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SMI's Fund Upgrading Strategy Evolves: Introducing Upgrading 2.0

The lack of true downside protection has long been a concern for those using SMI's Fund Upgrading strategy. Fortunately, recent developments in the study of momentum have laid the foundation for a new defensive protocol that provides a "safety net" for Upgrading. This new "2.0" protocol gives us confidence that Upgrading will be up to the task of defending member portfolios during the next bear market.

by Austin Pryor and Mark Biller

SMI's Fund Upgrading strategy, which uses a concept known as "performance momentum" to make investment recommendations, has been part of the SMI newsletter in some form or fashion from its earliest days in 1990. By the late 1990s, Upgrading had settled into roughly the form used today. In the years since, the only significant change to Upgrading, at least on the stock-fund side, has been the switch from recommending four funds in each risk category to only three (in April 2015).

In the meantime, academic and industry research on the momentum principles on which Upgrading is based has been anything but idle. In fact, momentum has been one of the most heavily researched investing topics for several decades now. This is largely due to its status as "the premier market anomaly." Momentum is an easily observable exception to the conventional wisdom that stock market prices are set by such an efficient process that it's difficult—if not impossible—for investors to outperform the market over time.

That "premier anomaly" label was attached by none other than Eugene Fama, who won a Nobel prize for his work on the Efficient Market Hypothesis. As the name implies, his life's work has been explaining why factors such as momentum *shouldn't* work. Yet just this past year, Fama conceded, "Momentum is a big embarrassment for market efficiency."

Because momentum has been such a persistent thumb in the eye of the indexing/efficient markets community, researchers have undertaken many studies of momentum. Actually, the earliest such research dates back nearly a century, but up until about a decade ago, most of the research focused on variations of *relative momentum*—i.e., how an investment has performed relative to others. This relative-momentum analysis is the type SMI has always used in SMI's Upgrading strategy, and is reflected in our monthly *Fund Performance Rankings* report.

While the research studies on relative momentum affirmed its robustness and effectiveness, it wasn't until somewhat recently that a new momentum idea emerged. This was the study of how an investment performed, not against other investments, but *against its own past*. This second type of momentum is referred to as *absolute momentum*. Relative momentum asks the question: "In recent months, how has this investment performed compared to others?" But this newer momentum measure asks the question: "In recent months, how has *(continued on page 3)*

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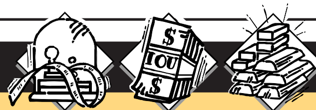

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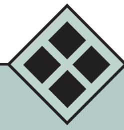
"FOR GOD HAS NOT GIVEN US THE SPIRIT OF FEAR BUT OF POWER, AND OF LOVE, AND OF A SOUND MIND."



EDITORIAL

What's on Your "To-Be" List for the New Year?

New Year's resolutions usually are focused on what to do in the year ahead, such as losing weight or getting out of debt.

However, of the many sermons I've heard since becoming a Christian at age 29, one that's stayed with me is a New Year's message from Lee Strobel, who was then a teaching pastor at Willow Creek Community Church near Chicago. Instead of thinking only about what we plan *to do* in the year ahead, he suggested thinking about *who we're going to be*. He explained that who we are dictates all that we do.

As Scripture cautions us, our words come from what's in our heart, as do our actions: "A good man brings good things out of the good stored up in his heart, and an evil man brings evil things out of the evil stored up in his heart. For the mouth speaks what the heart is full of" (Luke 6:45).

In other words, what we say and do flow out of who we are. This insight goes a long way toward explaining one of the greatest financial ironies: Even though there is no end to the amount of readily available free information about how to manage money, there is also no end to the number of people who struggle with financial issues.

Clearly, we need more than information about *what to do* with money. As Christians, we need to consider the beliefs and convictions that make us who we are, and allow them to be the primary determinants of what we do.

It's a point brothers Chip and Dan Heath make in their 2010 book, *Switch*. They present a scenario in which a scientist is approached about consulting for a pharmaceutical company. The offer is tempting because of its financial rewards. However, when he stops to consider the question, "What would a scientist like me do in a situation like this?" it gives him pause, raising concerns about what strings might be attached and what compromises he may have to make to please the client.

As we go about planning for the New Year, we would be wise to consider, "What would a Christian like me do?"

The starting point of a conversation about our identity is to consider who we are in God's eyes: "Yet to all who did receive him, to those who believed in his name, he gave the right to become *children of God*" (John 1:12, emphasis added).

That stunning reality, that the God of the universe considers you and me to be his children, leads to questions about how a child of God is to live.

Early in my journey of faith, The Parable of the Talents (Matt. 25:14-30) opened my eyes to my place in the world. For the first time, I understood God's ownership of everything and my role as a manager of everything He has entrusted to me—not just money and material things, but relationships, opportunities, and more.

Everything we have–our spouse, children, job, resources—has been temporarily entrusted to our care. For me, that was a completely new way of thinking.

One day the Master will return and take account of what we did with all that He entrusted to us, so it would be helpful to live each day asking, "What would a child of God do in a situation like this? And in this one? And this?" Fortunately, His Word gives us direction in each of our areas of responsibility. Here are a few examples.

As a husband, I am both convicted and motivated by the question, "How can I love my wife sacrificially and unconditionally (Eph. 5:21-33)?"

As a father, "How can I help teach our children (Deut. 6:5-9, Prov. 22:6), discipline them (Prov. 13:24), and not frustrate them (Eph. 6:4)?"

As an employee, "How can I work every day 'as working for the Lord' (Col. 3:23)?"

As someone with financial resources, "How can I daily acknowledge the Source of my income (Deut. 8:18), faithfully grow in generosity (2 Cor. 9:10), save adequately (Prov. 21:20), invest patiently (Prov. 21:5), make God-honoring spending decisions (Luke 16:10-11), and avoid materialism (Luke 12:15)?"

At first glance, all this *being* may seem to point toward a whole lot of *doing*. For me, though, it comes down to just one action item. Instead of my typical routine of starting my day catching up on the news, I plan to start each day cultivating my relationship with Jesus through time reading and meditating on His word and an extended time of prayer. I want my words and actions to flow out of who I am: A child of God.

So, to paraphrase Thoreau, instead of starting each day with *The Times*, I'm going to start with "the eternities." What plans do you sense God calling you to make for 2018?

MATT BELL
MANAGING EDITOR

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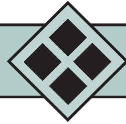
F E A T U R E  A R T I C L E

SMI's Fund Upgrading Strategy Evolves: Introducing Upgrading 2.0

(continued from front page)

the investment performed in an absolute sense, looking at its own history, ignoring what others have done?"

Multiple studies have confirmed that asking this question can lead to profitable investing choices going forward, but credit for popularizing absolute momentum belongs to Gary Antonacci, who detailed it extensively in his award-winning book, *Dual Momentum Investing*. In addition to compiling the results of all the research done on absolute momentum, much of it his own, Antonacci also took the crucial step of marrying the two forms of momentum—relative and absolute—into a simple investment strategy that readers of his book could apply easily. The backtested results of this approach were surprisingly good, despite the approach being extremely simple.

In a nutshell, while Antonacci demonstrated what SMI Upgraders have long known, that relative momentum can be a powerful return enhancer, he added a critical new dimension as well: showing how applying absolute momentum criteria could limit downside loss significantly.

Improving on SMI's "Bear Alert"

Since Antonacci's book came out in 2014, SMI has been working on how we might apply this new information to our Stock Upgrading strategy. This research has been through many iterations in our quest to strike the best balance of simplicity and effectiveness. The result of this research is our new "Upgrading 2.0" being introduced this month.

To set the stage for this new Upgrading approach, it's helpful first to back up and look at how SMI has addressed the issue of downside risk within Upgrading in the past. The Upgrading strategy has some risk mitigation built into it through the normal process of rotating from aggressive funds into more conservative ones as conditions change. While helpful, this alone is unable to provide sufficient protection to an investor during deep bear markets.

In an attempt to bolster our ability to handle downside risk and bear markets, SMI created a "Bear Alert" indicator following the 2000-2002 bear market. In the years since, the guidelines regarding how to best implement the Bear Alert within Stock Upgrading have been modified a few times. While the Bear Alert has been helpful (certainly during the 2008 financial crisis), it has raised questions among many SMI members as to how best to use it. Additionally, the Alert yielded some false signals along the way (2010 and 2011).

Upgrading 2.0 improves on the quality and accuracy of the Bear Alert signals, while also bringing that risk management function *into the Upgrading strategy itself*. This is a key point in terms of ease of use: Upgraders will no longer need to monitor a second signal, external to Upgrading, and decide how (or if) to apply it to their holdings. With Upgrading 2.0, SMI members will be able to simply follow the monthly fund replacement signals as they always have; however, they'll now have a robust risk-management system running in the background (as *part* of the Upgrading strategy) looking for signs of trouble.

Applying absolute momentum to Stock Upgrading

This means that when the defensive aspects of absolute momentum kick in for Stock Upgrading, the actions we'll take will function completely within the context of normal Upgrading. As before, you'll check to see which funds, if any, are to be sold, but instead of switching immediately into another stock fund, the proceeds from any sold funds will be held in cash.

Behind the scenes, SMI will be running all the normal *relative* momentum calculations we always have, identifying funds to buy and sell based on their recent performance compared to others in their risk category. But now we'll also be running some new processes that tell us when to start looking at the *absolute* momentum of each fund in our universe. At a certain point in a weakening market, these absolute momentum screens will tell us we're better off *not* owning certain stock funds. As that happens, the recommended-fund "slots" increasingly will suggest holding money in cash instead.

This however, is the rare exception, not the rule. In fact, we've purposely designed Upgrading 2.0 to kick in *only when the risk of significant declines has measurably increased*. As long-term readers would expect, there's no predictive element to this—it requires certain signals that show market deterioration is *already under way* in order for these new defensive protocols to trigger. You'll never see cash recommendations within Upgrading when the market is near all-time highs, as it is today. Only when the market has begun to fall and passes certain "tripwires" will the protocol kick in and open the door to absolute momentum to start gradually shifting some of our Upgrading holdings to cash.

Break glass only in emergency

This is an important point to understand: Upgrading 2.0 is designed to turn on *infrequently*, during only the most significant bear markets. We have built it using criteria and settings that shouldn't prompt defensive actions during "run of the mill" market corrections.

The pair of market corrections in late 2015 and early 2016 provide a helpful example. To review that period, the market fell roughly -12% on two separate occasions within a seven month period. The popular stock-market indexes, such as the S&P 500, first lost -12% in August of 2015. While those large-company dominated indexes gained back all of those losses by October, small-company stocks rebounded only mildly before plummeting again in January 2016. For the large-company dominated indexes, the events looked like a pair of -12% corrections. But those invested in small-company stocks experienced a mild bear market with losses exceeding -20%.

Our testing of Upgrading 2.0 showed it would have ignored the August 2015 episode entirely, and started taking only mild defensive steps when the second leg of the downturn was reaching its climax in early 2016. In that 2016 instance, each of Stock Upgrading's risk categories had one fund turn to cash in February, and a second turn in March. By April, all of Upgrading's slots were back invested in normal stock funds.

In hindsight, it would have been ideal for our defensive measures to have not turned on at all in this case. The correc-

tion ended in mid-February, so our defensive measures ultimately caused Upgrading 2.0's backtested 2016 performance to decline slightly. But given the depth of the losses in small-company stocks at that time, it was appropriate to start taking measured defensive steps.

Perhaps most importantly, outside of 2000-2002 and 2008-2009, the two major bear market periods when we surely would have wanted defensive measures to activate, *this two month period in 2016 was the only "false signal" or whipsaw in the 20 years of testing we did.* While this is obviously no guarantee against whipsaws in the future, it's an encouraging sign.

The idea of not trying to protect against 10%-15% declines may seem strange to newer readers. Wouldn't we want to protect against *any* downturns? It's important to understand there is always a tradeoff involved in any attempt to reduce market risk. Is the potential benefit greater than the potential cost? Protecting against market risk requires taking some sort of defensive measures. If the market moves higher rather than lower once those defensive measures have been put in place, performance will suffer (as it would have in early 2016 had Upgrading 2.0 been active).

Stock-market declines of 10%-15% have been common historically, occurring every one to two years on average. We want our system to avoid being triggered during shallow corrections. Yet we want those defensive measures to still kick in early enough to protect us from the bulk of the losses suffered during deep bear markets.

Add all of this up and we're talking about a defensive system designed to turn on only during the "big" bear markets while ignoring everything else. Said differently, Upgrading 2.0 is designed to look exactly like Upgrading has always looked—*except during those roughly once-a-decade bear markets that take the markets down for the count*.

Upgrading 2.0 backtesting results

How does the new Upgrading 2.0 meet these goals? Quite effectively, if our backtesting of the past 20 years is representative of what we can expect in the future.

Obviously we'd love to have more history to test on, but we have good Upgrading fund data to work with only going back to around 1998—prior to that, our fund selection process was different enough that the older data isn't useful. However, the lack of fund data is somewhat irrelevant because there weren't any market events between SMI's inception in 1990 and the start of our "good data" in 1998 that would have triggered the new 2.0 protocol.

As it is, our testing period includes the two big bear markets: the 2000-2002 dot-com crash and the 2007-2009 financial crisis, as well as the numerous milder "panics" we've had along the way, which include 1998, 2010, 2011, and the aforementioned 2015-2016 twin corrections.

Overall, the results have been fantastic. Here's why: As we've explained before, there's a "cruel math" attached to investment losses. If a portfolio loses 25%, it doesn't require merely a 25% gain to get back even—it requires a 33.3% gain. A 50% loss, such as the indexes have experienced during the past two big bear markets, doesn't require a gain of 50% to get back to breakeven—it requires a 100% gain from that low to recover.

Understanding that, one can see how important minimizing losses can be for long-term performance. The addition of absolute momentum in creating Upgrading 2.0 works wonders along those lines, despite not being "turned on" very often over the 20-year test period.

Table 1 shows the theoretical results of the full 20-year test period. It shows how "actual Upgrading"—what SMI readers experienced, on average, using normal Upgrading—handily beat the market with a performance difference of +9.0% vs. +7.4% annually over those two decades. But adding the absolute momentum process of Upgrading 2.0 sent that annual return soaring to +14.1% in our backtesting!

TABLE 1

Period	Stock Market	Actual Upgrading	2.0 Research
1998-2007	+6.3%	+11.4%	+16.9%
2008-2017[1]	+8.5%	+6.7%	+11.4%
20 Years	+7.4%	+9.0%	+14.1%

[1] 11 Months

(Full disclosure: our ability to reproduce what the *exact* results would have been in this backtest isn't as precise as with other "purely mechanical" testing we've done, such as with DAA. That's due to the small degree of subjective evaluation we apply when choosing from among two or three "finalists" when selecting new Upgrading recommendations. There is no doubt that the 2.0 protocols add a significant degree of capital protection to Upgrading. The exact degree of protection can't be known, but it should be close to that illustrated in the table above, perhaps plus or minus a percent or two.)

The percentage differences in Table 1 may be better appreciated in terms of their dollar impact on a portfolio. A portfolio of $100,000 invested 20 years ago at the market's rate of return would have grown to $418,000. A "regular" Stock Upgrading portfolio would have done considerably better, growing to $564,000. But an Upgrading 2.0 portfolio? A shocking $1.4 *million*—more than double the market's total gain.

Table 2 shows how it happened. Upgrading 2.0's defensive protocol, built on the principle of absolute momentum, put a safety net under Upgrading's performance during the two big bear markets of the past 20 years. In 2000-2002, regular Upgrading did a pretty good job of limiting losses. While the market was down -44.1% between September 2000-September 2002, regular Upgrading lost -26.5%. But Upgrading 2.0 would have done substantially better, limiting that bear market's loss to only -11.9%.

TABLE 2

Period	Stock Market	Actual Upgrading	2.0 Research
Sep 2000 thru Sep 2002	-44.1%	-26.5%	-11.9%
Nov 2007 thru Feb 2009	-51.0%	-50.0%	-17.4%

The more recent financial-crisis bear market was even more stark, given that its reach extended to every corner of the market, leaving no risk categories where regular Upgrading could find a safe haven. The market lost -51.0% between November 2007-February 2009, and regular Upgrading was only slightly better at -50.0%. But Upgrading 2.0 limited that loss dramatically, falling just -17.4%. Remembering our "cruel math" of investing losses, it's easy to see how such a dramatic limiting of bear-market losses can lead to incredible improvement in the long-term strategy performance record.

Effortless implementation

Earlier, we referenced Gary Antonacci's book, which contained a simple system for combining relative and absolute momentum into a workable long-term strategy. That approach was appropriate for the wide audience that would read his book and try to implement his system on their own.

Our initial research focused on similarly simple approaches, but what we discovered was that in our effort to keep the system simple, we were leaving a lot of potential profit on the table. In addition, the approaches we looked at initially had the significant issue of either creating too many "false" signals, which caused whipsaws (exits followed by rapid re-entry signals), or being too "dull" and losing too much during big bear markets.

As a result, we ended up studying refinements that would help us fine-tune the absolute momentum outcomes a bit. The result is a combination of technical indicators that alert us when market risk has risen to a degree sufficient that we should begin watching for the absolute momentum signals at the individual fund level.

(If reading that last paragraph felt a little confusing, you'll understand why we won't be making all the details of the new Upgrading 2.0 system public. Not only would it be confusing to less-advanced readers, it simply isn't necessary to bog readers down with the indicators behind what has become a more complicated system. The strategy is a simple one on the surface, and can be implemented by just following the same steps Upgraders are accustomed to in running their portfolios.)

Here is all you really need to know: When the defensive protocol kicks in and absolute momentum becomes a factor in our Upgrading process, you'll see individual fund "slots" on the Basic Strategies page (page 10 in this issue) turn to "Cash." If that happens to a fund you own, simply sell it as usual. But rather than immediately replace it with another stock fund, let the proceeds of that sale temporarily sit in cash in your account until, eventually, a new stock fund is recommended.

Phased-in exit signals

Note that this "move to cash" won't happen to all funds at once. In fact, one of the aspects we tested and eventually built into the system was the concept of a "phased-in" application of these signals. All this means is you won't ever see more than one recommended fund *per risk category* go to cash in a single month.

This phased-in approach may cost us slightly during the occasional true bear market, as it can take us as long as three months to completely exit a particular risk category. But overall performance using this system during the big bear markets was so outstanding (see Table 2) that we felt it was well worth the tradeoff to limit our exposure to cash early on in market declines. The research suggests that doing so likely will protect us from moving too quickly to cash during the ultimately short-lived corrections (such as 2016) which occur more frequently.

While this means most Upgraders won't have to sell all their funds and go to cash all at once, it's worth noting that the signals can be interpreted in different ways depending on your risk-tolerance. A more conservative member may opt to move his or her holdings in a particular risk category to cash as soon as *any* of the recommended funds in that category switch over to cash. In contrast, another member may wait until all three holdings for a given category go to cash. By waiting longer, the chances of being whipsawed are decreased.

A natural downside of not spelling out all the working parts of the new system is that those in 401(k) and other plans won't know precisely when these various triggers are firing behind the scenes. But it will be easy to tell when it's time to take action by simply watching what's happening on the Basic Strategies page. Again, the conservative-aggressive spectrum may alter your implementation by a month or two, but overall, any investor tuning in to the official Upgrading fund recommendations will know when the system is indicating it's time to take defensive cover.

Phased-in re-entry signals

Our criteria for re-engaging with the market is phased as well. Historically, we know that when the market has lost between -10% and -15%, it will have quite a bit further to fall if we're entering a major bear market. So if our system moves us to cash at those relatively modest loss levels, it's designed to require a strong contrary signal to get us to reverse our defensive positions and move back into stocks.

The criteria we've established, however, will make the decision to re-enter easier as bear-market losses intensify. As long as a selloff remains mild, the hurdle for once again buying stocks is set relatively high, but as the market falls below various loss thresholds, the hurdle is lowered. That means we're more likely to go back into stocks when the market is down -35% than we are when it's down -20%. As overall market losses deepen, our focus shifts to making sure we get back in for what is typically a sharp bounce off the ultimate bear-market low.

Given that bear markets tend to be multi-year events, we'll have plenty of time to write more about the re-entry side of this system when we finally do go through another bear market.

Conclusion

The new Upgrading process we're unveiling this month has two huge potential impacts:

1. The performance of Upgrading should be drastically improved by avoiding most of the worst losses (see Table 1).
2. It *should* have a huge impact on how willing you are to stay invested during late-stage bull markets. Those late stages tend to provide some of the strongest returns to investors. Being able to harvest late-cycle gains, while still avoiding the bulk of any subsequent bear markets, is a game-changer for Upgraders.

Importantly, there are no extra signals for you to watch for, or even anything complicated to do on the rare occasions when our defensive protocol kicks in. When it does, you'll simply sell as normal, then sit in cash until regular Upgrading resumes with new stock-fund recommendations. Just follow the monthly Upgrading instructions as you always have and you'll be all set. It is as easy as that. ◆

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

THE ESSENTIAL STEPS FOR GETTING OUT OF DEBT

by Matt Bell

Getting out of debt is one of the most common goals people set at the start of a new year. Since it seems to be one of the top financial goals at the beginning of *every* year, it's a safe assumption that many of this year's would-be debt crushers have been down this path before.

What if this is the year you actually *do* get out of debt, and what if you do so in a way that helps you *stay* out of debt forever?

I once had $20,000 of credit-card debt, so I know the pain of being buried in bills. Thankfully, I also know the joy of successfully navigating the journey out of debt. Here is a tried-and-true eight-step formula for ditching your debt once and for all.

1. Stop adding to your debt. Today! No exceptions, no excuses. You can't get out of debt if you keep going further into debt, so make a commitment to take on no more debt from this day on.

If your credit cards tempt you to spend more than you can pay off each month, get rid of them. Take them out of your wallet/purse and cut them up.

2. Organize your debts. When pursuing any goal, it helps to define it well. In this case, that means totaling up *exactly* how much debt you have.

Go to the Accelerated Debt Payoff Calculator[1] and list your debts in order, from the lowest balance to the highest—credit cards, personal loans, college loans, car loans, home equity loans, and any others. You don't have to include your mortgage, but you can if you want to make that part of your deleveraging plan as well.

3. "Fix" and roll your payments. We've explained this powerful step before,[2] and we encourage you to review that article for a full explanation. But the main point is to make sure you keep making (at least) *this month's* minimum required payment every month, instead of falling for your credit card company's standard tactic of reducing your minimum payment each month as your balance falls.

4. Accelerate your payments. This step is also covered in more detail in the above-mentioned article, but it's an easy enough concept—paying *more* than the fixed minimum each month will really speed up the process of getting out of debt. If you have multiple debts, target your *lowest balance* debt first. Completely paying off some of your smaller debts will be very motivating.

5. Tell someone. This may be the scariest step of all, but also the most beneficial. There's something powerful about telling another person how much debt you have, that you're committed to getting out of debt, and what your plan is. Invite them to ask you about your progress from time to time and ask them to pray for you.

This request for accountability will be tremendously helpful to you, and it might just be helpful for the other person as well. You see, many people have debt, but few are eager to admit and talk about it. Your willingness to open up about *your* debt might create the atmosphere necessary for them to talk about *theirs*, and then you can be each other's accountability and encouragement partners.

6. Keep going. For motivation, run some numbers to see how much faster you'd get out of debt if you put an extra $10 per month toward your debts. What about an extra $25, or even $100 per month? You can run these "what-if scenarios" using the calculator mentioned earlier. Enter these extra amounts in the box where it says, "Enter a monthly dollar amount you can add to your debt payoff plan."

Seeing the difference may motivate you to cut your entertainment or clothing spending to free up money to pay off debt faster. You might decide to sell some things or even pick up an extra part-time job to raise cash.

7. Make sure you *stay out* of debt. The two most practical steps you can take to stay out of debt are to use a budget[3] and build an emergency fund.[4] A budget will help prevent overspending, and an emergency fund will enable you to cover many of life's unexpected expenses without going back into debt.

8. Focus on the big picture. It took me four-and-a-half years to pay off my $20,000 of credit-card debt. There were plenty of times when the journey felt like it would go on forever.

A turning point came when I read about the "thorn" in the Apostle Paul's side (2 Corinthians 12:7-9). God's response to Paul's plea for relief—"My grace is sufficient for you, for my power is made perfect in weakness"—helped me see a greater purpose for my long journey out of debt.

I realized that in my weakness God was molding my heart. He was teaching me how to follow and trust Him. He was teaching me patience, and He was showing me that my value does not depend on how much money I have or what I own.

Beginning to understand that God was using this difficult time in my life for a greater purpose was very encouraging. Eventually, I started volunteering with a stewardship ministry, helping others apply God's principles to their financial issues. Eventually, writing and speaking about biblical money management became my life's work. That helps me look back on my battle with debt with gratitude.

If you follow the steps outlined above, you *will* get out of debt eventually. But along the way, look for what else God has for you in this experience. It's possible that He has a purpose for this journey that goes well beyond money. ◆

[1] bit.ly/SMIdebtcalc [2] bit.ly/SMIoutofdebt [3] bit.ly/SMIbudgeting [4] bit.ly/SMIemergencyfund

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

6 STEPS TO CREATING A LONG-TERM INVESTING PLAN

In light of James 4:13-14, some Christians feel uneasy about engaging in long-term financial planning: "Come now, you who say, 'Today or tomorrow we will go to such and such a city, and spend a year there and engage in business and make a profit.' Yet you do not know what your life will be like tomorrow. You are just a vapor that appears for a little while and then vanishes away."

Obviously, these verses teach that we shouldn't have an arrogant or overly self-reliant attitude toward planning and provision. Still, Scripture provides ample support for the idea that we should take responsible steps to plan for our financial future. (See, for example, Genesis 2:15, Proverbs 6:6-8, and Luke 16:11.)

As is often the case, a mature Scriptural approach involves a *balance*. Too little attention to planning can lead to not having enough money to live on in our later years, or to taking too much investment risk later in life in an attempt to make up for lost time. But too much of a focus on long-term wealth goals can lead to a neglect of immediate priorities, such as giving.

We believe being a faithful steward involves (1) managing the resources you have as effectively as possible while (2) trusting God for the outcome. A wise management step to take here at the beginning of a new year is to create a *written* long-term financial plan. Without a written plan, your ongoing financial decisions likely will be driven by the emotions of the moment—hardly a formula for long-term success.

Here are six key elements that should inform your written plan.

1. Understand the big picture. At SMI, we refer to this as being an "inside-out" investor.[1] Most investors' choices are motivated by outside considerations—current events, magazine articles, broker recommendations, and so on. That's the wrong approach. Instead, focus on your own financial needs and build an investment strategy designed to meet those needs. Sounds simple, but few people actually operate this way.

2. Budget. Any financial plan you create—whether modest or ambitious—will be only as effective as your ability to manage your income and expenses. In other words, you can plan perfectly and yet it won't do a bit of good if you don't execute the plan! For most people, executing the plan requires a budget to help track and control spending in real-time. Thankfully, there are great tools available today to help you with this process, including various smartphone and web-based apps.[2]

3. Know what you need. A key element of financial planning is projecting what your future needs will be. Without that knowledge, you'll have a tough time making appropriate decisions. If you don't have a specific target at which to aim, you're only guessing when it comes to deciding which investment choices and asset allocation are best for you.

How do you figure out how much you'll need? MoneyGuidePro®, the financial software available to SMI Premium-level members,[3] is an invaluable aid—especially as you draw within 10-to-15 years of retirement. Investors at that stage face the dual need of growing their portfolios *and* protecting the assets they've already accumulated. Good planning can help you cross the "finish line" without taking on outsized risk that could put your resources in jeopardy.

Because life doesn't stand still (and neither do the markets!), assessing your future needs isn't a one-time thing. You should revisit this step from time-to-time.

4. Allocate appropriately. Your asset allocation (i.e., stocks vs. bonds) will determine the performance of your portfolio more than any other single factor. The "Start Here" section at SoundMindInvesting.com provides details on how to gauge your risk tolerance and combine it with your season of life to determine an appropriate stock/bond allocation.[4]

Revisit this process regularly as well. If your periodic "needs assessment" (step 3 above) ever indicates you can reduce your risk level and still meet your goals, it is wise to do so. (This month's Level 3 article has more on asset allocation.)

5. Make good investment decisions. Easier said than done, right? No one is going to make all the "right" investment decisions. But you can improve your odds of success by taking certain steps. At SMI, we're big believers in using mechanical strategies that eliminate emotional decision-making. Most people's emotions tell them exactly the wrong thing when it comes to investing (e.g., that sick feeling you get when the market drops is *not* a good reason to sell!).

6. Monitor and adjust. Your budget won't likely be the same at age 45 as at age 25, and neither will your asset allocation. Life happens—an illness, job change, unexpected blessings that cry and need diapers changed. These and many other factors mean you need to review and adjust your plan as you age. That's okay. Just *don't abandon the old plan without putting a new plan in place.*

And don't act from fear. One of the most counterproductive things investors do is change their whole strategy when they are overtaken by fear during market declines. If your strategy dictates that you change *specific investments*, that's fine. But wholesale changes in strategy should never be made under duress.

This kind of "stay committed, but be flexible" approach is reflected in the changes we're making in our Upgrading strategy, as detailed in this month's cover article. Committed *(continued on page 13)*

[1]Jun2017p87 [2]Jan2013:p6 [3]Feb2017:Cover, Mar2017:Cover [4]Asset allocation is "built in" to SMI's Dynamic Asset Allocation (DAA) strategy, therefore this step is not required if using DAA.

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

SMI'S 2018 REBALANCING GUIDE

As we discuss how to rebalance to your ideal portfolio allocation for 2018, remember that the most important characteristic of your portfolio—the factor that influences the performance of your portfolio more than any other—is the way you divide your money between asset classes.

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.

SMI's core strategies approach this asset allocation task quite differently. Dynamic Asset Allocation (DAA) doesn't require you to choose an allocation, as *the strategy shifts the portfolio allocation automatically* based on market conditions. (More on DAA in a moment.)

In contrast, 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 invest in 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. That said, this month's introduction of a new "safety net" within SMI's Upgrading strategy (see this month's cover article) may be significant enough to warrant a review of your overall portfolio allocations.

Note that 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 2018 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 recent years, we've been allocating *evenly* across the stock-risk categories (see table). While we may deviate from this occasionally in the future in response to what we perceive to be unusual opportunities or risks, we expect those instances to be the exception rather than the rule.

This year the rebalancing task for Upgraders is simply to bring their portfolio allocations back to the same starting percentages as last year.

Bonds will continue to be allocated as they have in recent years: Whatever an investor's overall bond allocation is, half of that is invested in the rotating Upgrading selection,[3] 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).

Precision not required

Recent research has tended to indicate annual rebalancing isn't as necessary or helpful as was once believed.[4] SMI still thinks the process is worthwhile, but this body of research has made us 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).

Rebalancing in DAA

Those with premium memberships also have access to our Dynamic Asset Allocation and Sector Rotation strategies. As we noted earlier, DAA tells you how to allocate as you go.

If you're following the DAA strategy, you begin by investing one-third of your DAA portfolio in each of three asset classes *(continued on page 13)*

ORGANIZING YOUR PORTFOLIO IN 2018

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%

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

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

HOW TIME CAN TURN $3,000 INTO $50 MILLION

By Paul Merriman[1]

[Editor's note: If you're the parent or grandparent of a baby, how would you like to make a small one-time investment that could grow mostly tax-free and ultimately provide your child/grandchild with a comfortable retirement, while *also* leaving a sizable sum for your favorite ministry or charity? Our friend, Paul Merriman,[1] shows us how.]

As hard as it may be to believe, it's possible to turn a one-time $3,000 investment into $50 million in a single lifetime. I can't say that I have done it, but I'm going to show how you could.

This is a very tall order, one that requires an entire lifetime and more than one person to carry it out. If you're a parent or grandparent, you can do this. Someday, your child or grandchild could be very grateful that you did.

The plan I am about to describe isn't magic. It's a recipe with four essential ingredients:

1. An initial investment of $3,000
2. A Roth IRA
3. An investment likely to grow at 12% over a very long time
4. A long lifetime (plus ample patience)

Want to try it? Here's how, using an imaginary infant named Brendon as an example.

When Brendon is born, set aside a lump sum of $3,000. Invest it in an ETF or a mutual fund that holds small-cap value stocks. Leave the money in that asset class to grow. And grow.

As soon as Brendon has taxable earned income, start transferring the money to a Roth IRA in his name, keeping it invested in a small-cap value mutual fund or ETF. That way, at least under current tax law, it will never be taxed. Do this every year until all the money is within the Roth account.

Assuming Brendon leaves this money alone and it continues to compound at 12%, when he is 65 years old, your one-time $3,000 investment will be worth about $4.75 million.

[SMI note: Paul suggests small-cap value stocks because they have returned roughly 12% annually over many decades. That's tops among the traditional stock "risk categories." While a 12% average annual return may sound overly optimistic, our backtesting shows that Dynamic Asset Allocation would have generated average annual returns of 12.5% from 1982 to the present, while Sector Rotation has returned over 16% annually since its debut in 2003. So while 12% is an aggressive goal, it isn't out of the question using SMI's strategies.]

That is still far short of $50 million. Let's follow the money and see how this scenario plays out.

Assume that at 65 Brendon starts withdrawing 5% of the balance of his account every year. That first year, he takes out $237,281. Because the money continues to compound at 12%, his balance grows, and so do his yearly withdrawals.

When he's 70, he'll take out $323,572, based on his account value of $6.47 million. At 80, the account is worth slightly more than $12 million, and he takes out $601,710 — theoretically without any tax liability.

If we assume Brendon keeps this up until his death at 95 (his final annual withdrawal being $1.5 million), his account will be worth about $30.5 million. Starting at age 65, he will have taken out a total of $21.6 million. That final value plus all the withdrawals come to more than $50 million from your initial $3,000. And, presumably, very little of it will have been taxed.[2]

So let's ask ourselves: What could go wrong with this picture?

First, future returns of 12% aren't assured. Not by a long shot.

Second, by the time Brendon is a young adult he will figure out that he has a lot of money, and he will have to resist the temptation to spend it. Of course, there are no guarantees here. Consider writing Brendon a letter that explains what you have done on his behalf and why, along with instructions that you'd like him to follow.

Third, it's extremely unlikely that today's tax laws will remain unchanged for the next 95 years. Congress could very well find ways to tax accumulations of wealth inside Roth IRAs.

Fourth, the elephant in the room, so to speak, is inflation. A withdrawal of $237,281 sounds like a bucket of money at age 65. But I can almost guarantee you that a dollar in the year 2083 won't be worth the same as it is in 2018.

Assuming future inflation of 3%, Brendon's account at age 65 would be worth $694,821 in today's dollars, and his first withdrawal would be worth $34,741. (That seems much less spectacular than the previous numbers I cited, but in real purchasing power, that single withdrawal has more than 11 times the real value of your entire $3,000 initial investment.)

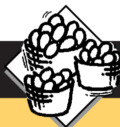
At the end of his life at age 95, Brendon's annual retirement withdrawals would total about $1.83 million, and his account would be worth about $1.84 million. There, in "real" dollars, is the payoff: $3,000 becomes nearly $3.7 million.

Brendon doesn't have to do much to achieve this result, except for probably paying some taxes along the way. Presumably, he will have discretionary income to invest in his own retirement account. That plus (if he is fortunate) Social Security and other savings may meet most of his retirement needs.

That means the account may be available to him for "extras." And it also provides a very generous pool of money ($1.84 million in today's dollars) for him to leave to his heirs or charity.

Here, too, is an opportunity to include instructions in the letter mentioned earlier. You might suggest *(continued on page 14)*

[1]Paul Merriman is a nationally recognized authority on investing. He founded an investment advisory firm in 1983 and today writes a weekly column for MarketWatch.com. Learn more at www.paulmerriman.com.
[2]To see the spreadsheets behind the math in this article, go to bit.ly/2BQroc1.

SOUND MIND  PORTFOLIOS

Basic Strategies

The fund recommendations shown for Upgrading accountholders are based primarily on "momentum" scores calculated just before this issue was published (not the earlier end-of-month scores shown on this page). Consistency of performance is also considered, along with the portfolio manager's philosophy and number of years at the helm. Three recommendations are made in each risk category. 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 11/30/2017	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	41.3	24.9%	0.6%	4.6%	9.4%	27.3%	6.4%	1.15	0.11%	20%	16%	12%	8%	VXUS
Extended Market Index ETF	Small company stocks	41.1	17.7%	3.1%	8.9%	12.3%	19.9%	10.1%	1.21	0.08%	40%	32%	24%	16%	VXF
S&P 500 Index ETF	Large company stocks	41.2	20.2%	3.1%	7.6%	10.8%	22.7%	10.9%	1.00	0.04%	40%	32%	24%	16%	VOO
Total Bond Mkt Index ETF	Medium-term bonds	3.5	3.0%	-0.1%	-0.6%	0.7%	3.4%	2.1%	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 11/30/2017[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. Calamos Intl Growth	12/17	No	NTF	NTF	60.6	36.7%	1.4%	7.7%	16.0%	36.9%	8.2%	1.23	1.38	85	None	CIGRX
	2. Vanguard Intl Growth	09/17	Yes	Yes	Yes	62.5	41.6%	0.8%	5.7%	14.7%	42.0%	10.9%	1.41	0.46	133	None	VWIGX
	3. Selected International S	06/17	NTF	NTF	NTF	46.0	33.9%	0.8%	4.6%	10.0%	31.5%	7.7%	1.47	1.30	39	2%30days	SLSSX
Category 4 Small/Growth	1. Conestoga Small Cap	11/17	NTF	NTF	NTF	59.0	30.0%	1.5%	11.7%	17.2%	30.1%	17.8%	1.36	1.10	49	None	CCASX
	2. Oberweis Micro Cap	11/15	NTF	NTF	NTF	66.2	30.7%	3.8%	13.9%	19.2%	33.0%	20.0%	1.35	1.65	89	1%90days	OBMCX
	3. Baron Discovery	04/17	NTF	NTF	NTF	57.7	35.8%	2.9%	7.9%	14.2%	35.5%	13.7%	1.59	1.35	64	None	BDFFX
Category 3 Small/Value	1. Royce Opportunity	06/17	NTF	NTF	NTF	49.9	20.5%	1.6%	11.3%	15.2%	23.4%	11.5%	1.64	1.49	246	1%30days	RYOFX
	2. AllianzGI NFJ Mid-Cap Val	06/17	No	NTF	NTF	48.3	25.8%	2.6%	8.1%	11.2%	29.0%	12.3%	1.12	0.99	101	None	PQNAX
	3. Zacks Small Cap	11/17	NTF	NTF	NTF	49.1	17.7%	-0.2%	11.4%	15.3%	22.4%	13.5%	1.34	1.39	104	2%30days	ZSCCX
Category 2 Large/Growth	1. iShares Edge USA Momentum	12/17	ETF	ETF	ETF	66.8	37.3%	2.8%	11.0%	17.0%	38.8%	15.9%	0.97	0.15	129	None	MTUM
	2. Fidelity OTC	06/17	Yes	NTF	Yes	58.6	37.8%	1.5%	6.1%	12.3%	40.2%	16.1%	1.49	0.81	262	None	FOCPX
	3. Guggenheim S&P 500 Tech	04/17	ETF	ETF	ETF	56.7	33.5%	1.0%	9.3%	13.1%	34.3%	17.7%	1.40	0.40	70	None	RYT
Category 1 Large/Value	1. SPDR Dow Jones Industrial	12/17	ETF	ETF	ETF	57.8	25.4%	4.2%	11.2%	16.9%	29.7%	13.5%	1.09	0.17	31	None	DIA
	2. Toreador Core	05/17	NTF	NTF	NTF	55.9	23.9%	2.3%	11.8%	15.9%	28.1%	10.5%	1.22	1.20	102	2%60days	TORLX
	3. Miller Opportunity	06/17	Yes[10]	Yes[10]	NTF	44.6	24.3%	3.7%	7.8%	10.9%	25.9%	6.6%	2.13	1.36	37	None	LGOAX[10]
Bond Categories	Vanguard I-T Bond Index[6]	07/17	ETF	ETF	ETF	2.8	3.4%	-0.3%	-1.2%	0.3%	3.6%	2.5%	1.31	0.07	6.5[7]	None	BIV[8]
	Vanguard I-T Bond Index	01/15	ETF	ETF	ETF	2.8	3.4%	-0.3%	-1.2%	0.3%	3.6%	2.5%	1.31	0.07	6.5[7]	None	BIV[8]
	Vanguard S-T Bond Index	07/12	ETF	ETF	ETF	0.7	1.2%	-0.3%	-0.6%	0.0%	1.3%	1.1%	0.46	0.07	2.7[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-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. **[10]** At some brokers, the load-waived share class is LMNOX. Read the fund writeup (June2017: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 page 8 in this issue.

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 Calamos International Growth, the highest-rated Cat. 4 fund available is Conestoga Small Cap, 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%

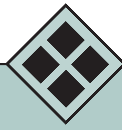
❸ BUY YOUR FUNDS

Example uses an 80/20 mix between stocks and bonds		Dollars	Invest In Funds
Stock Cat. 5: Foreign	16%	$8,000	Calamos Intl Growth
Stock Cat. 4: Small/Growth	16%	$8,000	Conestoga Small Cap
Stock Cat. 3: Small/Value	16%	$8,000	Royce Opportunity
Stock Cat. 2: Large/Growth	16%	$8,000	iShares Edge USA Momentum
Stock Cat. 1: Large/Value	16%	$8,000	SPDR Dow Jones Industrials
"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

SIGHTING: TURNING THE TIDE AGAINST CHOLERA

[Note: This Sighting isn't about finances, but isn't it nice to start the year with news that everyone can agree is good? — AP]

Two hundred years ago, the first cholera pandemic emerged from Bangladesh…. Since that first escape, it has circled the world in seven pandemic cycles that have killed tens of millions…. Today cholera garners panicky headlines when it strikes unexpectedly in places like Ethiopia or Haiti. But it is a continuing threat in nearly 70 countries, where more than one billion people are at risk.

Now, thanks largely to efforts that began in cholera's birthplace, a way to finally conquer the long-dreaded plague is in sight. A treatment protocol so effective that it saves 99.9 percent of all victims was pioneered here. The World Health Organization estimates that it has saved about 50 million lives in the past four decades.

Just as important, after 35 years of work, researchers in Bangladesh and elsewhere have developed an effective cholera vaccine. It has been accepted by the W.H.O. and stockpiled for epidemics like the one that struck Haiti in 2010. Soon, there may be enough to begin routine vaccination in countries where the disease has a permanent foothold.…

Because cholera is a constant threat to hundreds of millions of people lacking safe drinking water in China, India, Nigeria and many other countries, scientists have long sought a more powerful weapon: a cheap, effective vaccine.

Now they have one.

— By Donald G. McNeil Jr., a science and health reporter covering the world's poor for *The New York Times*. To read the full article, go to nyti.ms/2BhUyEk. ◆

SIGHTING: HOW BITCOIN COULD CRASH THE MARKETS

Asset bubbles usually only hurt the buyers who overpay, but that changes when you add leverage to the equation. Leverage means "buying with borrowed money." So when you buy something with borrowed money and can't repay it, then the lender loses too. The problem spreads further when lenders themselves are leveraged. For bitcoin mania to infect the entire financial system, like securitized mortgages did in 2008, buyers would have to use leverage. The bad news is that a growing number do just that.

This month commodity regulators allowed two different US exchanges to launch bitcoin futures contracts. Oddly, instead of griping about slow regulatory approval, futures industry leaders think the government moved too *fast*. To get why, you need to understand how futures exchanges work.

One key difference between a regulated futures exchange and a private bet between two parties is that the exchange absorbs counterparty risk. When you buy, say, gold futures, you don't have to worry that whoever sold you the contract will disappear and not pay up. If you close your trade at a profit, the exchange clearinghouse guarantees payment.

The clearinghouse consists of the exchange's member brokerage firms. They all pledge their own capital as a backstop to keep the exchange running. So, when the Commodity Futures Trading Commission (CFTC) gave exchanges the green light to launch bitcoin futures, member firms collectively said (I'll paraphrase here): "What are you thinking?"…

So as of now the very same capital that backs up stock index, Treasury bond, and foreign currency futures also stands behind bitcoin futures. To me, that seems extremely unwise.

Bitcoin futures volume has been light so far, so it's not a big risk yet. But I expect that will change as the whole world (including people who have never before invested in anything) falls prey to the bitcoin cult.

Leveraging bitcoin won't necessarily cause a systemic crisis—but it could. At least one transmission channel is open now via the futures exchanges, and more will probably follow.

That makes it your problem, whether you like bitcoin or not, and whether you own bitcoin or not. Like other historic bubbles—few of which ended well—bitcoin has:

- Large numbers of people,
- Trading a speculative, highly volatile asset,
- With borrowed money and
- Systemic risk exposure.

A dangerous combination. We may look back at December 2017 as the month bitcoin broke the firewall. Now it's loose in the theoretically safer, "regulated" financial markets. The regulators responsible for financial stability think this is fine. They'd better be right.

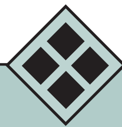
— By Patrick Watson, editor of Mauldin Economics' *Connecting the Dots* newsletter. To read the full article, go to bit.ly/2CEVKh8. ◆

WASHINGTON WATCH: WHY IT'S OK THAT TAX CUTS WILL FIRST FINANCE SHARE BUYBACKS

The Republican plan to slash the corporate tax rate permanently to 21% is a long-term reform that will improve growth prospects and increase wages across the economy. But it's crucial that its advocates do not go wobbly in the face of stories about companies reacting to the lower tax rate in different ways.

Already, corporate-rate-cut skeptics have pounced on declarations from Pfizer, Coca-Cola and Cisco Systems, who say they intend to use after-tax gains from rate cuts to increase dividends to shareholders or buy back more of their own shares. Rather than creating jobs or increasing wages, critics say, this shows it will be wealthy shareholders who will overwhelmingly benefit from a lower statutory corporate rate. This is exactly what we'd expect to happen in the very short term; indeed, the key benefits to workers arise because of the incentive for new investment that will take time to filter through.

When the corporate rate falls dramatically, the first effect is that it provides an immediate windfall to "old capital." Existing investments that have already been made receive a higher after-tax return than envisaged. This is a big reason why the stock market has surged as tax-reform prospects



improved. It takes time for a fall in the tax rate to attract new capital to the corporate sector, so the key beneficiaries in the first instance are existing capitalists.

The really important consequence of a lower corporate tax rate though is that, in time, it will bring more capital into the corporate sector as domestic companies face an increased incentive to invest, foreign companies are more likely to expand investments or shift operations to the U.S., and U.S. companies are more likely to repatriate profits from foreign subsidiaries. Coupled with the introduction of immediate expensing of equipment, greater capital per worker stemming from this extra investment should in turn raise productivity and wages.

The immediate benefit of reducing the corporate tax burden may well go overwhelmingly to owners of capital, but economic insights suggest in the longer term, workers will reap the rewards too.

— By Ryan Bourne, the R. Evan Scharf Chair for the Public Understanding of Economics at the Cato Institute. To read the full article, go to on.mktw.net/2BfhnZk. ◆

ATTENTION HUSBANDS: YOU SHOULD KNOW ABOUT SMI'S MINISTRY TO WIDOWS

by Austin Pryor

In the mid-1990s I was in talks with Moody Publishers about the possibility of writing a second book. They asked what topics interested me, and among the ideas we discussed was a book tailored to the financial needs of widows. Due to writing fatigue after my first book, coupled with the time demands of the SMI newsletter, that follow-up book never got written.

I know from the correspondence we receive that the SMI newsletter has been helpful to many widows, and for that I'm grateful. These dear women often turn to friends and relatives for advice, who refer them to financial professionals they know. But far too many times that results in widows being sold high-commission investments that are inappropriate for their situation. It grieves me to read of the ways they are taken advantage of, and their needs have remained on my heart.

I want to see widows get the kind of personalized, objective financial advice they need. However, due to legal/regulatory restrictions, we at SMI are not allowed to offer individualized counsel. A widow needs a trusted and competent financial planner who will listen to her story, review her financial situation, and suggest a prudent course of action.

There are many such financial planners among our readership, but since I don't know each one personally, I don't feel comfortable trying to establish a referral network.
I do, however, know our friends at Ronald Blue & Co., both those in the Georgia home office as well as in many of their offices around the country. In fact, the Indianapolis office helps me with my own financial-planning needs.

So, due to that comfort level, in 2009 I announced an effort to help widows among our readership. I offered to pay the cost for one such woman each month to receive a two-hour counseling session from Ronald Blue & Co. To be considered, she would need to (1) be an active SMI member, and (2) write to us explaining her situation and why she has a need for financial counseling. Despite the offer, and announcing it periodically in this section of the newsletter, we receive only two or three requests a year.

It may be that's the extent of the need among our membership. But it also may be that eligible women don't know about it because, in some cases, SMI is read primarily by the husband, and in his absence the widow doesn't read the newsletter and/or cancels the membership.

So I'm targeting this reminder to the husbands out there. Let your wives know of this offer and our desire to help them work through the many financial decisions they face. Tear this page out and let her know where to find it should the need arise. Don't assume that only "older" men should attend to this, for "no one knows when their hour will come" (Ecclesiastes 9:12).

A widow who applies should include her phone number (and email address if applicable) when she writes to us. The letter should be addressed to SMI, Suite 202, 9700 Park Plaza Avenue, Louisville, KY 40241-2287.

If selected, we will connect her with our friends at RBC. One of their advisers has been a widow herself and understands the challenges. Your wife will be well cared for. ◆

LEVEL 2 / CONTINUED FROM PAGE 7:

6 STEPS TO CREATING A LONG-TERM INVESTING PLAN

flexibility also is at the heart of our Dynamic Asset Allocation strategy that moves in and out of asset classes as market trends change.

Please note that the six steps listed above aren't comprehensive in terms of taxes, estate planning, insurance, and so forth. They simply offer a suitable guide for most people to gauge their basic investing needs and get started. There's time to fine-tune things once you're underway.

Remember, the major obstacle that keeps people from getting on the road to financial freedom is inertia—i.e., "a tendency to do nothing." Don't let that describe you. It's a new year. Get going. ◆

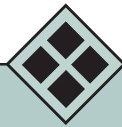
LEVEL 3 / CONTINUED FROM PAGE 8:

REBALANCING YOUR PORTFOLIO FOR THE NEW YEAR

(represented by three recommended ETFs). Over time, as positions are sold and the proceeds reinvested in different ETFs, your portfolio will lose that equal balance. Your primary rebalancing task is to periodically restore equality to the three positions. But this doesn't have to happen at the beginning of the year—an imbalance between the three holdings can be addressed *any time* a holding is being replaced. So feel free to either rebalance your DAA holdings now, or wait until a month when you'll be making DAA trades anyway.

For those members who are diversifying between *strategies*,[1] an additional rebalancing task is necessary. For ex-

[1]See www.soundmindinvesting.com/articles/view/a-few-more-thoughts-on-rebalancing for more on DAA rebalancing.



MONEYTALK

ample, someone dividing their investments evenly between DAA and Fund Upgrading may need to rebalance slightly so the same amount is invested in each as we begin 2018.

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 DAA, with many including Sector Rotation as well.[1]

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. While it may not be obvious, so is this month's cover article topic of bringing potential bear market protection into the Upgrading strategy itself (as opposed to our old Bear Alert guidelines, which were external to the strategy), so all a member has to do is follow the normal Upgrading buy/sell instructions on the Basic Strategies page. It's our goal to keep things as simple as possible for SMI members, and to that end we'll continue to look for ways to gain simplicity without sacrificing performance. ◆

LEVEL 4 / CONTINUED FROM PAGE 9:

HOW TIME CAN TURN $3,000 INTO $50 MILLION

that Brendon indicate in his will or trust that the remaining assets in this account be placed in a donor-advised fund, along with his intentions for how that money should be distributed by his own children or grandchildren.

This scenario illustrates how a very-long-term approach can create opportunities for future generations in a family. And, of course, it's not necessary to start with $3,000. Even a $1,000 initial gift can yield very rewarding results over a long lifetime. ◆

MARKET NOTES, QUOTES, AND ANECDOTES

The nature of bubbles

• "…the toughest thing about Bubbles is that they go on longer than most investors would think and, in fact, usually rise at an exponentially faster rate as we get close to the crescendo. Jeremy Grantham (co-founder and chief investment strategist of Grantham, Mayo & van Otterloo) quantified this for us a couple weeks ago at his annual meeting in Boston when he said that the last twenty-one months of a Bubble usually rise 50% (seems impossible, but that is what the data says). By this calculation, the final leg of the [market] Bubble began in March of this year when the [S&P 500 and Dow Industrials] Indexes broke through two standard deviations above Fair Value (2,400 and 21,000), so we could see a continued inflation of the Bubble until the end of 2018 that would take the SPX to 3,600 and the DJIA to 31,500 (seemingly stunning numbers)." — Mark Yusko, founder and chief investment officer of Morgan Creek Capital Management, in his 3rd quarter "Letter to Fellow Investors." Read more at bit.ly/2zVDCS9 (PDF).

Adventures in forecasting

• "Forecasting where the stock market will finish a year from now is next to impossible.… Over the past 38 years, the S&P has typically gained +10% per year. This is the average. But *the standard deviation from this average is 16%*. The standard deviation measures how much any single year typically varies from the average. In other words, it would be normal for the S&P to return anywhere between a loss of -6% to a gain of +26% in any one year. That range captures about 70% of the annual returns since 1980." — Urban Carmel, on his *The Fat Pitch* blog on 12/15/17, arguing that making a precise stock-market forecast is an exercise in futility. Read more at bit.ly/2oFN8oo.

What could go wrong?

• "Cyber is just morphing constantly and is probably the No. 1 risk that the whole system faces—not just financials, not just investment firms, not just financial services more broadly, but the entire corporate infrastructure." – Bill McNabb, outgoing CEO of Vanguard Group, quoted by *Bloomberg News* on 11/28/17 that his biggest worry isn't a market correction but "some sort of cyber event." Read more at bloom.bg/2zcceOY.

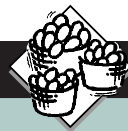
Financial lessons are found in unusual places

• "Investing is not the study of finance. It's the study of how humans behave with money. When you realize it's the study of human behavior, you see that it incorporates the lessons and laws from all kinds of different fields. Psychology. Sociology. Statistics. History. Politics. Rule of thumb: If it looks into how people behave in groups and respond to incentives, it'll teach you something about investing." – Morgan Housel, writing on the *Collaborative Fund* blog about what investors should read. Read more at bit.ly/2BnfZ5X.

Sometimes it's not complicated

"Why have global markets done so well this year? Trump? Interest rates? China? The G8 Summit? It's all beside the point. Here's the big thing that mattered most: The 20,000 or so companies representing the world's stock markets were reporting higher profits. This trend [has] been apparent since the summer of 2016. It's not complicated.… The longer I'm in the game, the less I pay attention to chatter and the more I respect price and trend." — Joshua M. Brown, writing in his *The Reformed Broker* blog, on why investors should focus "solely on what *was happening* and not on what other people speculated *might happen*." Read more at bit.ly/2CFJTzj. ◆

[1] bit.ly/SMI504010article, bit.ly/SMI504010

SOUND MIND  PORTFOLIOS

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

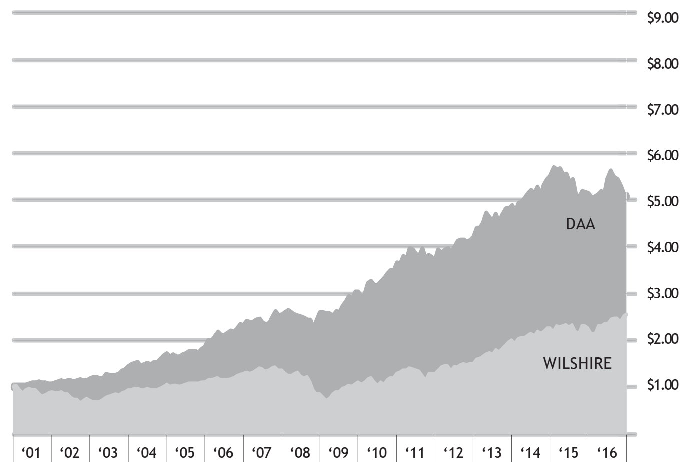
Overview

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]	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%	-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

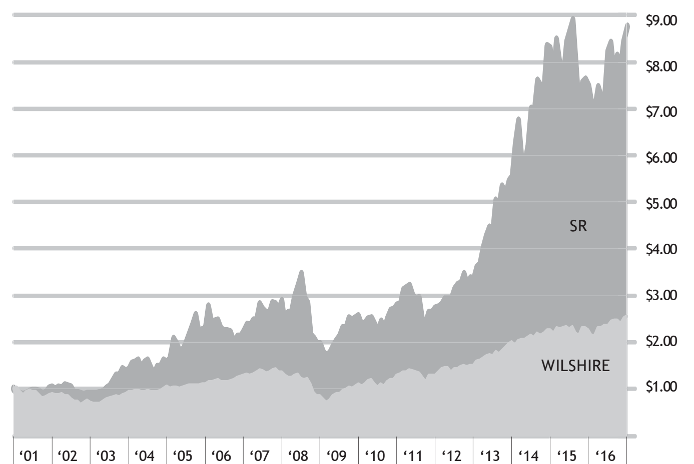
Overview

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

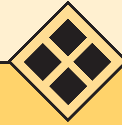


Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Avg[1]	Worst 12[1]	Rel Risk[1]
Sector Rotation	3.7%	-13.1%	54.4%	12.6%	46.1%	-1.9%	28.1%	-31.5%	30.5%	9.1%	-3.2%	23.3%	65.7%	49.9%	-9.7%	16.8%	14.5%	-38.6%	1.66
Wilshire 5000	-11.0%	-20.9%	31.6%	12.5%	6.4%	15.8%	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 NOVEMBER 30, 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]	19.7%	3.0%	7.8%	22.2%	10.9%	15.7%	8.5%	9.9%
Just-the-Basics[2]	20.2%	2.6%	7.5%	22.5%	9.7%	13.9%	7.5%	10.1%
Stock Upgrading[3]	17.6%	1.7%	7.5%	19.2%	9.0%	13.5%	6.8%	11.0%
U.S. Bond Market[4]	3.0%	-0.2%	-0.6%	3.3%	2.0%	1.8%	3.8%	4.1%
Bond Upgrading[5]	2.2%	-0.3%	-1.0%	2.3%	1.7%	2.8%	6.1%	6.6%

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]	14.4%	1.5%	3.5%	14.5%	2.4%	7.1%	8.8%	11.7%
Sector Rotation[7]	59.6%	0.9%	27.1%	65.5%	18.8%	32.9%	17.9%	20.1%
50-40-10 Blend[8]	20.2%	1.5%	7.7%	21.4%	6.8%	12.5%	9.4%	12.8%

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 11/30/2017	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	16.50%	1.52%	6.72%	18.23%	6.58%	11.95%	5.49%
Wilshire 5000	19.70%	3.04%	7.80%	22.17%	10.94%	15.70%	8.45%
S&P 500	20.49%	3.07%	7.65%	22.87%	10.91%	15.74%	8.30%

Quarterly Returns as of 9/30/2017	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	12.65%	3.19%	6.13%	15.94%	6.75%	11.04%	5.11%
Wilshire 5000	13.73%	2.41%	4.59%	18.89%	10.96%	14.27%	7.61%
S&P 500	14.24%	2.06%	4.48%	18.61%	10.81%	14.22%	7.44%

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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