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Sound Mind Investing®

Financial Wisdom for Living Well

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Facing Your Fears: Modeling the Impact of a Significant Bear Market on Your Financial Plan

Investors have enjoyed a powerful bull market over the past 8½ years. But they also carry the emotional scars of the steep declines of 2000 and 2008. With stock valuations currently stretched to levels reached only at the end of prior bull-market peaks, many wonder if another steep decline is close at hand. Here's how to determine the type of impact a new bear market would have on your ability to meet your long-term financial goals.

by Mark Biller

It's an under-appreciated fact that *emotions* are the primary obstacle to investing success, rather than a lack of knowledge. As Warren Buffett once famously quipped, "If past history was all there was to the game, the richest people would be librarians." Knowing the right investing things to do is certainly important, but it's insufficient by itself. The key is to know the right things to do and *then to follow through on those decisions*, which requires winning the emotional battle.

Over SMI's 27+ year life, we've tried to help our members win this emotional battle by preparing them in advance with knowledge of what to expect, so that when the market's inevitable winds start howling, they're prepared. "*Praemonitus, praemunitus*"—forewarned is forearmed. At least in theory, being warned in advance of what to expect should give a person a tactical advantage in navigating any situation, which includes market events.

This is why SMI starts sounding cautious as bull markets get extended (and why, on the other side of the spectrum, you can count on us providing bullish encouragement in the depths of the next bear market). Part of our role is to act as an emotional counterweight to the prevailing emotion of the moment. Which means that today, with the stock market 8½ years into a bull market which hasn't experienced even a 15% correction since way back in 2011, we feel the need to remind readers that, as surely as night follows day, every bull market is followed by a bear market.

Granted, the timing of these market shifts is notoriously difficult to pin down. We've never found a predictive system that could reliably tell us when a bear market is about to begin, which is why we make no effort to change our portfolios *in advance* of a market shift from bull to bear. Rather, our strategies take action only in response to market changes *that already have occurred*, such as when our Dynamic Asset Allocation strategy shifts us out of one asset class and into another in response to market action. With the bull market still intact, our strategies remain fully engaged with stocks.

However, the fact that we don't take preemptive actions based on predictions of what the market will do next doesn't mean we aren't paying attention to changes in market conditions. On the contrary,

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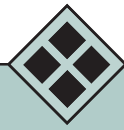
"FOR GOD HAS NOT GIVEN US THE SPIRIT OF FEAR BUT OF POWER, AND OF LOVE, AND OF A SOUND MIND."



EDITORIAL

Are You Being Diligent?

While there are reasons to be concerned about the health of the eight-plus-year-old bull market (historically high valuations, Federal Reserve tightening, and an economy performing below expectations), there are also arguments for optimism. Inflation and interest rates remain low. Corporate profits continue to climb and exceed expectations. Job creation has been strong, contributing to low unemployment. Economists are projecting continued economic growth with no hint of a recession in sight.

All this works to reinforce my normal sunny optimism. Of course, there are some factors I haven't taken into account—those pesky unknown events hidden in the future. That could be a problem, a potentially big problem, according to the late Peter Bernstein, author of the critically acclaimed history of financial risk, *Against the Gods.*

Bernstein is widely acknowledged to have been a very, very smart guy. I once read an interview with him that helped me to realize that—while not wanting to worry you—I should probably do more to balance my optimism with occasional reminders that risk is real and things may not work out at all like we expect (as we saw in 2008).

Here's a key segment from the interview where Bernstein has just been asked to name the important lessons about risk from his book:

> Two things. First, in 1703 the mathematician Gottfried von Leibniz told the scientist Jacob Bernoulli that nature does work in patterns, but "only for the most part." The other part—the unpredictable part—tends to be where things matter the most. That's where the action often is.
>
> Second, Pascal's Wager. It essentially says that in making decisions under conditions of uncertainty, *the consequences of being wrong must carry more weight than the probabilities of being right*. You begin with something that's obvious. But because it's hard to accept, you have to keep reminding yourself: We don't know what's going to happen with anything, ever. And so it's inevitable that a certain percentage of our decisions will be wrong. There's just no way we can always make the right decision. That doesn't mean you're an idiot. But it does mean you must *focus on how serious the consequences could be* if you turn out to be wrong: Suppose this doesn't do what I expect it to do. What's going to be the impact on me? If it goes wrong, how wrong could it go and how much will it matter?
>
> Pascal's Wager doesn't mean that you have to be convinced beyond doubt that you are right. But you have to think about the consequences of what you're doing *and establish that you can survive them if you're wrong*. Consequences are more important than probabilities.... Risk-taking is an inevitable ingredient in investing, and in life, but never take a risk you do not have to take. [Emphasis added.]

By sharing Bernstein's observations, I'm hoping to remind you that, despite the profits we've made in our various SMI strategies over the past few years, it's important you don't let complacency set in. While we believe their stellar performance bodes well for the future, mathematician Leibniz would say that's true "only for the most part." Not every year. Not always.

No portfolio can maximize profits during good markets and simultaneously insulate you from the inevitable bad markets. SMI's biblical philosophy, however, *can* position you so the shocks aren't overwhelming. If you will follow the priorities and guidelines God has provided for your protection, your finances will be resting on a strong foundation. One such guideline: "The plans of the diligent lead to profit as surely as haste leads to poverty" (Proverbs 21:5).

A key to building that strong foundation is having a personalized plan in place. It should be designed to achieve your financial goals, taking into account the occasional (and inevitable) bear-market shocks that befall all investors. Do you have such a plan in place?

I asked Mark to write this month's cover article to not only encourage you to create (or review) your plan, but to also show you how to stress-test it against the impact of a theoretical bear market. If you will take the time to do this now, then whether the coming months bring good or ill for the markets, your family's financial foundation will be secure.

AUSTIN PRYOR
FOUNDER/PUBLISHER

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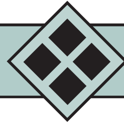
FEATURE  ARTICLE

Facing Your Fears: Modeling the Impact of a Significant Bear Market on Your Financial Plan

(continued from front page)

we monitor the status of many market indicators and signals. And currently, more than a few indicate the conditions for a bear market are either close or already in place. Perhaps most importantly, the Fed has shifted from adding accommodation to the financial markets in recent years to now removing it. While this may be appropriate, it adds a new element of risk to the markets. These factors don't mean a bear market *will* happen soon. It merely means that it *could*. We have to take that risk seriously, in a way that wasn't the case a few years ago.

Enter MoneyGuidePro®

In early 2017, SMI premium members gained access to a powerful tool. Our affiliated partners at SMI Advisory Services made personal access to the MoneyGuidePro® financial planning software available for a one-time fee of only $50. This software—ranked the number one financial planning software *by advisors* the past eight consecutive years—normally costs financial planners $1,295 *per year* to use. Individuals typically can gain access to it only by working with an advisor, so to have access to it on an individual basis and at a price any SMI member can afford presents a tremendous opportunity.

Not surprisingly, SMI members responded quickly. More than 1,000 have signed up and started using MoneyGuidePro® in the six months since it became available. That's outstanding! But that means thousands of SMI members have yet to take advantage of this tremendous opportunity. If you're among those who haven't signed up for MoneyGuidePro,® we urge you to revisit our February issue and do so.[1] This is a powerful weapon in waging the emotional war every investor faces!

Modeling the next bear market in MoneyGuidePro®

MoneyGuidePro® does many things, but this month we want to focus on just one: how to use the software to model the impact of the next bear market on your financial plan. It's our belief that you will derive two tangible benefits from seeing how the next bear market is likely to impact your portfolio and your ability to meet your long-term financial goals.

• **First, it will help reveal if your current portfolio mix is appropriate, or whether you need to make adjustments.** Amazingly, many people have no real idea what the impact of a bear market would be on their long-term financial future. This lack of knowledge causes some to plow ahead with investing plans far riskier than they should be. Investors who cavalierly loaded up on technology stocks throughout the dot-com bubble are a good example of this group. They never dreamed the tech-focused Nasdaq index could fall 83% in the ensuing bear market, digging a hole so deep it would require decades to emerge from.

• **Second, it will provide tremendous peace of mind when you have a plan in place that you can trust to weather the next bear market and still hit your goals!** It may require some effort to refine your financial plan to the place where you feel comfortable heading into a future bear market. But it's worth the effort! Having run the numbers and seen the outcome in advance, you will be in the best possible place to withstand the emotional storms ahead. Those emotional winds will drive many investors to make counterproductive, potentially life-altering moves during the next bear market. These misguided decisions to sell near the bear market bottom when they should hold on will cause them to miss the inevitable rebound on the other side. *This happens to millions of investors during every bear market.* It may have happened to you in 2000 or 2008. There's no reason it ever needs to happen to you again.

George Santayana is credited with saying, "Those who fail to learn from history are doomed to repeat it." That's true, but as we noted earlier, it's not enough to simply *know* the history. You need to have the emotional steel to *act* on it. Seeing your personal plan withstand the ravages of the next bear market *in advance* and emerge successfully will help provide the mettle you need to make the right decisions in the heat of the bear market cauldron. That's a worthy goal, and it's what we're hoping to achieve as the result of this exercise this month!

Losses during the Great Recession

MoneyGuidePro® has excellent built-in functionality to make modeling the next bear market simple for users. However, due to the specifics of the SMI investing strategies, only some of this functionality will work for SMI members. Some of it will not. We'll walk through those specifics now.

[Note: If you're new to MoneyGuidePro®, we recommend following the detailed walkthroughs presented in the February and March issues of SMI before reading further here. Those were written specifically as introductory articles for SMI readers. Both articles are available on the SMI website.]

Whether you are just starting with MoneyGuidePro® and are using the initial guided-lab experience, or have completed the lab and are working with the full-featured final version of MoneyGuidePro,® the specific processes we will be examining in this article are virtually identical.

The first place the issue of a future bear market arises is on the "Select Your Risk Score" screen (found under the "About You" heading, after selecting the "Risk & Allocation" menu option). As the screen shot on the next page shows, this page allows you to select a risk score using the slider bar. As you move the slider bar along the risk scale, two things happen.

First, the "appropriate portfolio" for your selected level of risk changes, showing you a suggested mix of SMI strategies. Based on your risk tolerance, as measured by the Great Recession loss shown for the various strategies, you will

TABLE 1

SMI STRATEGIES LOSS TABLE

NOV 2007 - FEB 2009

Wilshire 5000	-51%
Just-the-Basics	
100% Stock	-53%
80/20	-41%
60/40	-29%
40/60	-18%
DAA	-1%
Sector Rotation	-39%
Upgrading	
100% Stock	-50%
80/20	-39%
60/40	-28%
40/60	-17%
100% Bonds	+5%
50/40/10	
100% Stocks	-26%
80/20[1]	-20%
60/40[1]	-16%
40/60[1]	-11%

[1]The Upgrading portion split between stocks/bonds

[1]There's never been a better time for SMI Basic Members to upgrade to Premium, which includes the ability to sign up for MoneyGuidePro.® See the details of our 27th anniversary promotion at http://soundmind.ontraport.com/tl/45.

select a risk score. In our example, Bill has selected a risk score of 62, which results in a 50/40/10 portfolio being displayed. (This means a portfolio comprised of 50% Dynamic Asset Allocation, 40% Upgrading and 10% Sector Rotation, with the Upgrading portion divided 60% to Stock Upgrading and 40% to Bond Upgrading.) For more information on blending these strategies, see our May 2014 cover article, *Higher Returns With Less Risk: The Best Combinations of SMI's Most Popular Strategies.*

Second, statistics regarding the "Great Recession Loss for this Portfolio" are displayed. In the graphic below, these are on the right of the screen (though they may display at the bottom of the page, depending on your browser and screen settings). MoneyGuidePro® automatically calculates the percentage loss a portfolio like this would have experienced between November 2007-February 2009. The program also translates that loss into dollar terms based on the portfolio specifics you've entered into the program. So in our example, MoneyGuidePro® displays that this 50/40/10 portfolio would have lost -39%, which would translate (based on the amount Bill has invested) into a current portfolio loss of -$160,970 were it to happen again today.

Translating SMI strategies to MoneyGuidePro®

Unfortunately, those calculated figures are *wrong*. That's not the fault of MoneyGuidePro®—it's simply a limitation of using SMI's specific strategies within the software. While MoneyGuidePro® has accurate *overall* performance data for each of the SMI strategies, which allows the software to accurately make future return projections, it doesn't have the *granular historical data* on our strategies that it would need to model the past performance between these specific dates. As a result, in this specific "Great Recession Loss" instance, the software has to rely on more generic market index data, which doesn't correspond at all closely to a 50/40/10 portfolio that includes the distinctly non-index-like Dynamic Asset Allocation (DAA) strategy.

Bottom-line: What this means is simple. If you're using Just-the-Basics (or indexing in general), these numbers will be fairly accurate. But if you're using Upgrading, DAA, or Sector Rotation in your portfolio, you should ignore these "Great Recession Loss" figures on this particular screen of MoneyGuidePro®.

What are you afraid of?

Thankfully, MoneyGuidePro® has another feature that makes bear market modeling a breeze. Under the "Results" heading, the last option in the drop-down list is the "What Are You Afraid Of?" screen (next page). This screen presents six of the primary fears investors face and allows them to easily model the effects of these six factors on their financial plans.

The first of these fears is labeled "Great Recession Loss"

and it looks similar to what we just saw on the "Select Your Risk Score" screen. The difference is that here we get to select the exact level of loss we wish to model using the slider bar at the bottom of the screen.

The key to using this feature correctly is knowing what loss number to enter using the slider bar. To help you determine that, we've calculated the actual historical losses that would have been experienced by the various SMI strategies between November 2007-February 2009 and compiled them in Table 1 (page 131). In our earlier example, we saw that our hypothetical couple was using a 50/40/10 portfolio, with a 60/40 blend of Upgrading. Whereas the Risk Score screen indicated such a portfolio would have experienced a loss of -39%, Table 1 shows that portfolio would actually have lost a much milder -16%.

Using the slider bar to set the loss at -16, we see that the difference between those two loss levels makes a huge difference in the financial plan outcomes. Whereas a -39% loss would have knocked our couple's chances of meeting their "Needs Only" down to 26%, a loss of -16% keeps their "Needs Only" probability at 91% and their "Needs & Wants" solidly within the confidence zone at 79% (see below).

Conclusion/Application

Do we know that such a portfolio would only lose -16% again in the next bear market? Of course not. It could lose more, which we can model by sliding the bar further to the right (to say, 20%). But it's also possible such a portfolio could lose *less*—after all, the last bear market was unusually severe.

The beauty is MoneyGuidePro® gives you the ability to easily test a *range of outcomes*. Many people will run through this exercise, see the results, and want to tweak the portfolio mix (or other aspects) of their Recommended Scenario. This is easily done a few screens prior on the "Recommended Scenario" page (see the February & March articles for more details on this process).

The key is that by testing various portfolio combinations, return assumptions, and worst-case scenario "fears," you'll hopefully arrive at a combination that instills confidence that you can withstand the next bear market by simply sticking to your plan. Knowing that if you *persevere and follow the strategies as they're laid out*, you're likely to hit your financial goals will change everything regarding bear-market psychology. Without a plan, you would be tempted to think you need to take action in the midst of the bear market to save your financial future. But with a plan that has already modeled the bear market and survived intact, you can relax knowing that the only steps you need to take are those dictated by the strategies you've selected. That's investing with a Sound Mind! ◆

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

MOVING YOUR CAREER FORWARD THROUGH MENTORING

The biblical admonition to do your work "with all your heart, as working for the Lord" (Colossians 3:23) stands in stark contrast to many people's daily experience.

According to the latest in a long-running series of Gallup studies, only one-third of U.S. workers are "engaged"—that is, involved in, enthusiastic about, and committed to their work and workplace. That number has "barely budged" over the past 15 years. More than half (51%) of today's workers are not engaged ("indifferent") and another 16% are actively disengaged ("miserable in the workplace"). No wonder more than half of all workers are actively looking for another job or watching for openings.

Labor Day is an appropriate time to take stock of *your* career. If you're feeling less than engaged, mentoring—whether *being* mentored or *serving* as a mentor—might just breathe some new life into your work.

The elements of engagement

According to Gallup, engagement is a much more comprehensive concept than employee satisfaction or happiness. The organization measures 12 aspects of engagement, asking employees to indicate the degree to which various statements ring true for them, such as, "I know what is expected of me at work," "I have the materials and equipment I need to do my work right," and, "At work, my opinion seems to count."

Three of the 12 elements are about professional development:

- "There is someone at work who encourages my development" (only 3 in 10 employees strongly agreed with that statement).
- "In the last six months, someone at work has talked to me about my progress" (3 in 10 strongly agreed).
- "This last year, I have had opportunities at work to learn and grow" (4 in 10 strongly agreed).

The good that mentoring can do

Several times in its report, Gallup recommended mentoring as a way to foster stronger career engagement.

People often confuse mentoring with coaching, but there are important differences. A coach helps you focus on near-term tactical performance and skill development. For example, a sales coach might help you improve your prospecting or closing techniques. On the other hand, a mentor helps you focus on *longer-term strategic issues*, such as career management.

Ideally, mentoring is a two-way street, with benefits flowing to the person being mentored and the one doing the mentoring. For mentors, contributing to someone else's success may rekindle their passion for the work they do or remind them of why they were drawn to their field in the first place.

A mentoring short-course

If you've never had or been a mentor, Ken Blanchard's latest book provides a good framework. *One-Minute Mentoring*, co-written with author and speaker Claire Diaz-Ortiz, is a quick, inspiring, and beneficial read. Written as a parable, it teaches the essentials of mentoring.

To find a mentor, start with your HR department if your company has one. There may already be a mentoring program in place that has an established process for connecting mentors and mentees. If not, or if you work for a small company, think about some of the key qualities you're looking for in a mentor, such as personal values. Then think of people whose careers you admire—typically people who are farther along in their careers—who also embody those values.

A prospective mentor doesn't have to work at the same company where you work, nor does he or she have to work in your field. Think of past teachers or supervisors, people you've met through volunteer activities or professional associations, friends or even family members.

See if the person you identify would be willing to meet and discuss a possible mentoring relationship. Come to the meeting prepared to describe your current work situation, issues you're facing or decisions you're considering, and what you hope to glean from future conversations. Be especially attentive to how easily rapport is built. Is there is a natural connection between the two of you? Blanchard and Diaz-Ortiz call it *essence*. Is spending time together comfortable? Does conversation flow easily?

Anthony Tjan, CEO of a venture capital firm and author of the book, *Good People*, said the importance of rapport between mentor and mentee cannot be overstated. Writing in the *Harvard Business Review*, Tjan said, "Studies show that even the best-designed mentoring programs are no substitute for a genuine, intercollegial relationship between [mentor and mentee]." In fact, research conducted by Belle Rose Ragins, a mentoring expert and professor at the University of Wisconsin-Milwaukee, found that if there is *not* a good fit of personalities, there is no discernable career benefit derived by mentees when compared to those not mentored.

So, a first meeting between a prospective mentor and mentee should be largely about discerning if there is a good fit. If there is, it's time to move on to *form*, which is about the structure of the mentoring relationship—how often you'll meet (early in the relationship, weekly is best) and whether your meetings will take place in person, on the phone, or online (in person is ideal, at least in the beginning). If things come up between meetings, agree to keep the door open for additional contact, but also establish boundaries. *(continued on page 141)*

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 strategy is best for your situation.

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

THE IMPORTANCE OF BOUNDARIES

As investors, we are our own worst enemies. This observation stems not only from our decades of practical experience in the financial arena, but also is confirmed by Scripture. Given our fallen natures, it would be surprising if we *weren't* the primary problem we face when investing! Consider for a moment the kind of people we are: our wisdom is flawed (1 Corinthians 3:18-19); our motivations are impure (Jeremiah 17:9); our emotions can overpower us (Romans 7:18); and our vision into the future is limited (James 4:13-16).

As we renew our minds in God's word, we can begin to put proper boundaries in place that not only define our Christian priorities and values but *also will serve to protect us from the markets and ourselves.* The reason for having an individualized investment strategy is to provide these needed boundaries.

Having a specific strategy (or blend of strategies) in place helps *contain and focus* your impulses by providing boundaries. It boxes you in and takes away your freedom to do what you might want. But it offers a new kind of freedom—the freedom to do what you should. It gives you a sense of perspective and a new way of knowing what's "right" for you.

Here are four biblically based boundaries that we believe will enhance your investment effectiveness: (1) objective, mechanical criteria for decision making; (2) a portfolio that is broadly diversified; (3) a long-term, get-rich-slow perspective; and (4) a manager's (rather than owner's) mentality.

Let's look at how the first of these suggested boundaries can come into play in practical ways. Mechanical guidelines require that you develop objective criteria to follow when making buying and selling decisions. One example of this would be using the risk matrix (*Start Here* section of the SMI website) to select a specific mix of stocks and fixed-income investments for an Upgrading portfolio. The suggested allocations provide explicit, objective boundaries to help you diversify according to your risk tolerance and age. They help make your investment decision-making purposeful.

Another example of using mechanical boundaries involves the way SMI's Dynamic Asset Allocation strategy (DAA) shifts between asset classes. Rather than trying to discern how much of your portfolio should be invested in U.S. Stocks (or any of the other asset classes), you rely on the objective and time-tested process in DAA to make those determinations. This eliminates any "beliefs" you might have about what the market is likely to do next and puts your decision-making on a more reliable footing.

The type of mechanical decision-making that takes place in DAA can work in your favor by forcing you out of stocks after a long bull market (when the gains of recent years may make you reluctant to reduce your stock exposure), as well as by forcing you to *get back into* stocks after a bruising bear market. Many investors missed the big rebound in stocks from 2009-2013 because they were so battle-scarred from seeing stock prices cut in half during 2007-08. DAA would have forced investors back in early in the recovery, after limiting losses dramatically in the first place.

Mechanical guidelines can help you control your losses in other ways as well. When you buy a stock or fund that doesn't perform as you hope, it can be difficult emotionally to admit it didn't work out. People often hold on to weak companies for years hoping to sell when they can "get even." This is a form of denial; the loss has already taken place. This emotional trap can be avoided by a mechanical guideline that says, "I'll sell if it drops x% from where I bought it because if it gets that low, there's a strong probability I misjudged the situation."

Dollar-cost-averaging is a mechanical guideline that can help you know how much to invest and when.[1] The discipline imposed by this program is helpful because most people's judgment tends to be unduly influenced by current news events. There will always be bad news, but news is rarely as bad or good as it might first appear. These guidelines protect you from overreacting (along with everyone else) to the crisis or euphoria of the moment.

The markets go to extremes because they are driven by emotions, not reason. Also, professional money managers are afraid of getting left behind and looking bad (they want job security too, you know), so they go along with the crowd and panic like everyone else. *Mechanical guidelines help you harness the powerful emotions that often cause investors to do precisely the wrong thing at precisely the wrong time.* Mechanical rules may appear dull, but that's actually a virtue—the most successful market strategies tend to be dull because they are measured, not spontaneous. ◆

BOUNDARY	Using mechanical guidelines rather than your own intuition and judgment.	Building a broadly diversified portfolio to protect against the uncertainties of the future.	Developing a long-term, get-rich-slow perspective on growing your portfolio.	Accepting management responsibility which leads you to study the basics and seek counsel.
BIBLICAL RATIONALE	He who trusts in himself is a fool, but he who walks in wisdom is kept safe. (Proverbs 28:26)	Give portions to seven, yes to eight, for you do not know what disaster may come upon the land. (Ecclesiastes 11:2)	Dishonest money dwindles away, but he who gathers money little by little makes it grow. (Proverbs 13:11)	Every prudent man acts out of knowledge, but a fool exposes his folly. (Proverbs 13:16)

[1] April2016:p55

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

BITCOIN AND CRYPTOCURRENCIES: ARE THEY A PASSING FAD OR THE FUTURE OF FINANCE?

2017 has been a good year for stock-market investors thus far. But the gains seen in even the strongest stock market sectors have been no match for the performance of "bitcoin" and other "cryptocurrencies." The price of a single bitcoin has skyrocketed by more than 325% since the start of 2017 (as of late August). Bitcoin's total market capitalization—i.e., the price multiplied by the total number of bitcoins—has grown to more than $70 billion, putting the digital currency at roughly the same level of valuation as Caterpillar, Adobe, or Netflix.

Consider this: If you had invested $1,000 in bitcoin in 2010, it would be worth $55 million today—more or less.

Actually, "more or less" is a key consideration. On any given day, the value of a cryptocurrency can be *significantly* more or less. The digital-currency market is known for volatility. While the U.S. stock market has experienced one of its *least*-volatile runs for much of this year, hair-raising price swings in the world of cryptocurrencies have been commonplace.

During January, for example, bitcoin plummeted by 30% in a single week. But happier times were ahead. It zoomed up more than 50% during the first two weeks of August. And bitcoin seems tame in comparison with some of the other 800(!) digital currencies now in existence.

Bitcoin's chief rival is "ether" (sometimes referred to as Ethereum, but that is actually the *network* that runs ether transactions). By May, ether was up an almost unbelievable 3000% for the year. Then came a precipitous month-long decline that saw the cryptocurrency lose nearly half its value. But wait. Over the four weeks that followed, ether's price largely rebounded.

More than a mania?

Some observers are dismissing the cryptocurrency phenomenon as nothing more than a speculative mania—and certainly, there is a level of mania at work. After all, when an asset begins offering triple- or quadruple-digit gains, hordes of people—many dismissing the risks and caveats—rush to sign up.

"The American middle class is falling in love" with bitcoin, NBC News recently reported. The network noted that bitcoin buyers have expanded beyond high rollers and "techno-nerds" and now include bus drivers, flight attendants, ironworkers and other average-income people who may not "fully understand how bitcoin or its rivals work," but who have heard about big returns and "want a piece of the action."

That certainly has "mania" written all over it. But the cryptocurrency craze may be *more* than a mania, similar to the somewhat justifiable excitement surrounding the dot-com boom of the 1990s. Although that boom went bust, many now-familiar companies emerged from the rubble, including Amazon, eBay, and Google. Proponents argue that the cryptocurrency explosion could well be the early stages of a world-changing re-working of how money is created and how it flows.

Mining money

In contrast to "traditional" money created by governments via central banking systems, bitcoin and other cryptocurrencies are created in a *non*-centralized way using what is known as "blockchain" technology. The process involves "miners"—people all over the world who use computers (typically many computers strung together for greater computing power) to solve highly complex mathematical problems. Each time a problem is solved, the miner who solved it is rewarded with a newly created bit of cryptocurrency that can be used as a medium of exchange. ("Crypto" comes from the use of advanced cryptography that converts information into code to ensure security.)

This newly created money is rendered as an extremely large number in hexadecimal (i.e., base 16) format. These large numbers form the "blockchain"—entries in a secure, distributed transaction ledger not controlled by any centralized authority—that becomes the basis for all subsequent transactions and verifications. Although bitcoin and other cryptocurrencies often are represented pictorially (in news articles and on websites) as actual coins, they are not; they are entirely virtual.

Cool tech, but how useful?

The interesting technology aside, the question that looms large for cryptocurrencies is: "What are they good for?" Obviously, cryptocurrencies have a built-in appeal to those who want to move money and make transactions free from government oversight and control. But more-specific applications are largely potential, not actual.

One application that *is* taking hold is using cryptocurrency as a mechanism for crowdfunding. Startups are creating their own "digital coins" (sold in exchange for run-of-the-mill government-issued money) to finance a range of proposed products and services. This year, "initial coin offerings"—to fund everything from cloud computing projects to "smart contracts" development—have raised an estimated $1.3 billion. (It is this means of new business funding that explains most of the growth in the *number* of different cryptocurrencies.)

But even with all the attention the cryptocurrency marketplace is getting, it remains tiny in comparison with more traditional methods of conducting transactions and raising capital—and wider acceptance could still be a long way off. As asset manager and financial historian Zachary Karabell noted in a recent column for *Barron's*, the *(continued on page 141)*

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

CATCHING FIRE — WHAT TO MAKE OF THE EARLY-RETIREMENT MOVEMENT

An increasing number of millennials are focusing on FIRE—becoming **F**inancially **I**ndependent and **R**etiring **E**arly. No one knows the size of the growing FIRE movement, but the number of blogs and podcasts related to FIRE is expanding, with names such as The Mad Fientist, Physician on FIRE, Fiery Millennials, Abandoned Cubicle, A Life Less Conventional, ChooseFI, and (one of the earliest FIRE devotees and advocates) Mr. Money Mustache.

As the names suggest, followers of FIRE strategies tend to hide their identities online. But they share an abundance of financial details about pursuing the goal of retiring in their 40s—or even in their 30s. The Mad Fientist, a software developer who began his FIRE journey as recently as 2012, retired last year at age 33. Mr. Money Mustache, a former engineer, retired 12 years ago at age 30. (And, yes, he and his wife are raising a family.)

Although earning a good income (such as those made by software developers and engineers) makes it easier to achieve financial independence, the FIRE movement is less focused on high earnings than on low spending. FIRE is all about frugality. Followers of FIRE strategies are laser-like focused on living on half (or even less) of their income. What they don't spend, they save or invest.

Super savers

The conventional approach to retirement savings calls for investing 12%-15% of one's current income and then relying on rate-of-return and decades of compounding to do the rest. Ideally, when retirement time rolls around, the "ordinary" retiree will have a pool of money large enough to live on for the rest of his or her life.

But FIRE devotees, whose goal is to shave a few decades or more off their working years, can't wait for the passage of time to do its compounding work. And since rate-of-return is uncontrollable (and unknowable), followers of FIRE strategies step up their retirement set asides to the highest possible level. Rather than save 12%-15% of their earnings, they ramp up that figure to 50% or more.

Focusing on the goal

A commonly used definition of "financial independence" is amassing a nest egg equal to 25 times one's annual expenses. That means a FIRE follower with a $36,000-a-year lifestyle (i.e., $3,000 per month for living expenses) would achieve "FI" when he or she reaches $900,000 in retirement savings.

So, in theory (not taking into account salary increases and a rising cost of living), a worker netting $80,000 annually, living on $36,000 and saving the remaining $44,000, would reach financial independence in about 20 years—likely much sooner when investment earnings are accounted for. (The bull market that began in 2009 has been a boon to FIRE followers.)

As you might imagine, dedicating such a large portion of one's income for saving/investing demands a radical reduction in living expenses. Common FIRE approaches to keeping outlays at a minimum include living in modest housing (perhaps a fixer upper or small apartment), rarely eating out, taking low-cost camping vacations, and owning only one car (thus cutting both insurance and maintenance costs). Some FIRE followers have no automobile at all. These folks either work from home, or they find inexpensive housing close enough to work and shopping that they can walk, bike, or take public transportation.

Although FIRE is a relatively recent movement, its intellectual godfather may well be the famed investor Sir John Templeton, who during the first years of his career, saved (and invested) 50 cents of every dollar he earned. Templeton's investment prowess propelled him into the elite category of one of the world's richest men.

But many in the FIRE movement say they're not focused on getting rich. Instead, they simply want the freedom-of-lifestyle that comes from being able to live on passive (or portfolio) income rather than having to continue to "punch the clock" for decades on end.

World views in conflict?

A focus on living modestly and saving for the future is commendable, but Andrew Spencer of the Virginia-based Institute for Faith, Work & Economics worries that at least some FIRE devotees "see the cessation of work as a good in itself."

Indeed, many FIRE bloggers now working toward financial independence stress that the prospect of a life of leisure is a key motivation. In contrast, Spencer notes, Genesis 1:26-28 teaches that work is not some kind of "necessary evil" that we must endure. Instead, it is "a part of the creational design of this world."

Spencer also suggests that Jesus's Parable of the Rich Fool (found in Luke 12) should serve as cautionary tale for all who, in admiration of their own self-reliance, would say to themselves, "You have ample goods laid up for many years; relax, eat, drink, be merry."

A few FIRE advocates, however, argue that seeking financial independence is not necessarily about being self-focused. A person no longer driven by the demands of earning a salary can "start working for the benefit of other people," says the FIRE blogger Physician on FIRE. Further, he argues, being able to retire early and live on passive income gives FIRE followers the flexibility to be more involved caregivers for aging parents or grandparents. "Financial Independence gives you the irreplaceable ability *(continued on page 142)*

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 7/31/2017	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	40.1	18.7%	3.4%	7.1%	14.1%	18.9%	3.1%	1.17	0.11%	20%	16%	12%	8%	VXUS
Extended Market Index ETF	Small company stocks	25.6	8.5%	1.1%	2.7%	6.2%	16.7%	8.9%	1.25	0.08%	40%	32%	24%	16%	VXF
S&P 500 Index ETF	Large company stocks	29.6	11.4%	2.1%	4.2%	9.5%	16.0%	10.8%	1.00	0.04%	40%	32%	24%	16%	VOO
Total Bond Mkt Index ETF	Medium-term bonds	3.0	2.8%	0.4%	1.2%	2.6%	-0.7%	2.7%	1.02	0.05%	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 7/31/2017[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. ☎ Vanguard Intl Growth	09/17	Yes	Yes	Yes	61.4	30.8%	5.4%	11.4%	22.0%	28.1%	7.4%	1.41	0.46	136	None	VWIGX
	2. Oakmark International	12/16	NTF	NTF	NTF	59.8	21.9%	5.0%	6.8%	17.1%	36.0%	6.5%	1.51	1.00	85	None	OAKIX
	3. Selected International S	06/17	NTF	NTF	NTF	58.2	28.4%	5.9%	9.3%	22.7%	26.3%	6.1%	1.48	1.30	40	2%30days	SLSSX
Category 4 Small/Growth	1. Baron Discovery	04/17	NTF	NTF	NTF	64.5	25.3%	0.6%	9.3%	21.7%	33.5%	12.6%	1.64	1.35	61	None	BDFFX
	2. Oberweis Micro Cap	11/15	NTF	NTF	NTF	46.9	14.4%	1.8%	5.7%	12.2%	29.0%	15.2%	1.34	1.65	91	1%90days	OBMCX
	3. Wm Blair Small Cap Grow	05/17	NTF	NTF	NTF	41.4	15.1%	-0.3%	4.7%	13.7%	23.0%	11.1%	1.38	1.50	87	None	WBSNX
Category 3 Small/Value	1. AllianzGI NFJ Mid-Cap Val	06/17	No	NTF	NTF	50.3	16.8%	0.8%	9.3%	13.8%	27.1%	10.8%	1.13	1.30	101	None	PQNAX
	2. ☎ Fidelity Low-Priced Stock	09/17	Yes	NTF	Yes	27.6	9.9%	2.0%	3.8%	8.6%	15.2%	7.5%	0.89	0.88	909	None	FLPSX
	3. Royce Opportunity	06/17	NTF	NTF	NTF	39.4	9.3%	1.2%	3.2%	8.3%	27.8%	7.9%	1.64	1.49	247	1%30days	RYOFX
Category 2 Large/Growth	1. Fidelity OTC	06/17	Yes	NTF	Yes	56.7	26.8%	2.7%	8.7%	20.0%	28.0%	17.2%	1.50	0.91	230	None	FOCPX
	2. Guggenheim S&P 500 Tech	04/17	ETF	ETF	ETF	50.0	19.8%	3.7%	5.5%	14.7%	29.9%	17.3%	1.39	0.40	69	None	RYT
	3. Baron Partners	05/17	NTF	NTF	NTF	52.1	27.5%	-0.7%	5.9%	20.7%	25.6%	11.1%	1.61	1.35	26	None	BPTRX
Category 1 Large/Value	1. Toreador Core	05/17	NTF	NTF	NTF	29.4	8.9%	1.6%	1.7%	6.3%	21.5%	8.0%	1.20	1.20	77	2%60days	TORLX
	2. Dodge & Cox Stock	12/16	Yes	Yes	Yes	33.8	8.7%	1.8%	3.2%	6.3%	24.3%	9.5%	1.24	0.52	68	None	DODGX
	3. Miller Opportunity	06/17	Yes[10]	Yes[10]	NTF	69.0	20.5%	0.4%	11.9%	20.5%	36.7%	9.4%	2.14	1.36	35	None	LGOAX[10]
Bond Categories	Vanguard I-T Bond Index[6]	07/17	ETF	ETF	ETF	3.4	3.5%	0.6%	1.2%	3.2%	-1.0%	3.3%	1.31	0.07	6.5[7]	None	BIV[8]
	Vanguard I-T Bond Index	01/15	ETF	ETF	ETF	3.4	3.5%	0.6%	1.2%	3.2%	-1.0%	3.3%	1.31	0.07	6.5[7]	None	BIV[8]
	Vanguard S-T Bond Index	07/12	ETF	ETF	ETF	1.9	1.5%	0.4%	0.5%	1.2%	0.2%	1.5%	0.44	0.07	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 late-August, 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. **[10]** At some brokers, the load-waived share class is LMNOX. Read the fund writeup (June:p93) before purchasing.

☎ 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 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 is Vanguard International Growth, the highest-rated Cat. 4 fund available is Baron Discovery, 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%

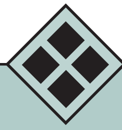
❸ BUY YOUR FUNDS

Example uses an 80/20 mix between stocks and bonds		Dollars	Invest In Funds
Stock Cat. 5: Foreign	16%	$8,000	Vanguard Intl Growth
Stock Cat. 4: Small/Growth	16%	$8,000	Baron Discovery
Stock Cat. 3: Small/Value	16%	$8,000	AllianzGI NFJ Mid-Cap Value
Stock Cat. 2: Large/Growth	16%	$8,000	Fidelity OTC
Stock Cat. 1: Large/Value	16%	$8,000	Toreador Core
"Rotating" Bond Fund	10%	$5,000	Vanguard I.T. Bond Index
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 in each risk category that is 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, Longleaf Partners International (LLINX, 9/2016) is being replaced.$** Longleaf has been an excellent holding for us, both in absolute and relative terms. Recommended last September, the fund has gained +21.1% over the past year (through 8/24), an outstanding one-year return. Morningstar divides the foreign-fund universe into six smaller groups (which SMI consolidates into a single foreign- risk category), but Longleaf's return compares favorably to the average returns of all six groups, which range between 15.1%-19.4%. In recent months, however, Longleaf has struggled to keep pace with the other foreign funds, which has resulted in it slipping down the momentum rankings and require it to be replaced.

SMI members investing in Longleaf through a taxable account will want to pay especially close attention to their exact buy/sell dates. Holding the fund longer than one calendar year enables taxable accounts to take advantage of the lower long-term capital-gains tax rates. With a significant gain in the fund over the past year, that could substantially reduce the total tax owed. Investors using a tax-advantaged account, such as a 401(k) or IRA, don't need to pay attention to this one-year holding period.

• **Vanguard International Growth (VWIGX) is being added.[1]** SMI has a long history with Vanguard International Growth, having used it for the better part of two decades as the international component of our Just-the-Basics strategy (before switching to an all-index-fund lineup several years ago). The fund has changed some over the years though.

To understand this, it's important to know how Vanguard typically manages its active (i.e., non-index) funds. Vanguard frequently hires multiple sub-advisors to manage individual "sleeves" of a particular fund independently. So in the case of Vanguard International, three different managers each ran part of the fund until recently. It's one way that Vanguard can allow its funds to get so large—this International Growth Fund has nearly $30 billion in assets.

Just over a year ago, Vanguard dropped one of the subadvisors, going from three down to two. The one that was dropped managed the smallest share of the fund, but was also the most valuation-conscious. The two remaining advisors are a bit more aggressive, so with this change, the overall risk profile of the fund has gone up.

This has served the fund well over the past year. One would expect it to perform well in the recent environment, given the heavy outperformance of growth generally and the strong returns of global stocks. But the higher growth profile also comes with greater downside risk: when the market eventually turns lower, Vanguard International Growth may not hold up as well as it has in the past.

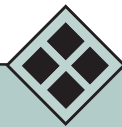
◆ **In the Small/Value group, AMG Fairpointe MidCap (CHTTX, 3/2017) is being replaced.** Growth stocks have outperformed value stocks in a dramatic fashion so far in 2017. Through August 24, the average small/value fund tracked by Morningstar had *lost* -3.0% year-to-date, while the average small/growth fund had *gained* +8.2%. With such a stark difference between the two investment styles, it stands to reason that those funds classified as value but with hints of growth methodology hidden in their process would have had an advantage. Unfortunately, AMG Fairpointe MidCap is more of a true value fund, so it has lagged. In the first five months we owned it, the fund gained only +0.2%. The average small/value fund gained +1.8%, so it's not as if we trailed by much there, but it does mean the fund has slipped down the rankings and is due to be replaced.

• **Fidelity Low-Priced Stock (FLPSX) is being added.[1]** The 1980s and 1990s were the era of the superstar fund manager. Managers such as Peter Lynch were, if not household names, at least well recognized by most investors. These days, that type of manager name recognition is rare, and few investors can name even a single fund manager. But that doesn't mean there aren't still some stars working their magic despite the lack of fanfare. Fidelity Low-Priced Stock's Joel Tillinghast is one such star, having outperformed his fund's Russell 2000 benchmark by more than 4% annually since his 1989 debut. Four percent may not seem like a huge margin of victory, but compounded over nearly three decades it results in a huge advantage over the market!

The fund's unusual name derives from its rule of only buying stocks currently priced at $35 per share or less. It's an odd rule, initially designed to focus the fund on small stocks. These days, with over $38 billion in assets, the fund has to cast a wide net to hold to that limitation, which it does with a portfolio of more than 800 stocks and nearly 40% of that in overseas stocks (almost enough to place the fund in Morningstar's "world" category). But Tillinghast continues to make it work, helped by the fact that he can work his way up the company-size ladder into "mid-cap" territory (as well as the fact that stocks can *appreciate* to over $35 in price and still be held, they just aren't *purchased* above that price point).

This fund does have a greater growth focus than many in the small/value camp. That more growth-oriented approach, coupled with strong performance in international stocks, have provided tailwinds to the fund's rise up the performance rank-

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



ings this year. There's a lot to like about this fund: a proven process, long-time manager, and strong returns—recently and over the long-term. Hopefully, those factors will bode well for this new recommended fund. ◆

LEVEL 1 / CONTINUED FROM PAGE 134:

MOVING YOUR CAREER FORWARD THROUGH MENTORING

Next, develop a mission statement that describes the purpose of the mentoring relationship from both of your perspectives. If you're the mentee, it might be about being more intentional about managing your long-term career path, or even discerning whether your current work is the best fit for you. If you're the mentor, it might be about regaining some passion for the work you've been doing for a long time or discovering your own next career steps.

It can be helpful for both parties to keep a journal. Write down the mission statement and then record specific goals, concerns, needs, questions, and signs of progress.

One of the greatest benefits a mentor can bring to a mentee is his or her network, but the mentee's network might prove helpful to the mentor as well. Both parties should agree not to misuse any introductions made by the other, such as a mentee treating a mentor's contacts as a sales prospecting list.

Some mentors and mentees stay in touch for decades, with mentors continuing to serve as sounding boards when various career issues emerge. Others mutually decide when their relationship has fulfilled its purpose. There is no one-size-fits-all formula for how long the relationship should last.

Quantifying the impact of mentoring

Sun Microsystems is one of many companies that has invested in the development of a formal mentoring program, and its analysis of the program's benefits shows it to be an effective career development tool. After tracking the five-year progress of about 1,000 employees—a mix of people who had participated in the program and those who had not—Sun found that employees who had received mentoring were promoted five times as often as those without mentors, and those who had served as mentors were six times as likely to be promoted than those who had not.

As you consider entering into a mentoring relationship, keep in mind the words from Ecclesiastes 4:9-10: "Two are better than one, because they have a good return for their labor: If either of them falls down, one can help the other up. But pity anyone who falls and has no one to help them up." ◆

LEVEL 3 / CONTINUED FROM PAGE 136:

BITCOIN AND CRYPTOCURRENCIES: ARE THEY A PASSING FAD OR THE FUTURE OF FINANCE?

introduction of a medium of exchange isn't easy. Early on, U.S. paper money, even when backed by silver or gold, "suffered from extreme valuation, volatility, and ubiquitous public skepticism," he wrote. Although that skepticism finally faded, it recurred when the gold standard ended. "The beginning of the fiat currency era in the mid-20th century still makes some traditionalists in financial markets nervous," Karabell noted. "[S]o it should hardly be a surprise that bitcoin, barely a decade old, has not convinced many of its value."

Despite the naysayers, one notable figure who is willing to be convinced is Abigail Johnson, chief executive officer of Fidelity Investments. In August, Fidelity—in a move that likely boosted the fortunes of bitcoin and other cryptocurrencies—began allowing clients to monitor their digital-currency holdings via their Fidelity accounts.

"I like to think huge new markets and products will be built on these [cryptocurrency] platforms," Johnson said at a May conference sponsored by the virtual-currency site CoinDesk. However, if cryptocurrencies are to achieve widespread adoption, a few obstacles must be overcome. These include an uncertain regulatory environment (how will securities and tax authorities try to regulate cryptocurrencies?), plus the lack of a "formalized management structure" inherent in a decentralized system. The Fidelity chief also cited what she called "the human problem"—namely that most people simply won't use technologies that have "few obvious applications in their daily life."

A July report from financial-services company Morgan Stanley echoed Johnson's point about marketplace acceptance—or a lack thereof. The report noted that bitcoin—though it is the oldest and most-established cryptocurrency—is accepted by only three of the top 500 online merchants. Morgan Stanley also pointed out that speculation is holding back the potential of bitcoin and other cryptocurrencies as mediums of exchange: Why make a purchase with a cryptocurrency today, so the thinking goes, if its asset value could be significantly higher tomorrow?

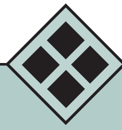
How to buy (and, more importantly, should you?)

Although the digital-currency market remains erratic, the process for investing in a cryptocurrency is relatively smooth—especially if you buy via an online exchange such as coinbase.com (founded in 2012). Coinbase offers bitcoin, ether, and a third cryptocurrency called litecoin.

On the site (or using Coinbase's mobile app), simply enter your email address, then follow the sign-up prompts. Purchases can be made via bank transfer, or by using a credit or debit card. (Don't be surprised if you get an almost immediate fraud-prevention call from your bank or card issuer making sure that it's really you making the transaction.)

After you buy, your cryptocurrency will need to be stored in a "digital wallet" (this wallet contains the digital keys necessary to access your holdings). Coinbase is a "hosted" wallet service, i.e., your wallet will reside on their servers (similar to having your important documents and photos stored "in the cloud.") Some buyers of cryptocurrency, however, prefer to use a private wallet—one that exists on a personal computer, smartphone, or external hard drive.

Keeping virtual currency safely locked away is a key con-



MONEYTALK

cern. In 2014, hackers attacked the now-defunct Mt. Gox exchange and stole $460 million in bitcoin. More recently, some cryptocurrency investors have suffered heavy losses after their cellphone numbers were hacked. "Once they get control of the phone number, [hackers] can reset the passwords on every account that uses the phone number as a security backup," reports *The New York Times*. Within minutes of getting control of investor Chris Burniske's phone last year, "his attackers had changed the password on his virtual currency wallet and drained the contents—some $150,000 at today's values," according to the Times' story.

All cryptocurrency transactions are irresversible—which has implications not only for security but also for the level of caution needed when buying digital currency. If you're going to invest, it's probably best to take only small steps at first. Familiarize yourself with various currencies, open an account at an exchange, then make only a modest initial purchase. Once you're acquainted with how things work, you can make additional purchases if you wish to.

Most importantly, keep in mind the always-present relationship between risk and return. *Investing in cryptocurrencies is a highly risky, speculative undertaking*—not the sort of investment that SMI encourages. Much like the dot-com boom of a couple decades ago, there may be some big winners that eventually emerge as long-term, viable investments, but it's also possible that many or even all of these cryptocurrencies wind up worthless. So don't risk money you can't afford to lose. ◆

LEVEL 4 / CONTINUED FROM PAGE 137:

CATCHING FIRE — WHAT TO MAKE OF THE EARLY-RETIREMENT MOVEMENT

to be with loved ones in a time of need."

Other considerations

The prospect of being able to leave the paid workforce (or perhaps cut back to part-time) and live on one's savings and investments is enticing, but as with any significant lifestyle change, there are likely to be unintended consequences.

Although we're not aware of any SMI members who have followed a defined FIRE strategy in pursuit of financial independence, we do have members who've amassed enough financial resources to be able to retire early. One reader told us that after retiring in his early 50s, he soon began missing the daily interaction with co-workers and "the opportunity of sharing Christ with those folks."

Another SMI member, who sold his business and retired at age 50 following a back injury, found early retirement to be unfulfilling. "The first few years I tried RV traveling, fishing, sightseeing and all the other activities that 'happily retired folks' are supposed to do and enjoy," he says. "I hated every day of this 'retired' life." Eventually, after God miraculously healed his back, he resumed working. "I realized I loved my job."

The Mad Fientist, a well-known FIRE blogger who retired last year at age 33, recently posted about his first year of retirement. "This is a great position to be in, but losing your main source of motivation"—i.e., his focus on wealth-building in pursuit of early retirement—"is incredibly disorienting," he wrote. "I've had to reevaluate my entire life and all my plans while simultaneously finding a new source of motivation."

In addition to unexpected quality-of-life consequences, retiring early can have unanticipated *financial* ramifications. Retirement savings can't be withdrawn from tax-advantaged accounts without penalty until age 59½, so FIRE followers could sacrifice a substantial portion of their retirement savings if they need to access those funds early. (One option for avoiding a penalty is to pursue a withdrawal method known as a "72t distribution" requiring "substantially equal periodic payments" as calculated by using IRS guidelines.)

Retiring early also will affect Social Security benefits. "Social Security [has] higher benefits for those who work for more years," notes financial planner Michael Kitces. "As a result, benefits are...much higher for those with a full working career."

The FIRE blogger known as Root of Good retired at age 33. He argues that—at least for him—working until his full retirement age of 67 in pursuit of a higher Social Security benefit wasn't worth it. "That would be 34 additional years of work," he notes, "and all I would get is slightly more than double the benefit I qualify for right now,"—an increase from $1,036 per month to $2,248 per month. "It would be pure insanity to work another 34 years just to double my SS benefit."

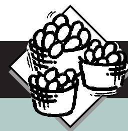
FIRE advocates also are quick to point to a substantial tax-related *perk* of retiring early: reduced income taxes. Taxes drop substantially for those no longer working to earn an income, or who move to working only part-time.

Get FIRE'd up?

If you're thinking about pursuing a FIRE strategy—or perhaps have more modest ambitions about retiring early—give careful thought to these questions:

- Do you see quitting work as a good in itself, or as a means to increase your availability to God and to others?
- How do you plan to guard against an attitude of self-reliance that could crowd out God-reliance?
- Where does generosity fit into the picture? (Can you live on a smaller portion of your income, vigorously ramp up your retirement savings, and still give generously?)
- Are you willing to sustain a radically frugal lifestyle over many decades—not only while working toward financial independence but afterward? (For your FIRE nest egg to last, you'll need to live on roughly the same level of expenses you had before retiring.)
- If you're married, are you and your spouse of one mind about pursuing FIRE?
- If you have children, is it realistic to try to live on 50 percent or less of your income?

Prayerful consideration of these questions will help you decide if pursuing the goal of "Financially Independent, Retiring Early" is for you. ◆



PREMIUM STRATEGIES

The strategies described below are available to those with an SMI Premium web membership. These strategies can be used in combination with—or in place of—our Just-the Basics and Upgrading portfolios. They 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

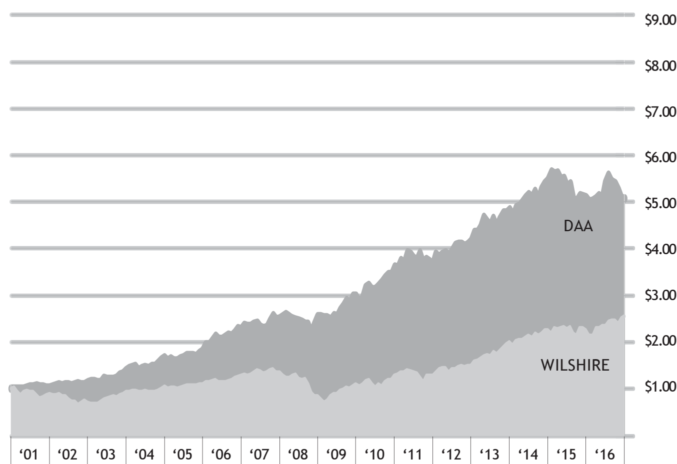
Overview

This is a stand-alone strategy that can be used in combination with (or in place of) SMI's basic strategies. DAA 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, but 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 Jan 2001 - Dec 2016



Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Avg[1]	Worst12[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%	-0.5%	10.7%	-13.7%	0.64
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%	13.4%	6.1%	-43.3%	1.00

SECTOR ROTATION

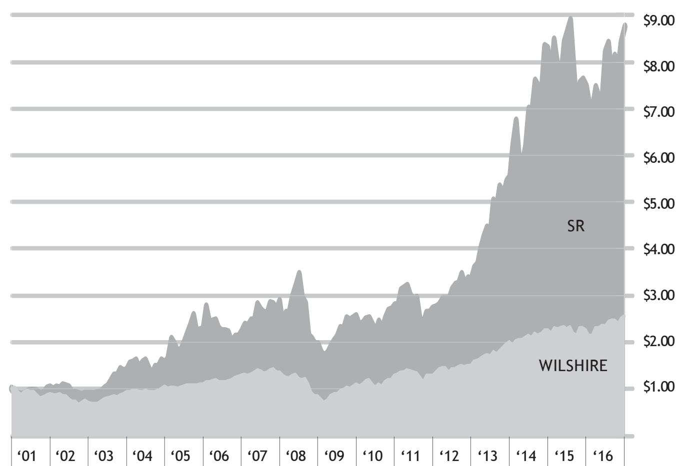
Overview

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 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 Jan 2001 - Dec 2016

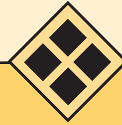


Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Avg[1]	Worst12[1]	Rel Risk[1]
Sector Rotation	3.7%	-13.1%	54.4%	12.6%	46.1%	-1.9%	28.1%	-31.5%	30.5%	9.1%	-3.2%	23.3%	65.7%	49.9%	-9.7%	16.8%	14.5%	-38.6%	1.66
Wilshire 5000	-11.0%	-20.9%	31.6%	12.5%	6.4%	15.8%	5.6%	-37.2%	28.3%	17.2%	1.0%	16.1%	33.1%	12.7%	0.7%	13.4%	6.1%	-43.3%	1.00

[1]The three data points on the far right in each of the two tables are for the Jan2001-Dec2016 period. "Avg" represents the average annualized return from 2001-2016. "Worst12" represents the worst investor experience over 169 rolling 12-month periods from 2001-2016.

PERIODICALS POSTAGE
PAID AT LOUISVILLE, KENTUCKY

Dated Investment Material
Please Do Not Delay!



PERFORMANCE DATA

SOUND MIND INVESTING MODEL PORTFOLIOS • DATA THROUGH JULY 31, 2017

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]	10.8%	1.9%	3.8%	16.2%	10.7%	14.8%	7.9%	9.6%
Just-the-Basics[2]	11.7%	2.0%	4.2%	17.0%	8.6%	13.6%	7.0%	9.7%
Stock Upgrading[3]	9.7%	1.8%	4.1%	15.4%	7.7%	13.1%	6.6%	10.7%
U.S. Bond Market[4]	2.8%	0.4%	1.1%	-0.8%	2.5%	1.8%	4.3%	4.3%
Bond Upgrading[5]	2.3%	0.6%	1.0%	0.5%	2.9%	3.3%	6.8%	6.8%

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]	9.8%	1.8%	2.9%	-0.3%	3.0%	6.5%	9.2%	11.6%
Sector Rotation[7]	21.8%	7.0%	10.5%	26.9%	15.4%	27.1%	15.1%	17.8%
50-40-10 Blend[8]	10.9%	2.3%	4.1%	8.5%	6.3%	11.3%	9.2%	12.3%

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.

THE SOUND MIND INVESTING MUTUAL FUND (SMIFX)

Current Returns as of 7/31/2017	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	8.71%	2.42%	3.94%	12.63%	5.42%	11.21%	5.33%
Wilshire 5000	10.78%	1.88%	3.80%	16.22%	10.71%	14.80%	7.86%
S&P 500	11.59%	2.06%	4.14%	16.04%	10.87%	14.78%	7.74%

Quarterly Returns as of 6/30/2017	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	6.14%	0.70%	2.93%	13.53%	3.59%	10.72%	4.91%
Wilshire 5000	8.74%	0.87%	2.95%	18.55%	9.34%	14.61%	7.29%
S&P 500	9.34%	0.62%	3.09%	17.90%	9.61%	14.63%	7.18%

Total/Gross expense ratio: 1.97% as of 2/28/17 (includes expenses of underlying funds)
Adjusted expense ratio: 1.15% as of 2/28/17 (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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