MacArthur [4] Matthew 25:26 [5] Matthew 25:21,23 [6] Luke 19:13 [7] 2 Corinthians 9:8 [8] 1 Corinthians 16:22, Revelation 22:20 [9] 2 Timothy 4:8 [10] Galatians 6:9

FEATURE ARTICLE

Is This a Good Market? Please Don't Ask!

(continued from front page)

or even *whether* it will go up or down. All the major advances and declines have been surprises to me.

Since the stock market is in some way related to the general economy, one way that people try to outguess the market is to predict inflation and recessions, booms and busts, and the direction of interest rates. True, there is a wonderful correlation between interest rates and the stock market, but who can foretell interest rates with any bankable regularity? There are 60,000 economists in the U.S., many of them employed full-time trying to forecast recessions and interest rates, and if they could do it successfully twice in a row, they'd all be millionaires by now.

They'd have retired to Bimini where they could drink rum and fish for marlin. But as far as I know, most of them are still gainfully employed, which ought to tell us something. As one perceptive person once said, if all the economists of the world were laid end to end, it wouldn't be a bad thing.

Well, maybe not *all* economists. Certainly not the ones who are reading this book, and especially not the ones like Ed Hyman at C.J. Lawrence who looks at scrap prices, inventories, and railroad car deliveries, totally ignoring Laffer curves and phases of the moon. Practical economists are economists after my own heart.

There's another theory that we have recessions every five years, but it hasn't happened that way so far. I've looked in the Constitution, and nowhere is it written that every fifth year we have to have one. Of course, I'd love to be warned before we do go into a recession, so I could adjust my portfolio. But the odds of my figuring it out are nil. Some people wait for these bells to go off, to signal the end of a recession or the beginning of an exciting new bull market. The trouble is the bells never go off. Remember, things are never clear until it's too late.

There was a 16-month recession between July 1981 and November 1982. This was the scariest time in my memory. Sensible professionals wondered if they should take up hunting and fishing, because soon we'd all be living in the woods, gathering acorns. This was a period when we had 14% unemployment, 15% inflation, and a 20% prime rate, but I never got a phone call saying any of that was going to happen, either. After the fact a lot of people stood up to announce they'd been expecting it, but nobody mentioned it to me before the fact.

Then at the moment of greatest pessimism, when eight out of ten investors would have sworn we were heading into the 1930s, the stock market rebounded with a vengeance, and suddenly all was right with the world.

The difficulty of taking the long view

Stock market news has gone from hard to find (in the 1970s and early 1980s), then easy to find (in the late 1980s), then hard to get away from. The financial weather is followed as closely as the real weather: highs, lows, troughs, turbulence, and endless speculation about what's next and how to handle it. People are advised to think long-term, but the constant comment on every gyration puts people on edge and keeps them focused on the short term. It's a challenge not to act on it. If there were a way to avoid the obsession with the latest ups and downs, and check stock prices every six months or so, the way you'd check the oil in a car, investors might be more relaxed.

Thanks to the day traders and some of the professional hedge fund managers, shares now change hands at an incredible clip. Have the day traders given Mr. Market the shakes? Does the brisk commerce in stock indexes have something to do with it? Whatever the cause (I see day traders as a major factor), frequent trading has made the stock markets more volatile. A decade ago stock prices moving up or down more than 1 percent in a single trading session was a rare occurrence. At present we get 1 percent moves several times a month.

As a very successful investor once said: "The bearish argument always sounds more intelligent." You can find good reasons to scuttle your equities in every morning paper and on every broadcast of the nightly news.

History tells us that corrections (declines of 10 percent or more) occur every couple of years, and bear markets (declines of 20 percent or more) occur every six years. Severe bear markets (declines of 30 percent or more) have materialized five times since the 1929-32 doozie. It's foolish to bet we've seen the last of the bears, which is why it's important not to buy stocks or stock mutual funds with money you'll need to spend in the next 12 months to pay college bills, wedding bills, or whatever. You don't want to be forced to sell in a losing market to raise cash. When you're a long-term investor, time is on your side.

What's my point in recounting all this? It would be wonderful if we could avoid the setbacks with timely exits, but nobody has figured out how to predict them. Moreover, if you exit stocks and avoid a decline, how can you be certain you'll get back into stocks for the next rally?

Here's a telling scenario: If you put $100,000 in stocks on July 1, 1994, and stayed fully invested for five years, your $100,000 grew into $341,722. But if you were out of stocks for just thirty days over that stretch—the thirty days when stocks had their biggest gains—your $100,000 turned into a disappointing $153,792. By staying in the market, you more than doubled your reward.

Penultimate preparedness

No matter how we arrive at the latest financial conclusion, we always seem to be preparing ourselves for the *last* thing that's happened, as opposed to what's going to happen next. This "penultimate preparedness" is our way of making up for the fact that we didn't see the last thing coming along in the first place.

The day after the market crashed on October 19, 1987, people began to worry that the market was *going* to crash. It had already crashed and we'd survived it (in spite of our not having predicted it), and now we were petrified there'd be a replay. Those who got out of the market to ensure that they wouldn't be fooled the next time as they had been the last time were fooled again as the market went up. [Editor's note: That's exactly what happened following the 2008-2009 financial crisis as well.]

The great joke is that the next time is never like the last time, and yet we can't help readying ourselves for it anyway. This all reminds me of the Mayan conception of the universe.

In Mayan mythology the universe was destroyed four times, and every time the Mayans learned a sad lesson and vowed to be better protected—but it was always for the previous menace. First there was a flood, and the survivors remembered it and moved to higher ground into the woods, built dikes and retaining walls, and put their houses in the trees. Their efforts went for naught because the next time around the world was destroyed by fire.

After that, the survivors of the fire came down out of the trees and ran as far away from woods as possible. They built new houses out of stone, particularly along a craggy fissure. Soon enough, the world was destroyed by an earthquake. I don't remember the fourth bad thing that happened—maybe a recession—but whatever it was, the Mayans were going to miss it. They were too busy building shelters for the next earthquake.

Two thousand years later we're still looking backward for signs of the upcoming menace, but that's only if we can decide what the upcoming menace is. Not long ago, people were worried that oil prices would drop to $5 a barrel and we'd have a depression. Two years before that, those same people were worried that oil prices would rise to $100 a barrel and we'd have a depression. Once they were scared that the money supply was growing too slow. Now they're scared that it's growing too fast. The last time we prepared for inflation we got a recession, and then at the end of the recession we prepared for more recession and we got inflation.

Someday there will be another recession, which will be very bad for the stock market, as opposed to the inflation that is also very bad for the stock market. Maybe there will already have been a recession between now and the time this is published. You're asking me?

The cocktail theory

If professional economists can't predict economies and professional forecasters can't predict markets, then what chance does the amateur investor have? You know the answer already, which brings me to my own "cocktail party" theory of market forecasting, developed over years of standing in the middle of living rooms, near punch bowls, listening to what the nearest ten people said about stocks.

In the first stage of an upward market—one that has been down awhile and that nobody expects to rise again—people aren't talking about stocks. In fact, if they lumber up to ask me what I do for a living, and I answer, "I manage an equity mutual fund," they nod politely and wander away. If they don't wander away, then they quickly change the subject to the Celtics game, the upcoming elections, or the weather. Soon they are talking to a nearby dentist about plaque.

When ten people would rather talk to a dentist about plaque than to the manager of an equity mutual fund about stocks, it's likely that the market is about to turn up.

In stage two, after I've confessed what I do for a living, the new acquaintances linger a bit longer—perhaps long enough to tell me how risky the stock market is—before they move over to talk to the dentist. The cocktail party talk is still more about plaque than about stocks. The market's up 15 percent from stage one, but few are paying attention.

In stage three, with the market up 30 percent from stage one, a crowd of interested parties ignores the dentist and circles around me all evening. A succession of enthusiastic individuals takes me aside to ask what stocks they should buy. Even the dentist is asking me what stocks he should buy. Everybody at the party has put money into one issue or another, and they're all discussing what's happened.

In stage four, once again they're crowded around me—but this time it's to tell *me* what stocks *I* should buy. Even the dentist has three or four tips, and in the next few days I look up his recommendations in the newspaper and they've all gone up. When the neighbors tell me what to buy and then I wish I had taken their advice, it's a sure sign that the market has reached a top and is due for a tumble.

Do what you want with this, but don't expect me to bet on the cocktail-party theory. I don't believe in predicting markets. I believe in buying great companies, especially companies that are undervalued and/or underappreciated. Whether the Dow Jones industrial average was at 1,000 or 2,000 or 3,000 points today, you'd be better off having owned Marriott, Merck, and McDonald's than having owned Avon Products, Bethlehem Steel, and Xerox over the last ten years. You'd also be better off having owned Marriott, Merck, or McDonald's than if you'd put the money into bonds or money-market funds over the same period.

If you had bought stocks in great companies back in 1925 and held on to them through the Crash and into the Depression (admittedly this wouldn't have been easy), by 1936 you would have been very pleased at the results.

What stock market?

The market ought to be irrelevant. If I could convince you of this one thing, I'd feel this book had done its job. And if you don't believe me, believe Warren Buffett. "As far as I'm concerned," Buffett has written, "the stock market doesn't exist. It is there only as a reference to see if anybody is offering to do anything foolish."

Buffett has turned his Berkshire Hathaway into an extraordinarily profitable enterprise. In the early 1960s it cost $7 to buy a share in his great company, and that same share is worth $4,900 today. A $2,000 investment in Berkshire Hathaway back then has resulted in a 700-bagger (increase by 700 fold) that's worth $1.4 million today. That makes Buffett a wonderful investor. What makes him the greatest investor of all time is that during a certain period when he thought stocks were grossly overpriced he sold everything and returned all the money to his partners at a sizable profit to them. The voluntary returning of money that others would gladly pay you to continue to manage is, in my experience, unique in the history of finance.

I'd love to be able to predict markets and anticipate recessions, but since that's impossible, I'm as satisfied to search out profitable companies as Buffett is. I've made money even in lousy markets, and vice versa. Several of my favorite tenbaggers made their biggest moves during bad markets. Taco Bell soared through the last two recessions. The only down year in the stock market in the eighties was 1981, and yet it was the perfect time to buy Dreyfus, which began its fantastic march from $2 to $40, the twentybagger that yours truly managed to miss.

Just for the sake of argument, let's say you could predict the next economic boom with absolute certainty, and you wanted to profit from your foresight by picking a few high-flying stocks. You still have to pick the right stocks, just the same as if you had no foresight.

If you knew there was going to be a Florida real estate boom and you picked Radice out of a hat, you would have lost 95 percent of your investment. If you knew there was a computer boom and you picked Fortune Systems without doing any homework, you'd have seen it fall from $22 in 1983 to under $2 in 1984. If you knew the early 1980s was bullish for airlines, what good would it have done if you'd invested in People Express (which promptly bought the farm) or Pan Am (which declined from $9 in 1983 to $4 in 1984 thanks to inept management)?

Let's say you knew that steel was making a comeback, and so you took a list of steel stocks, taped it to a dart board, and threw a dart at LTV. LTV declined from $26.50 per share to $1.12 between 1981 and 1986, roughly the period in which Nucor, a company in the same industry, rose from $10 to $50. (I owned both, so why did I sell my Nucor and hold on to my LTV? I might as well have thrown darts, too.)

In case after case, the proper picking of markets *alone* would have resulted in your losing half your assets because you'd picked the wrong stocks. If you rely on the market to drag your stock along, then you might as well take the bus to Atlantic City and bet on red or black. If you wake up in the morning and think to yourself, "I'm going to buy stocks because I think the market is going up this year," then you ought to pull the phone out of the wall and stay as far away as possible from the nearest broker. You're relying on the market to bail you out, and chances are, it won't.

If you want to worry about something, worry about whether the sheet business is getting better at West Point-Pepperell, or whether Taco Bell is doing well with its new burrito supreme. Pick the right stocks and the market will take care of itself.

That's not to say there isn't such a thing as an overvalued market, but there's no point worrying about it. The way you'll know when the market is overvalued is when you can't find a single company that's reasonably priced or that meets your other criteria for investment. The reason Buffett returned his partners' money was that he said he couldn't find any stocks worth owning. He'd looked over hundreds of individual companies and found not one he'd buy on the fundamental merits.

The only buy signal I need is to find a company I like. In that case, it's never too soon nor too late to buy shares.

The basic story remains simple and never-ending. Stocks aren't lottery tickets. There's a company attached to every share. Companies do better or they do worse. If a company does worse than before, its stock will fall. If a company does better, its stock will rise. If you own good companies that continue to increase their earnings, you'll do well. Corporate profits are up 55-fold since World War II, and the stock market is up 60-fold. Four wars, nine recessions, eight presidents, and one impeachment didn't change that.

What I hope you'll remember most are the following points:

- Don't overestimate the skill and wisdom of professionals.
- Take advantage of what you already know.
- Invest in a house before you invest in a stock.
- Invest in companies, not in the "stock market."
- Ignore short-term fluctuations.
- Large profits can be made in common stocks.
- Large losses can be made in common stocks.
- Predicting the economy is futile.
- Predicting the short-term direction of the market is futile.
- The long-term returns from stocks are both relatively predictable and also far superior to the long-term returns from bonds.
- Common stocks aren't for everyone, nor even for all phases of a person's life.
- The average person is exposed to interesting local companies and products years before the professionals.
- In the market, one in the hand is worth ten in the bush.

[**Editor's note**: Peter Lynch's emphasis on taking the long view is certainly in accord with SMI's philosophy. But that shouldn't be interpreted to mean you should necessarily stay with the same fund for many years any more than you would stay with a stock that wasn't performing as expected. With very few exceptions, funds that outperform over a short period of time (12-18 months) revert to being average performers soon after, so you need to be ready to make adjustments to your fund portfolio as new leaders emerge and old leaders fall back to the middle of the pack.

Having said this, we are still long-term in our philosophy. We think you should commit your money to the market for an extended period, and follow essentially the same allocation guidelines for many years without paying much attention to what the market is doing at any given time. For instance, if you decide that, based on your season of life and risk tolerance, you should be 80% invested in stocks and 20% in bonds, we believe you should maintain your 80% stock allocation regardless of whether the market is going up, down, or sideways at the moment. The same is true in terms of your overall portfolio allocation to a strategy such as SMI's Dynamic Asset Allocation, in which the specific asset-class allocations fluctuate.

In summary, our commitment to buying and holding extends to maintaining your allocations and staying in the market even when your emotions are begging you to sell. But we don't hold that commitment to any specific fund. Leadership is constantly rotating, and significantly improved performance appears to be available by maintaining a shorter-term, opportunistic attitude toward individual funds. —AP] ◆

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

GETTING IN SHAPE IN 2017 WITH A 'FISCAL HEALTH DAY'

Several years ago, when *New York Times* personal-finance writer Ron Lieber was furloughed for a few days, he responded in true personal-finance expert fashion. By devoting one of his unpaid days off to taking care of a list of financial chores he had been meaning to get to some day, he turned what looked like a pay cut into profit.

In a subsequent "Your Money" column in the *Times,* Lieber related the results of his *fiscal health day*: "Financially, the total of my savings and new earnings [from what I was able to accomplish] will net out to about $2,000 annually after taxes," he wrote. The reward turned out to be so great that Lieber decided to make it an annual tradition. "I got enough done that I now plan to take a fiscal health day at least once a year…on a weekday when all phone lines and financial institutions are open."

Here are some of the things on Lieber's list for his first fiscal health day—along with related comments plus a few footnotes to previous SMI articles on these topics:

• **Open a high-yield savings account.** Why should your savings languish in a low- or no-yield account when credit unions and online banks[1] are offering higher rates?

• **Get a cash-back credit card.** Lieber opted for a 2% cash-back card tied to his investment account.

• **Shop for cheaper insurance.** Lieber saved $150 a year by reviewing his homeowner's insurance and making changes.[2]

• **Cut back on phone service.** Lieber got rid of costly phone features he never used.

• **Make progress on getting a will completed.** Lieber called three lawyers to price the possibilities.

• **Fill out a "here-is-what you-need-to-know-about-our-finances-if-I-die" form.**[3] This is a wonderful thing for your family to have during an emotionally wrenching time.

• **Set up automatic monthly contributions to non-profit groups.** Lieber hopes this will end his "end-of-the-year scramble to get donations out."

• **Check gift cards to see how much is left on them; then spend that money!** "The longer [gift cards] sit," Lieber wrote, "the more interest...the department store will earn from your money and the bigger the chance you'll misplace the card."

• **Organize health insurance paperwork.** Like many of us, Lieber was "adrift in a sea of forms" that needed to be sorted.

(Speaking of insurance, here's a preventive step that can save you down the road: make sure your computer has an ongoing backup—either to an external hard drive or to a cloud backup provider. There's a good chance you'll pay more to restore a crashed computer than you would for one of these backup systems.)

Like Ron Lieber, Larry Jones—a stewardship pastor and author of the *Generosity Pastor* blog,[4] has embraced the idea of taking a fiscal health day. He says setting aside time to tackle a financial to-do list is an effective way to battle against "financial creep"—i.e., those "money drains that come on gradually and almost unnoticed."

Here's what Jones accomplished:

• **Asking the cable company for a lower rate.** He got it. If your cable provider isn't as friendly, consider switching to a lower cost package.

• **Automating bill payment for insurance, electricity, gas, water.** This was a significant time saver.

• **Setting up an auto-draft for monthly savings.** Easy to do online.

• **Closing two old bank accounts.** Why keep what you don't need?

Jones estimates that the six hours he devoted to his first fiscal health day yielded an annual savings of about $600. In other words, he "earned" roughly $100 per hour for his labor.

If the idea of taking a fiscal health day appeals to you, here are a few other ideas to consider :

• **Check your credit.** With identity theft running rampant, it's important to check your credit reports. You're entitled to a free report each year from the three credit bureaus via annualcreditreport.com. Look for credit accounts you don't recognize, and if you find any, take the steps outlined on the reports.

• **Create an online budget.** Free online budget tools, like Mint.com, make it simple to track your cash flow.[5] That information enables you to truly *manage* your money, enabling you to proactively pursue your financial goals.

• **Change your income-tax withholding.** If you usually receive a sizeable refund each year, consider asking your employer's HR department to withhold less from each paycheck.[6]

• **Check your PMI.** If you bought your home with less than a 20% downpayment, you are probably paying for private mortgage insurance. Once you build up at least 20 percent equity, you should be able to drop that insurance. Check with your mortgage company to see how much equity you have.

• **Check your travel rewards.** If you're accumulating frequent flyer points at an airline or two, or frequent guest points at a hotel chain, find out if any of your points are due to expire soon. If so, see what minimal step you could take to protect those points.

While the exact savings will vary, taking a fiscal health day—whether during a furlough, a staycation, or just a day off—is well worth the investment of time. Indeed, the return could be so substantial that you start *looking forward* to facing your financial to-do list and getting more fiscally fit! ◆

[1] bit.ly/2gVA5cR [2] bit.ly/2hai9Jv [3] June2014:p89 [4] www.generositypastor.com [5] Jan2013:p6
[6] To estimate your taxes, go to www.irs.gov and search for the "withholding calculator."

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

SUCCESSFUL STOCK-FUND UPGRADING REQUIRES OWNING ONLY 5 FUNDS

SMI's Fund Upgrading strategy diversifies your portfolio across five stock categories. Within each category, we recommend three fund options (see page 10).

If you wish, you can invest in all three funds in each category. However, we assume that most of our members keep things simple by investing in only one fund in each category, and that's fine.

With such an approach, you invest in the top-ranked fund in each category at the outset, and when it's time for a fund you own to be replaced, you sell it and invest the proceeds in the fund that is top-ranked at that time. (The top-ranked fund is not necessarily the most recently recommended fund.)

Readers following our Upgrading recommendations naturally expect their results to be similar to those published in the newsletter. But there's a rub. Our published results are necessarily based on *all* of our fund recommendations, which means the average of all three of the funds recommended in each risk category. In other words, you would need to own all 15 of the recommended stock funds listed in the Upgrading section of page 10 to get our published results. However, due to fund minimums and brokerage availability, that may not always be possible. Even if it were, owning that many funds requires more effort and a level of complexity that would not be welcomed by every reader.

So that raises the question: How would buying only the top-ranked funds impact your returns as opposed to owning all of the recommendations?

We've been running this analysis periodically for more than a decade and have found that the relative performance between the two approaches ebbs and flows. For this test, we've gone back 15 years to the beginning of 2002, a period which encompasses multiple bull and bear markets.

Starting with the Upgrading funds recommended in the January 2002 issue of the newsletter, we created a portfolio of five funds composed of the top recommendation in each risk category, and started tracking the portfolio's performance month by month. Each time one of our five holdings was sold in the newsletter, we replaced it with the fund listed as that month's #1 recommendation for the risk category. (Important note: we replaced a fund *only* when it was *completely removed* from the recommended-funds list, *not* when it merely dropped out of the #1 slot.) The only exception to choosing the top-ranked fund was the handful of times a fund was closed to new investors, in which case we used the fund that was ranked #2.

At the beginning of each year, we rebalanced to the new year's recommended allocations, but continued to hold the same funds from the end of the prior year (unless replaced in the January issue). In other words, we tracked this portfolio exactly the way we would expect a reader following a "buy only the top-ranked funds" approach to have implemented the strategy in real life. There was no guesswork to this exercise—we used the actual fund recommendations from the newsletters over the past 15 years.

	Wilshire 5000	Buy All	Top Ranked
2002	-20.9%	**-14.0%**	-18.6%
2003	31.6%	**46.8%**	44.4%
2004	12.5%	17.3%	**18.9%**
2005	6.4%	12.1%	**16.0%**
2006	15.8%	**17.4%**	14.7%
2007	5.6%	14.2%	**15.5%**
2008	-37.2%	**-38.8%**	-42.9%
2009	28.3%	33.6%	**39.3%**
2010	17.2%	17.8%	**19.8%**
2011	1.0%	-5.3%	**-3.7%**
2012	16.1%	**14.1%**	11.9%
2013	33.1%	**34.5%**	32.9%
2014	12.7%	**5.1%**	3.8%
2015	0.7%	**0.6%**	-0.9%
2016 (9 Mos)	8.4%	6.1%	**7.9%**
Annualized	7.1%	8.8%	8.3%
Rel Risk	1.00	1.05	1.09

The far-right column of the nearby table shows the year-by-year results of this approach, compared with owning all of the recommended funds in each risk category. As you can see, it was a back-and-forth affair between the two portfolios (best performance is indicated in bold). The "Buy All" portfolio has a slim overall lead, with annualized gains of +8.8%, besting the "Top Ranked" portfolio's gains of +8.3%.

It's worth noting that the "Buy All" Upgrading portfolio also earned its returns with slightly less volatility. The Relative Risk scores at the bottom of the table show that owning all of the Upgrading recommendations was about 5% more volatile than the broad market, while the portfolio of only top-ranked funds was roughly 9% more volatile.

Conclusion

What conclusions can we draw from this exercise? First and foremost, it's important not to miss the fact that *both* of these Upgrading portfolios have performed well relative to the broad market over time. Clearly, Upgrading's emphasis on being in the best funds in each category isn't dependent on how many of those top funds are owned in each category (at least within the narrow confines of our experiment).

Given that, the decision of how to implement Upgrading is largely one of personal preference. This should be welcome news, as it's obviously more time consuming and expensive (due to transaction fees) to manage an Upgrading portfolio of 15 funds as opposed to only five. Simplicity has the added virtue of making it more likely that readers will make Upgrading changes promptly, which has always been a requirement for Upgrading success.

While many will welcome this simplified approach to Upgrading, there's certainly nothing *wrong* with owning more than one fund *(continued on page 13)*

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

REBALANCING YOUR PORTFOLIO FOR THE NEW YEAR

An "asset class" is a broad category of investments that tend to have similar risk characteristics and respond similarly to market forces. The most common classes are stocks, bonds, real estate, commodities, and cash equivalents.

Additional breakdowns can also be made within asset classes. For example, SMI divides stock funds into subgroups that are growth-oriented, value-oriented, and size-oriented (size being determined by market value).

The way you, as an investor, spread your money among these various asset classes and sub-groupings is your "asset allocation." As we discuss this process for 2017, remember that the most important characteristic of your portfolio—the factor that influences the performance of your portfolio more than any other—is your asset allocation.

The starting point for our two basic strategies—Just-the-Basics (JtB) and Fund Upgrading—is to determine how much of your portfolio should be allocated to investments in which you are an owner (stocks) and those where you are a lender (bonds). The more you put into stocks, the greater the growth potential but also the greater risk.

In determining your stock/bond percentages, it's important to consider your personal goals and risk tolerance. We've provided step-by-step instructions to lead you through this process in the "Start Here" section of the SMI website.[1] At the end of that process, you'll have stock- and bond-allocation percentages based on your investment "time frame"—that is, how long before you will need to begin withdrawing your money for living expenses.

If you are following Just-the-Basics or Upgrading, you should make any stock/bond allocation changes only in accordance with your long-term plan, and only as a thoughtful response to changes in your circumstances (perhaps your age now puts you in a different "season of life" category) or significant changes in your financial goals or fortunes. Target allocations should not be altered emotionally due to recent activity in the markets.

Even without intentional changes in your asset allocation, a well-diversified portfolio is going to gradually stray from its initial allocations as some investments perform better than others over the course of a year. It's necessary, then, to periodically "rebalance" the portfolio, bringing it back to its target allocations by selling some of the winners and adding money to the laggards.

If you're a Just-the-Basics investor, rebalance for 2017 simply by adjusting your current holdings to match your desired stocks vs. bonds percentage allocations.[2]

Simplifying the Upgrading process

If you're Upgrading, you have an additional step to take. After reaching your overarching stock/bond allocation decision, you have decisions to make about your percentage across the various stock- and bond-*risk categories*.

In the past, we've taken into account the current economic climate and offered suggested allocations annually for each of those categories. Last year we announced why we're changing that approach, instead allocating *evenly* across the stock-risk categories (see table). While there may be occasional years where we alter this "evenly weighted" posture in response to what we perceive to be unusual opportunities or risks, we expect those instances to be the exception rather than the rule.

Our goal is simplicity. It's easier for new members to begin Upgrading if there's less complexity in the process. It's also easier for existing Upgraders to rebalance when the category allocations are predictable from year to year.

Looser rebalancing guidelines

We've written before about new research indicating that annual rebalancing isn't as necessary or helpful as was once believed.[3] Generally speaking, SMI still thinks the annual rebalancing process is a positive one for most investors, but this growing body of research has made us a little less dogmatic about the level of precision it requires. As long as a person is *within a few percentage points* of his or her long-term allocation targets, that's probably close enough (especially if there are costs involved in making further trades to get closer to the target allocations).

Bonds will continue to be allocated as recommended under the new Bond Upgrading approach rolled out in 2015. To briefly review: Whatever an investor's overall bond allocation is, half of that is invested in the rotating Upgrading selection,[4] while the other half is divided evenly between short-term and intermediate-term bonds. For example, a person with a 40% total bond allocation would invest 20% in the rotating Bond Upgrading selection, and 10% in each of the Vanguard short-term/intermediate-term index funds (or ETFs).

ORGANIZING YOUR PORTFOLIO IN 2017

Portion of Portfolio Allocated to Stocks:	100%	80%	60%	40%
Portion of Portfolio Allocated to Bonds:	**None**	**20%**	**40%**	**60%**
Stocks: SMI Risk Category 5 — Foreign	20%	16%	12%	8%
Stocks: SMI Risk Category 4 — Small/Growth	20%	16%	12%	8%
Stocks: SMI Risk Category 3 — Small/Value	20%	16%	12%	8%
Stocks: SMI Risk Category 2 — Large/Growth	20%	16%	12%	8%
Stocks: SMI Risk Category 1 — Large/Value	20%	16%	12%	8%
Bonds: Upgrading Rotating Component	None	10%	20%	30%
Bonds: Medium-Term Indexed Core Holding	None	5%	10%	15%
Bonds: Short-Term Indexed Core Holding	None	5%	10%	15%

Rebalancing in DAA

Those with premium memberships also have *(continued on page 14)*

[1]www.soundmindinvesting.com/start-here/lets-get-started [2]The Just-the-Basics portfolio mix is permanently fixed, as shown at the top of page 10. [3]bit.ly/1Okt1wl [4]Shown monthly in the "Bond Categories" section on the "Basic Strategies" (page 10 this month).

L E V E L 4 F O U R

Looking Toward Retirement

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

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

HOW FEDERAL GOVERNMENT WORKERS CAN MAKE THE MOST OF THEIR THRIFT SAVINGS PLAN OPTIONS

The Thrift Savings Plan (TSP), the U.S. government's 401(k)-type retirement plan for federal workers, has undergone an important change since SMI last wrote about it. We'll get to that change in a moment, but first a little background.

Generous benefits

The TSP is one of the world's largest defined-contribution retirement plans, with approximately 4.8 million participants and more than $458 billion in assets. Participation is open to active employees of the Federal Employees' Retirement System (FERS), the Civilian Service Retirement System (CSRS), the uniformed services, and certain other categories of civilian government service.

The program offers a number of valuable benefits, especially for FERS employees. First, Uncle Sam makes an automatic contribution equal to 1% of the employee's salary each pay period. There is no waiting period and the employee doesn't have to be making any contributions of his or her own. (There is a two- to three-year vesting period, depending on the type of position the employee holds.)

Next, the government matches any contributions an employee makes dollar for dollar up to 3% of salary. Then, for the next 2% of salary, the government contributes 50 cents per dollar.

If you're covered under the Federal Employees' Retirement System, a great goal is to invest at least 5% of your salary. That will enable you to take full advantage of the free matching money.

For all TSP-eligible employees, the maximum annual amount that may be contributed to the plan in 2017 (not counting employer matches) is $18,000, with an additional $6,000 allowed for participants age 50 and older.

Traditional and Roth options

Originally, all TSP accounts were similar to traditional 401(k)s. Employee contributions were tax-deductible, with taxes due on the contributions and earnings when money is withdrawn in retirement. In 2012, a Roth TSP option was added. Just as with a Roth IRA or 401(k), money is contributed to a Roth TSP *after* the employee has paid income tax on it. When the contributions and earnings are taken out in retirement, no tax is due.

TSP-eligible employees may choose the traditional TSP, the Roth TSP, or a combination—in which case they would spread their contributions across the two plans while adhering to the previously described contribution limits.

Automatic opt-in

One TSP feature unique to FERS employees hired after July 31, 2010 is an automatic 3% employee contribution. In other words, instead of having to take the initiative to opt *in* to the program, they have to opt *out* if they do not want to participate. This opt-out provision is a relatively new trend among retirement plans, and has proven to help people save more for their retirement than traditional opt-in programs. (While 3% is a good start, that amount is unlikely to be enough to meet your retirement savings goals, so make sure you're investing enough either by contributing more to the TSP or to an IRA.)

Automatic investment selection

Investment options in the Thrift Savings Plan include three stock funds (the I, S, and C funds—International, Small Cap, and Common Stock), two fixed-income funds (the F and G funds—Fixed Income and Government Securities), and five blended "lifecycle" funds (L funds), which operate like target-date funds. An employee would choose the fund with the target date closest to his or her intended retirement date. The TSP's lifecycle funds are offered in 10-year increments: 2020, 2030, 2040, and 2050.

Each L fund is composed of a mix of holdings in the five stock and bond funds (I, S, C, F, and G). The more distant the target date of each lifecycle fund, the more it will allocate to the three stock funds. The closer the target date, the greater the allocation to the two fixed-income funds.

All TSP funds have low expense ratios, and all can now be tracked using SMI's Personal Portfolio Tracker tool. (Previously, only the I, S, C, and F funds were in the Tracker.)

Don't set it and forget it

By default, contributions to the TSP made by or on behalf of civilian employees who enrolled in the TSP prior to September 5, 2015 (and members of the uniformed services) are deposited into the G fund. Over the years, that design feature of the TSP has been criticized. After all, the G fund is a very conservative choice, especially for younger employees, and many never take the initiative to change that default selection.

As a result, the default investment choice for new TSP employees enrolled on or after September 5, 2015 is the L (lifecycle) fund with the target date closest to the date that the employee will turn 62.

All TSP participants would be wise to double-check how their contributions are being invested. If yours are still going into the G fund by default, you may want to make a change.

Even if your contributions are going into the L fund chosen for you by the TSP system, it's important to note that choice may be more conservative than is ideal.

The TSP lifecycle funds tend to lean to the conservative side when compared to other target-date funds. For example, the most aggressive fund, L2050, maintains a 16% allocation to bonds. By contrast, *(continued on page 14)*

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 11/30/2016	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	0.0	2.8%	-2.0%	-2.3%	1.7%	0.6%	-1.6%	1.14	0.13%	20%	16%	12%	8%	VXUS
Extended Market Index ETF	Small company stocks	25.6	14.1%	7.9%	4.7%	11.2%	9.7%	6.9%	1.28	0.09%	40%	32%	24%	16%	VXF
S&P 500 Index ETF	Large company stocks	16.0	9.9%	3.7%	1.9%	6.1%	8.0%	9.1%	1.00	0.05%	40%	32%	24%	16%	VOO
Total Bond Mkt Index ETF	Medium-term bonds	-2.5	2.2%	-2.6%	-3.4%	-1.2%	2.0%	2.6%	1.02	0.06%	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 11/30/2016[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. Oakmark International	12/16	NTF	NTF	NTF	14.6	4.4%	0.8%	4.2%	8.8%	1.6%	-1.5%	1.41	1.00	67	None	OAKIX
	2. ☎ Third Ave Intl Value	01/17	NTF	NTF	NTF	25.8	14.0%	1.6%	4.8%	10.9%	10.2%	-4.8%	1.59	1.65	37	2%60days	TVIVX
	3. Longleaf Partners Intl	09/16	Yes	Yes	Yes	22.2	13.0%	1.2%	1.8%	9.2%	11.2%	-3.1%	1.60	1.28	18	None	LLINX
Category 4 Small/Growth	1. Hodges	09/16	NTF	NTF	NTF	64.0	39.6%	12.6%	13.1%	25.3%	25.7%	9.8%	1.85	1.32	60	1%30days	HDPMX
	2. Oberweis Micro Cap	11/15	NTF	NTF	NTF	43.4	22.4%	11.3%	8.5%	17.8%	17.1%	8.2%	1.45	1.72	84	1%90days	OBMCX
	3. Champlain Mid Cap	05/16	NTF	NTF	NTF	24.1	16.4%	3.6%	3.3%	7.8%	13.1%	9.4%	1.09	1.20	63	None	CIPMX
Category 3 Small/Value	1. Towle Deep Value	06/16	Yes	Yes	Yes	85.9	50.8%	19.5%	18.8%	28.6%	38.6%	11.3%	2.26	1.20	36	2%90days	TDVFX
	2. iShares Russell 2000 Value	12/16	ETF	ETF	ETF	49.9	26.7%	13.2%	10.4%	19.7%	19.8%	7.5%	1.44	0.25	1355	None	IWN
	3. WisdomTree Sm Cap Divd	08/16	ETF	ETF	ETF	45.6	26.7%	11.1%	7.8%	16.5%	21.3%	9.2%	1.35	0.38	686	None	DES
Category 2 Large/Growth	1. ☎ Oakmark Fund	01/17	NTF	NTF	NTF	33.1	16.5%	7.2%	8.1%	12.9%	12.2%	8.7%	1.21	0.89	51	None	OAKMX
	2. Kinetics Paradigm	11/16	NTF	NTF	NTF	41.2	20.0%	5.5%	12.3%	15.3%	13.6%	3.5%	1.23	1.64	75	2%30days	WWNPX
	3. ☎ Parnassus Endeavor	01/17	NTF	NTF	NTF	38.5	19.0%	7.1%	6.4%	14.5%	17.6%	14.6%	1.11	0.95	24	None	PARWX
Category 1 Large/Value	1. Dodge & Cox Stock	12/16	Yes	Yes	Yes	43.0	19.8%	9.6%	10.6%	15.8%	16.6%	9.1%	1.23	0.52	66	None	DODGX
	2. Artisan Value	06/16	NTF	NTF	NTF	39.4	28.0%	7.5%	7.1%	12.3%	19.9%	7.2%	1.38	1.00	38	None	ARTLX
	3. Longleaf Partners	11/16	Yes	Yes	Yes	43.2	24.1%	4.6%	7.6%	13.7%	22.0%	2.7%	1.45	0.93	15	None	LLPFX
Bond Categories	Scout Unconstrained Bond [6]	09/16	NTF	NTF	NTF	4.6	5.4%	-0.7%	-0.4%	0.9%	4.1%	0.1%	1.10	0.80	-0.2[7]	None	SUBYX
	Vanguard I-T Bond Index	01/15	ETF	ETF	ETF	-3.4	2.8%	-3.3%	-4.1%	-1.6%	2.2%	3.3%	1.33	0.09	6.5[7]	None	BIV[8]
	Vanguard S-T Bond Index	07/12	ETF	ETF	ETF	-0.2	1.3%	-1.0%	-1.1%	-0.2%	1.1%	1.0%	0.44	0.09	2.8[7]	None	BSV[9]

Upgrading Footnotes: **[1]** The funds in each risk category are selected (and ranked 1 through 3) primarily based on their momentum scores in mid-December, not those shown on this report. The fund ranked third is the one that currently appears most likely to be replaced next. 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]** A 1.0 relative risk score indicates the fund has had the same volatility as the market in general over the past three years. For example, a fund with a score of 1.4 would mean the fund was 1.4 times (40%) more volatile than the market. See June2015:p88. **[5]** Depending on how long you hold this fund, a redemption fee may be applicable when selling (for example, a fee of 1% if you sell within 60 days of purchase). Fees change often and vary from broker to broker, so be sure to check with your broker for the most current information. **[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 VBILX where available, otherwise VBIIX. **[9]** Those preferring a traditional mutual-fund option can buy VBIRX where available, otherwise VBISX.

☎ Changes in our fund recommendations are explained in the MoneyTalk column.

Upgrading: Easy as 1-2-3

Fund Upgrading has long been SMI's most popular Basic Strategy. Whether used in isolation or in combination with SMI's Premium Strategies, Upgrading forms a solid foundation for an investing plan. Upgrading has proven itself over time with market-beating returns over the long haul, and it is easy to implement. This page explains exactly how to set up your own Upgrading portfolio.

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

WHY UPGRADE?

SMI offers two primary investing strategies for "basic" members. They are different in philosophy, the amount of attention they require, and the rate of return expected from each. Our preferred investing strategy is called Fund Upgrading, and is based on the idea that if you are willing to regularly monitor your mutual-fund holdings and replace laggards periodically, you can improve your returns. While Upgrading is relatively low-maintenance, it does require you to check your fund holdings each month and replace funds occasionally. If you don't wish to do this yourself, a professionally-managed version of Upgrading is also available (visit bit.ly/smifx).

SMI also offers an investing strategy based on index funds called Just-the-Basics (JtB). JtB requires attention only once per year. The returns expected from JtB are lower over time than what we expect (and have received) from Upgrading. JtB makes the most sense for those in 401(k) plans that lack a sufficient number of quality fund options to make successful Upgrading within the plan possible. See the top section of the Basic Strategies page at left for the funds and percentage allocations we recommend for our Just-the-Basics indexing strategy.

WHERE TO OPEN YOUR ACCOUNT

Opening an account with a discount broker that offers a large selection of no-load funds greatly simplifies the Upgrading process. This allows you to quickly and easily buy/sell no-load mutual fund shares without having to open separate accounts at all the various fund organizations. There are several good brokerage choices available. We recommend reading our latest Broker Review (August 2015:Cover article, also available online at bit.ly/smibroker) for details regarding the pros and cons of each broker, as your specific investing needs will largely dictate which broker is best suited to your situation.

401(K) INVESTORS

For a detailed explanation of how to Upgrade within your 401(k) plan, see bit.ly/smi401ktracker. That article also contains ideas on Upgrading in any type of account where your available fund choices are limited.

HOW TO BEGIN STOCK UPGRADING

❶ First determine your stock/bond target allocation by working through the investment temperament quiz online in the "Start Here" section (see the link near the top of the home page on the main navigation bar). For example, Table 1 below provides guidelines for those with an "Explorer" temperament. For more on asset allocations, see Jan2017:p8.

❷ Find the column that matches your stock/bond allocation in Table 2. (If your target falls between two listed columns, split the difference.) Multiply each percentage by the value of your total portfolio amount to calculate the dollar amount to invest in each risk category.

❸ Buying your funds is easy. Look at the recommended funds on the opposite page. In each category, start with the #1 listed recommendation. If it's available at your brokerage (indicated by Yes, NTF, or ETF), buy it. If it's not, continue down the list to the next available fund. Then contact your broker—online or via phone—to buy the fund you've picked.

Let's see how a new subscriber 12 years from retirement with $50,000 to invest and an account at Fidelity would proceed. First, he or she selects the proper stock/bond mix for their situation (let's assume 80/20). Then, from Table 2, finds the percentages for each risk category. Multiplying $50,000 by each percentage yields the dollar amount for each category as shown in Table 3.[1] Looking at the Fidelity column on the Recommended Funds page, the highest-rated Cat. 5 fund available at Fidelity is Oakmark International, the highest-rated Cat. 4 fund available is Hodges, and so on. After doing this for each category, the orders are placed and the stock portion of the Upgrading portfolio is complete!

From then on, it's just a matter of checking the Basic Strategies page each month. 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.

❶ PICK YOUR ALLOCATION

Seasons of Life	Stocks	Bonds
15+ years until retirement	100%	0%
10-15 years until retirement	80%	20%
5-10 years until retirement	70%	30%
5 years or less until retirement	60%	40%
Early retirement years	50%	50%
Later retirement years	30%	70%

Note: These are SMI's recommendations for those with an "Explorer" temperament. See Step ❶ in the text for information on our investment temperament quiz. You may want to fine-tune the above percentages to suit your personal approach to risk-taking.

❷ FIND YOUR PORTFOLIO MIX

Portion of Portfolio Allocated to Stocks:	100%	80%	60%	40%
Portion of Portfolio Allocated to Bonds:	**None**	**20%**	**40%**	**60%**
Stock Cat. 5: Foreign Stocks	20%	16%	12%	8%
Stock Cat. 4: Small Companies /Growth	20%	16%	12%	8%
Stock Cat. 3: Small Companies /Value Strategy	20%	16%	12%	8%
Stock Cat. 2: Large Companies /Growth	20%	16%	12%	8%
Stock Cat. 1: Large Companies /Value Strategy	20%	16%	12%	8%
Bond Cat. 3: "Rotating" Bond Fund	None	10%	20%	30%
Bond Cat. 2: Intermediate-Term Bond Fund	None	5%	10%	15%
Bond Cat. 1: Short-Term Bond Fund	None	5%	10%	15%

❸ BUY YOUR FUNDS

Example uses an 80/20 mix between stocks and bonds		Dollars	Invest In Funds
Stock Cat. 5: Foreign	16%	$8,000	Oakmark International
Stock Cat. 4: Small/Growth	16%	$8,000	Hodges
Stock Cat. 3: Small/Value	16%	$8,000	Towle Deep Value
Stock Cat. 2: Large/Growth	16%	$8,000	Oakmark Fund
Stock Cat. 1: Large/Value	16%	$8,000	Dodge & Cox Stock
"Rotating" Bond Fund	10%	$5,000	Scout Unconstrained Bond
Intermediate-Term Bond Fund	5%	$2,500	Vanguard I.T Bond Index
Short-Term Bond Fund	5%	$2,500	Vanguard S.T. Bond Index
Total	100%	$50,000	

BOND UPGRADING

Your bond allocation is divided among three funds as seen in Table 2. One-half of that is invested in the rotating Upgrading selection, which is reviewed monthly and changes from time to time. The other half is divided evenly between short-term and intermediate-term index bond funds, which are permanent holdings. For more on why SMI approaches bond investing in this way, see "Introducing an Upgrading Approach to Bond Investing that Outperforms the Bond Market" (bit.ly/smibondupgrading).

[1] Rounding off to the nearest hundred is fine. As time goes by, your portfolio will gradually move away from these starting percentages as some funds perform better than others. This will be fixed once a year when you "rebalance" back to your desired portfolio mix (see Jan2017:p8).

MONEYTALK

STOCK UPGRADING — NEW FUND RECOMMENDATIONS

[When more than one fund *in the same risk category* is replaced, you should evaluate which of the newly recommended funds is the best fit for your portfolio. The simplest method for picking new funds is to refer to our 1-3 rankings on the "Basic Strategies" page and invest in the highest ranked fund(s) available through your broker. • We choose our recommended funds with the hope they will be held for at least 12 months and therefore qualify for long-term capital gains tax treatment. Nevertheless, we suggest a fund change when a recommended fund's performance falls below the threshold of our mechanical guidelines. Our guidelines provide objective criteria for making the decision as to when to "upgrade" to a better-performing fund. When a fund no longer meets our performance guidelines, we suggest you sell it even if the 12-month holding period hasn't been met. However, a "$" symbol following the name of the fund being sold lets you know that we still think well of the fund and its management and you might elect to continue holding the fund for a month or two to achieve a tax benefit or to save on transaction or redemption fees. Be aware, however, that from 2006-2010, the average performance "cost" of retaining such funds has been roughly 0.5% per month. For more details, see Oct2011:p153.]

◆ **In the Foreign group, Wasatch International Opportunities (WAIOX, 7/2016) is being replaced.** This fund was an outstanding performer during the first few months we owned it, but emerging-markets stocks have seen significant losses since the U.S. elections in early November. U.S. interest rates have risen along with the value of the dollar relative to most emerging-market currencies. As the value of these currencies falls in comparison to the dollar, this falling exchange rate hurts U.S. investors whose foreign-fund returns are being converted back into dollars. Wasatch International Opportunities allocates more than most foreign funds to these more volatile emerging-market countries, and the fund's emphasis on the smallest "micro-cap" companies tends to amplify those profits/losses further. As a result, this Wasatch fund gave back almost all of its July-September gains in October/November, and the fund has slipped well below the foreign-fund group's quartile cutoff, triggering its replacement this month.

• **Third Avenue International Value (TVIVX) is being added.**[1] The Third Avenue fund family used to be well known to Upgraders, as SMI recommended three different Third Avenue funds a total of five times between 1996-2005. But since the financial crisis in 2008, Third Avenue's deep-value methodology has fallen out of favor. Only one Upgrading recommendation has followed in the past decade—for this International Value fund briefly in 2011. But with value strategies making a comeback since the end of the market correction early in 2016, Third Avenue's funds have been shining once again.

The Third Avenue approach has always been to try to determine what a business would be worth in a traditional cash sale, then find opportunities where they can buy the stock at a price significantly below what a private investor would pay for that company. That sounds great in theory, but of course there's no guarantee the market will ever come to agree with their estimate of a company's true value. And even if it does, this type of value investing can require great patience. The market can continue to undervalue a company for a long time, only to suddenly adjust its view. This means the approach tends to produce "lumpy" investing returns where gains aren't evenly distributed.

That said, the market has finally been rewarding value investors of late, and Third Avenue has strung together a solid performance record this past year. With the fund near the top of our momentum rankings, we're counting on this recent success continuing.

◆ **In the Large/Growth group, Powershares QQQ (QQQ, 11/2016) and Fidelity OTC (FOCPX, 10/2016) are being replaced.** Technology stocks were some of the strongest performers between the Brexit market reaction in late June and the U.S. elections in early November. But that dynamic changed swiftly and unexpectedly following Donald Trump's surprise victory. It's not clear why technology stocks have lagged while stocks generally have soared in the election aftermath. One theory is simply that when an "obvious" new trade presents itself, as the rotation into financial/banking and infrastructure stocks has been perceived to be, investors will sell whatever is most liquid (and decently priced) to create cash to buy the new opportunity. Tech stocks certainly fit that "easy liquidity and recent gains" profile, and some have suggested that selling in tech is nothing more than traders taking profits and redeploying into the market's new hot sectors. After all, tech stocks haven't been losing value; they've just had a less impressive rally than many other sectors that have sprung to life since the election.

At any rate, there's no reason to hang around in either Fidelity OTC or QQQ. Given that we've owned Fidelity OTC for three months, there shouldn't be a trading cost issue when selling. And the fact that QQQ is an ETF allows us to make a rare two-month quick exit without incurring any additional trading expense. They're both below the quartile, so we're moving on to funds with better recent momentum.

• **Oakmark Fund (OAKMX) is being added.**[1] Oakmark is a "blend" fund, meaning the manager's style isn't purely growth or value, but a mixture of both. As a result, Oakmark (and its more-concentrated but otherwise similarly-run sibling Oakmark Select) has bounced back and forth between SMI's large/value and large/growth categories over time. At present, value stocks are outperforming growth stocks, so it's helpful to have some "in-between" funds like Oakmark that can fill a recommended slot for us in either group.

Oakmark's manager, Bill Nygren, has never been afraid to go against the grain, whether that means loading up his fund with financial stocks, as he has done in recent years, or buying a few underpriced energy stocks when that sector was being ravaged a couple years ago. That said, while those value-oriented picks have been among the primary reasons for this fund's strong 2016 performance, the fund's largest holding is growth-oriented Alphabet, the parent company of Google. We don't mind that this fund has both value and growth holdings, but just want to make you aware this is a somewhat different animal than many of our more aggres-

[1]For more on this fund, visit www.morningstar.com.

sive large/growth category funds.

• **Parnassus Endeavor Fund (PARWX) is being added.**[1] This fund's stock selections lean a little more to the growth side than Oakmark's, but Parnassus Endeavor has recently offset that somewhat with a cash stake that was nearing 20% of the fund's assets at the end of November. While the fund is being selected on the basis of its current momentum score, it's worth noting that Parnassus is a "socially-responsible" fund that screens out companies involved with alcohol, tobacco, gambling, weapons, nuclear power, or having business with Sudan. ◆

LEVEL 2 / CONTINUED FROM PAGE 7:

SUCCESSFUL STOCK-FUND UPGRADING REQUIRES OWNING ONLY 5 FUNDS

in each category. Owning all of the recommended funds will continue to provide results that are the most similar to performance data published by SMI. And the additional downside protection (due to slightly lower volatility) provided by the better-diversified approach is attractive as well. It's worth pointing out that when we ran this analysis in 2010—looking specifically at only the 2000-2009 period which was dominated by two major bear markets—the "Buy All" portfolio

MARKET NOTES, QUOTES, AND ANECDOTES

Forecasters never learn, and never stop

• "Economic analysis colored by political bias equals awful investing advice."— Money manager/blogger Barry Ritholtz, writing in *Bloomberg View* on 12/14/16, about one of the many 2016 forecasts that missed the mark — the *Washington Times'* call for a recession in 2016. Read more at bloom.bg/2gUHrtA.

• "They have again obliged us today, by misguiding investors and ordinary Americans with more random information that they claim emulates the future... [Forecasters generally] are much worse than random chance alone would predict." — Salil Mehta, a former director of research for the Treasury's Troubled Asset Relief Program, discussing on his *Statistical Ideas* blog and in the *New York Times* a recent *Barron's* article that contained the 2017 market forecasts of many Wall Street analysts. Read more at bit.ly/1V4SJJU and nyti.ms/2hAXocb.

The nature of investing

• "First and foremost, don't even think about trying to extrapolate macroeconomic, demographic, and political events into an investment strategy. Say to yourself every day, 'I cannot predict the future, therefore I diversify.'" — Bill Bernstein, quoted in a 12/6/16 post by Ben Carlson in his *A Wealth of Common Sense* blog, in which he discussed how difficult it can be to stay diversified when one asset class is performing so much better than another. Read more at bit.ly/2gas3J8.

• "Every asset is an investment in some people's hands and a speculation in others'. So it isn't what you buy, but rather why you buy, that determines whether you are investing or speculating." — Jason Zweig, in a 12/9/16 *Wall Street Journal* column about the difference between investors and speculators. Read more at on.wsj.com/2hrpLYB.

• "Gathering information is a science. Filtering out noise is an art." — Morgan Housel, in a 12/8/16 *Collaborative Fund* post on the art and science of investing. Read more at bit.ly/2htCk5p.

• "Because humans are involved at every level and in every step, markets are always less predictable than we think and our human responses to those markets are always less rational than we'd like to think." — Robert Seawright, in a 12/9/16 post on his *Above the Market* blog about the need for an evidence-based approach to investing. Read more at bit.ly/2hKEJZa.

Choosing a strategy you can stay with

• "Rather than seeking optimization, investors would do well to implement a plan that they can stick with over the long term. We have to first be honest with ourselves about our true goals and what we're willing to sacrifice to achieve them." — Investing blogger Matthew Garrott, writing on 12/9/16 that the goal for most investors is not to make as much money as possible, but to maintain a certain standard of living while saving for retirement. Read more at bit.ly/2gLC1Et.

• "I can't prove this, but I'd imagine it's more difficult to go through prolonged periods of underperformance while the rest of the world is singing Kumbaya than it is to stay in stocks through a bear market. In the three years from March 1995-March 1998, the S&P 500 rose 134% while the Permanent Portfolio rose just 36%. It would have taken an almost inhuman amount of discipline to have stayed the course." — Michael Batnick, author of *The Irrelevant Investor* blog, writing on 12/2/16 with a lesson for SMI members who are using the Dynamic Asset Allocation strategy, which is patterned to a degree after the Permanent Portfolio. The strategy, designed with downside protection in mind, can be emotionally difficult to stay with during bull markets. Read more at bit.ly/2hpmiw4.

• "Let's remember that the removal of central-bank crutches, however gradual, and the transition to fiscal support could be bumpy and bring about a widening range of potential outcomes….It makes sense that a market less muffled by trillions in central-bank liquidity will become more volatile." — Kopin Tan in a 12/10/16 *Barron's* article explaining why risk is rising in the markets. Read more at bit.ly/2gXWJgZ. ◆

MONEYTALK

outperformed the "Top Ranked" with a total return of +85.0% to +73.1%. That result reinforces the logic that greater diversification helps during declining markets.

The most important take-away from this research is that any long-term benefit from Upgrading is likely to be achieved regardless of whether you take the simple approach (own only the top-ranked funds) or the more conservative—but time-consuming—diversified approach (own the entire recommended list). As always, it's your call. But for most readers, the simplicity of managing a smaller portfolio is probably worth the small performance gap. ◆

LEVEL 3 / CONTINUED FROM PAGE 8:

REBALANCING YOUR PORTFOLIO FOR THE NEW YEAR

access to our Dynamic Asset Allocation and Sector Rotation strategies. Investors in DAA adjust this division between asset classes quite differently. Dynamic Asset Allocation (DAA) doesn't require you to choose a specific percentage allocation *because the strategy shifts the portfolio allocations automatically* based on market conditions.

If you're following the DAA strategy, you begin by investing one-third of your DAA portfolio in each of three asset classes (represented by three recommended ETFs). Over time, as positions are sold and the proceeds reinvested in a different ETF, your portfolio will lose that equal balance. Your primary rebalancing task is to periodically restore equality to the three positions. Any imbalance between the three holdings can be addressed any time a holding is being replaced—it doesn't need to happen at the beginning of the year.

For those members who are diversifying between *strategies*,[1] an additional rebalancing task is necessary. For example, someone dividing their investments evenly between DAA and Fund Upgrading may need to rebalance slightly to get those two strategies back in balance.

Wrapping up

We recognize that understanding and applying SMI's investment strategies has become more complicated over time as we've added more options. Many members used to invest their entire portfolio in Upgrading. Now, some have chosen, despite the need for a little added number-crunching, to split their investments between Upgrading and Dynamic Asset Allocation, with many also including an allocation to Sector Rotation as well.[2]

Given this added complexity, we've looked for ways to simplify other aspects of maintaining an SMI portfolio. Keeping our Upgrading category allocations consistent from year to year is an example of this effort, as is our discussion on page 7 of owning only the top-ranked fund in each risk category. These are two areas where you can gain simplicity without sacrificing much in terms of performance. ◆

LEVEL 4 / CONTINUED FROM PAGE 9:

HOW FEDERAL GOVERNMENT WORKERS CAN MAKE THE MOST OF THEIR THRIFT SAVINGS PLAN OPTIONS

Fidelity's 2050 target-date fund has only a 5% bond allocation.

Plus, remember that the system's default assumes you plan to retire at age 62. If you plan to retire later than that, you should at least consider choosing an L fund with a later target date, assuming one is available.

If you're investing in an L fund, take a look at its asset allocation[3] and compare that to the optimal asset allocation suggested by SMI's asset-allocation process. You can work through SMI's process by visiting the *Start Here* section of the SMI web site (available only to SMI members). You may be able to get closer to your optimal asset allocation using the TSP's stock funds (I, S, and C) rather than an L fund.

The table below shows where each TSP fund fits in terms of SMI's risk categories. (Note that the TSP stock funds don't separate the growth and value components, so the C Fund is really a combination of SMI Stock Categories 1 and 2, while the S Fund is a combination of SMI Stock Categories 3 and 4.)

MANAGING THRIFT PLAN ALLOCATIONS

Investment Options for Federal Workers	For Asset Allocation Purposes
The I Fund: Invests in foreign stocks of 21 developed countries. Similar in performance to: Morgan Stanley EAFE Index	Treat as Stock Category 5
The S Fund: Invests in stocks of small and mid-size U.S. companies. Similar in performance to: Vanguard Extended Market Index	Treat as Stock Category 4
The C Fund: Invests in stocks of larger U.S. companies. Similar in performance to: Vanguard 500 Index	Treat as Stock Category 1
The F Fund: Invests in corporate and government-backed securities. Similar in performance to: Vanguard Total Bond Market Index	Treat as Bond Category 2
The G Fund: Invests in a non-marketable U.S. Treasury securities. Similar in performance to: Government-only money market funds	Treat as Bond Category 1
The L Funds: These funds invest in the five funds listed above. The percentage of holdings from each of the I, S, C, F and G funds varies based on target date.	

If the TSP is your only retirement account and you want to build, for example, an 80% stock, 20% bond portfolio, you might use SMI's Just-the-Basics allocations as your guide (see the top of page 10). That would mean putting 16% in the I fund, 32% in the S fund, 32% in the C fund, and 20% in the F fund.

If you have other investment accounts (such as an IRA) in addition to your TSP account, treating all of your accounts as one portfolio may enable you to implement SMI's Fund Upgrading strategy, using your IRA or other account to specifically target investments in SMI stock categories 2 and 3 and the Upgrading "rotating" bond selection. These would complement your TSP holdings, which favor SMI stock categories 1, 4, and 5 as well as bond categories 1 and 2.

To learn more about the TSP, visit www.tsp.gov where you'll find a downloadable 36-page booklet, *Summary of the Thrift Savings Plan*. You also may want to download the more detailed 192-page *Your Thrift Savings Plan*, a free privately produced guidebook.[4] ◆

[1]See www.soundmindinvesting.com/articles/view/a-few-more-thoughts-on-rebalancing for more on DAA rebalancing. [2]tinyurl.com/jx97xdn, tinyurl.com/hzamzge [3]You can see how each fund is allocated at bit.ly/21VjeXy [4]bit.ly/2gosz9O

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.

DYNAMIC ASSET ALLOCATION

Overview

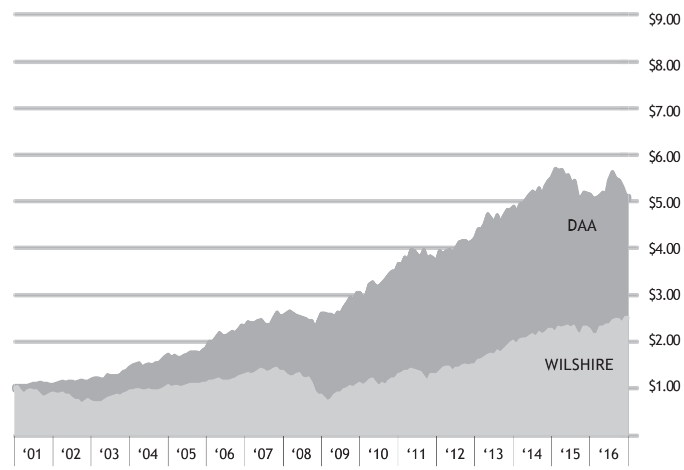
This is a stand-alone strategy that can be used in combination with (or in place of) SMI's basic strategies. It is designed to help you share in some of a bull market's gains, while minimizing or even preventing losses during bear markets. It's a low-volatility strategy that nonetheless has generated impressive back-tested results over the long term. DAA 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 who are more concerned with avoiding major losses during bear markets than they are with capital growth during bull markets. **Pros:** Excellent downside protection during bear markets, reflected in a very low worst-case result and relative-risk score. Great long-term track record. **Cons:** Subject to short-term whipsaws. Lags the market in up years. Making trades promptly and concentrating entire portfolio in only three asset classes can be emotionally challenging.

Dynamic Asset Allocation vs Wilshire 5000

Growth of $1 from Jan 2001 through Nov 2016



Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016[2]	Avg[1]	Worst 12[1]	Rel Risk[1]
Dynamic Asset Allocation	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%	-6.8%	6.0%	11.5%	-13.7%	0.62
Wilshire 5000	-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%	0.7%	8.4%	5.6%	-43.3%	1.00

SECTOR ROTATION

Overview

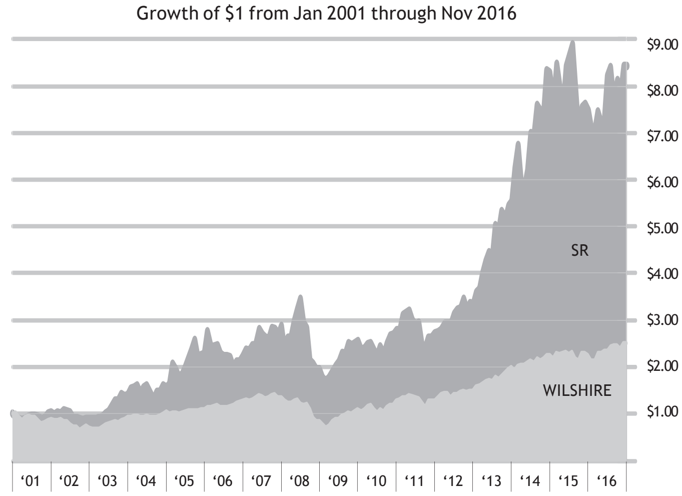
This high-risk strategy involves investing in a single special-purpose fund that focuses on a specific sector (such as biotech, energy, or financial services). Because these stock funds invest in a very narrow slice of the economy, they carry a higher degree of risk. Only one fund, selected based on having superior momentum relative to other sector options, is held at a time. The sector-fund recommendations in this strategy are designed to be used in combination with Just-the-Basics, Fund Upgrading, or DAA (or a combination of these) up to a maximum of 20% of the stock allocation. While the performance peaks and valleys of Sector Rotation have been higher and lower than all other SMI strategies, it's a strategy that has generated especially impressive long-term returns.

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.

Sector Rotation vs Wilshire 5000

Growth of $1 from Jan 2001 through Nov 2016



Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016[2]	Avg[1]	Worst 12[1]	Rel Risk[1]
Sector Rotation	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%	-9.7%	8.6%	14.4%	-38.6%	1.65
Wilshire 5000	-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%	0.7%	8.4%	5.6%	-43.3%	1.00

[1]The three data points on the far right in each of the two tables are for the Jan2001-Dec2015 period. "Avg" represents the average annualized return from 2001-2015. "Worst12" represents the worst investor experience over 169 rolling 12-month periods from 2001-2015. [2]January-September

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PERFORMANCE DATA

SOUND MIND INVESTING MODEL PORTFOLIOS • DATA THROUGH NOVEMBER 30, 2016

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]	11.1%	4.6%	2.5%	8.9%	8.9%	14.5%	7.1%	7.3%
Just-the-Basics[2]	10.2%	4.3%	2.2%	7.2%	6.1%	12.4%	6.3%	7.6%
Stock Upgrading[3]	8.9%	5.3%	3.7%	6.7%	5.6%	12.0%	6.5%	9.2%
U.S. Bond Market[4]	2.3%	-2.6%	-3.5%	1.9%	2.5%	2.2%	4.1%	4.3%
Bond Upgrading[5]	3.5%	-1.4%	-1.5%	2.9%	3.2%	3.6%	6.7%	6.9%

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]	-0.7%	-3.7%	-7.1%	-1.0%	2.1%	6.3%	8.3%	11.2%
Sector Rotation[7]	12.6%	7.8%	9.4%	10.7%	15.6%	26.2%	14.9%	15.3%
50-40-10 Blend[8]	4.5%	1.1%	-1.2%	3.3%	5.0%	10.7%	8.7%	11.3%
Enhanced Just Basics[9]	5.2%	1.0%	0.9%	3.6%	4.3%	10.7%	5.3%	8.3%

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] 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 11/30/2016	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	6.02%	4.37%	2.38%	4.24%	3.20%	9.81%	5.33%
Wilshire 5000	11.08%	4.55%	2.53%	8.89%	8.94%	14.45%	7.08%
S&P 500	9.79%	3.70%	1.83%	8.06%	9.07%	14.45%	6.89%

Quarterly Returns as of 9/30/2016	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	4.54%	0.95%	3.92%	9.44%	4.68%	11.38%	5.91%
Wilshire 5000	8.44%	0.09%	4.29%	15.35%	10.65%	16.31%	7.44%
S&P 500	7.84%	0.02%	3.85%	15.43%	11.16%	16.37%	7.24%

Total/Gross expense ratio: 2.03% as of 2/29/2016 (includes expenses of underlying funds)
Net expense ratio: 1.13% as of 2/29/2016 (excludes expenses of underlying funds)

Notes: The performance data quoted represent 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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