VOLUME 29 ◆ NUMBER 5

MAY 2018

Sound Mind Investing®

Financial Wisdom for Living Well

WWW.SOUNDMINDINVESTING.COM

Long-Term Care: How Would You Cover the Cost?

Just reading the phrase "long-term care" can strike fear in a Baby Boomer's heart. Many assume it's synonymous with *nursing-home* care (it isn't), and believe the cost could ruin them (it could; while the odds are relatively small, there's still a risk). Many long-term care insurance providers have exited the business and those still in it are charging a lot for their policies. It all adds up to a huge retirement-planning challenge. This article will help you understand the issues, assess the risks, and plan accordingly.

by Matt Bell

Of all the enjoyable ways to spend your time, thinking about the healthcare challenges you may experience toward the end of your life is probably pretty far down the list. Faithful stewardship, however, requires us to consider *all* seasons of life, and the last season is one of the most important. It's a time of life when some of a person's most sizeable Kingdom investments could be made. It's also a time when people want the peace of mind of knowing their family could handle the financial burdens of a debilitating illness.

To manage that healthcare risk, should you buy a long-term care insurance (LTCI) policy? If so, with premiums rising quickly, can you afford it? What other options are there?

The big picture

Reading articles about later-life medical needs can create fear about the future. For example, according to Fidelity, a 65-year-old couple would need $280,000 to cover their healthcare costs for the rest of their lives. And that does *not* include the cost of a potential nursing home stay.

But a closer look at that $280,000 figure is illuminating. If this couple lives another 20 years, they would spend $14,000 per year on healthcare, or $1,167 per month. You might *already* be spending that much for health insurance, out-of-pocket medical expenses, and possibly contributions to a health-savings account. In that light, $280,000 doesn't seem so scary after all.

However, as noted, that figure doesn't factor in a stay in a nursing home or assisted-living facility. If needed, that care would not come cheap. According to Genworth's 2017 Cost of Care Survey, the median cost for a private room in a nursing home is $267 per day, or nearly $97,500 per year. The median cost of an assisted-living facility is $123 per day, or $45,000 per year. So, let's assess *those* risks.

Will you need long-term care?

National long-term care (LTC) statistics are imperfect at best and even can be misleading. The definition of certain terms is critical. Here's what the research says about some of the key questions related to this topic.

• **What is long-term care?** According to the U.S. Department of Health and Human Services (HHS), while some long-term care involves *medical* care, most does not. *(continued on page 67)*

IN THIS ISSUE

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

EDITORIAL

How to Prepare for Investment "Accidents"

On April 17, less than an hour into its scheduled journey from New York to Dallas, Southwest Flight 1380 suffered an explosion in one of its two engines, causing shrapnel to pepper the plane's wing and fuselage. The resulting smashed window caused the ultimate nightmare scenario: an open hole in a rapidly depressurizing plane, with passengers fighting to avoid being sucked out of the plane.

Unlike the "Miracle on the Hudson" in 2009, when pilot Chesley "Sully" Sullenberger safely landed his crippled US Airways plane on the Hudson River, saving all 155 people on board, Southwest Flight 1380 resulted in the death of one passenger. But the situation could have been much worse, and Southwest pilot Tammie Jo Shults has been widely lauded for her performance under intense pressure.

How do these pilots keep their wits about them in dire situations with so much on the line? And what can we learn as investors from these terrible accidents?

1. Be your own NTSB. Air travel has become as safe as it is, in large part, because of the painstaking response to these types of events. When accidents occur, the National Transportation Safety Board swoops in and investigates every detail. If the problem is mechanical, new fixes are mandated. If pilot actions were partly responsible, new training procedures are created and put in place. One way or another, whatever caused that particular issue is identified and definitively addressed so the same situation doesn't recur.

Unfortunately, the precision involved in those meticulous investigative responses can't be duplicated when it comes to the economy or investing. Air travel is governed by physics, where the same inputs produce the same results every time. In contrast, the economy and financial markets are not "hard" sciences. Sure, it's possible to go back to a given recession or bear market and glean lessons from past experience. But those lessons are rarely ironclad—the next time around, investors may react differently to the same set of inputs. This is why economists can't keep recessions and bear markets from recurring, even when they closely resemble past episodes. There's too much behavioral variability involved.

While there may be no way for an "Economic NTSB" to stop these episodes from recurring at a macro level, it is possible to intervene at a "micro" (individual/personal) level. Often, the mistakes investors make are behavioral or emotionally-driven. For these, being your own NTSB can be remarkably effective. Identifying investment mistakes you've made and putting corrective measures in place can be a highly effective practice to keep you from repeating them.

2. Emulate the pilots. Faced with potentially crippling tension and fear, professional pilots manage to keep their wits about them. Recordings of their communications reveal remarkable clarity and steadiness. How do they do it? They train and prepare for these situations in advance, then rely on their training when disaster strikes. When these situations occur in the air, these pilots are able to respond cooly under pressure because they've drilled for those situations in simulators. It's not the first time they've seen something like this. While they may not have simulated the *exact* situation they now face, part of their training has been, in essence, to repeatedly ask themselves, "How would I deal with ___?"

This is a key technique we can emulate as investors. In fact, we have some advantages over pilots in this regard, because we know that many of the "accidents" we'll face aren't a matter of *if*, they're a matter of *when*. Some of them, like bear markets, recur frequently enough that we'll likely get to practice our response more than once!

Asking yourself how you'd deal with various investing scenarios is a valuable exercise.[1] SMI suggests the following three-step process for preparing for future trouble:

1. Create a plan in advance—preferably in writing.
2. Rely on mechanical triggers for future decisions. This eliminates making judgment calls under emotional duress, a sure recipe for failure. SMI strategies are built on such mechanical triggers, and some (like Dynamic Asset Allocation and Fund Upgrading) have defensive protocols already built in.
3. Stick to your plan! Believe it or not, this is the toughest part emotionally. But drilling for these scenarios in advance will help prepare you to control your emotions when scary future events arrive.

Mark

MARK BILLER
EXECUTIVE EDITOR

CONTACTING US
Correspondence can be emailed to SMI at help@soundmindinvesting.com. Our toll-free Reader Services line (877-736-3764) is available for handling clerical matters such as subscriptions, billings, newsletters not received, and changes of address. Please be advised, however, that the SMI staff is not trained in matters of personal counseling and it is our policy that they not attempt to do so over the phone. If our staff is busy when you call, you may leave your information on our secure answering system.

POSTMASTER
Sound Mind Investing is published monthly by Sound Mind Investing, 9700 Park Plaza Ave Ste 202, Louisville, KY 40241-2287. Periodicals postage paid at Louisville, Kentucky USPS (006344). POSTMASTER: Address changes to: SMI, 9700 Park Plaza Ave, Unit 202, Louisville, KY 40241-2287. This is Issue 335 • Volume 29 Number 5. Mailing date: 5/04/2018.

[1] The MoneyGuidePro® software available to Premium Members is an invaluable tool for modeling the impact of various "what-if" scenarios. See SMI's February 2017 cover article for details.

Long-Term Care: How Would You Cover The Cost?

(continued from front page)

Instead, it involves assistance with the *activities of daily living*, such as bathing, dressing, using the toilet, transferring to or from a bed or chair, caring for incontinence, and eating. It may also involve *instrumental activities* of daily living, such as grocery shopping, cooking, and cleaning.

• **How many people will need LTC?** According to HHS data, 69% of today's 65-year-olds eventually will need *some type* of long-term care,[1] whereas 52% will experience a *high need*— that is, a cognitive impairment or the need for help with at least two activities of daily living, which is the point at which long-term care insurance policies typically pay benefits. Because of their longer life expectancy, more women are likely to experience a high LTC need than men (58% vs. 47%).[2]

• **How long is LTC needed?** According to HHS, among those who need *any* type of long-term care, that need lasts for an average of three years. Among men who are expected to experience a *high need*, that need is expected to last 18 months, although 10% are likely to experience a high need that lasts five years or more. Among women who experience a high need, it is expected to last 30 months, although 18% are likely to experience a high need that lasts five years or more.

Working through the math, about 5% of *all* men are expected to experience a *high need for long-term care that lasts five years or more*, as are about 10% of *all* women.

• **Where is LTC provided?** Keep in mind that *long-term* care is not necessarily synonymous with *nursing home* care. In fact, HHS says most people who need long-term care can live at home for many years and unpaid caregivers, such as family members, provide 80% of in-home care.

In large part, the level of care needed is what determines *where* LTC can be provided. For example, is skilled nursing care needed, or only assistance with the activities of daily living? While reduced mobility could probably be managed at home, dementia likely needs to be managed in a professional-care facility, at least eventually.

Another factor is whether you have adult children and whether they're willing and able to help out. According to Rand Corporation research, older people with four or more children spend about 38% less on long-term care than those with no children; those with adult *daughters* spend even less.[3]

Still, the Department of Health and Human Services estimates that 37% of today's 65-year-olds eventually will receive *some* care in a facility, such as a nursing home or assisted-living facility.

Rand research says the percentage is higher. It analyzed 18 years of data from the Health and Retirement Study[4] and estimated that 56% of people age 57-61 will spend at least one night in a nursing home in their lifetime. However, it notes that most who receive nursing home care "will experience short stays… at a relatively affordable cost."

A study by Boston College's Center for Retirement Research found that among men who enter nursing homes, the average length of stay is less than a year; for women, it's 17 months. For many, their stay is even shorter, with half of men and 39% of women staying less than 90 days.[5]

However, some people experience nursing home stays that last much longer. According to Rand, someone currently age 57 to 61 has a 10% chance of spending three years or more in a nursing home and a 5% chance of spending four years or more.

• **What's the cost and how is it covered?** According to HHS data, about 27% of today's 65-year-olds are expected to incur LTC costs of $100,000 or more. (Remember, the median annual cost of a private nursing-home room nationally is nearly $100,000.) For 15%, the costs are expected to exceed $250,000.

As daunting as those figures may sound, here, too, definitions matter. These costs are not necessarily *out-of-pocket* costs. A 2013 analysis of data from the Centers for Medicare and Medicaid Services found that only 17% of all LTC spending was out-of-pocket. *Public spending* (mostly Medicaid and Medicare) covered 72%, with the remaining 11% covered by private insurance and other private sources.

When looking more closely at how long-term care costs are covered, Rand concluded that only about one-third of people age 57-61 will spend *any* of their own money on long-term care and just 5% will experience out-of-pocket long-term care expenses exceeding $47,000.

Admittedly, the national statistics on long-term care can be bewildering. Still, they provide a broad-brush view of the average person's probability of needing *some type* of long-term care (fairly high), and if so, the likelihood they'll experience a long nursing-home stay (relatively low).

To better understand *your* risk, take a good look at your health. Do you have diabetes, high blood pressure, or heart problems? Is there any family history of stroke, heart disease, cancer, or most importantly, dementia? According to the Alzheimer's Association, the risk of getting Alzheimer's goes up significantly if you have a primary family member who has had it,[6] and half of all nursing home residents in 2014 had Alzheimer's or other dementias.[7]

If you need LTC, won't the government help?

This is an area of much confusion, with many people wrongly assuming that Medicare will pay for a nursing home stay. Medicare typically does *not* pay for extended nursing home stays, but it *does* cover skilled nursing care if you are there for rehabilitation purposes following a hospital stay. In those cases, Medicare covers the first 20 days and part of the cost for the next 80 days. Medicare may also provide short-term home health care if you are recovering from an illness or injury, as well as hospice care if you are in the last stage of a terminal illness.

Medicaid, on the other hand, is a state and federal government program that pays for nursing-home services for people with low income and few assets. In most states, it also pays for long-term care services at home. Eligibility and the services covered vary by state. The quality of care may vary as well, as only certain nursing homes are Medicaid-approved.

Should you buy long-term care insurance?

The natural solution to managing the risk of costly long-term care is to buy a long-term care insurance policy. However, the LTCI industry is in upheaval. Many insurers were

[1] bit.ly/2JZQut5 [2] bit.ly/2K1L1ly [3] bit.ly/2qKXy3W [4] bit.ly/2qHEEMc
[5] bit.ly/2F0NDwi [6] bit.ly/2HckOyJ [7] bit.ly/2qN5EJl

caught in a perfect storm of *under*estimating how many claims would be filed and how long they would have to be paid, *over*estimating how many people would eventually drop their policies, and failing to account for low interest rates that have minimized earnings on their investments.

Those missteps have led to a painful ultimatum for many current LTCI policyholders: Either keep your current benefits in exchange for a steep rate hike, or keep your premiums the same in exchange for reduced benefits. The mispricing of policies also has resulted in massive industry consolidation. According to an insurance industry report, 90% of insurance companies that once offered long-term care insurance no longer do so.[1]

The companies still writing policies are believed to have done a better job of pricing in their future risks. That means new policyholders may be less vulnerable to hefty future rate hikes. However, it also means today's policies are expensive.

For example, a 55-year-old man buying a policy from Northwestern Mutual that provides $7,500 in monthly benefits for three years after a 12-week *elimination* (waiting) period would pay $2,205 per year. And that's without any inflation protection. Building in an automatic 3% annual increase in monthly benefits pushes the annual price to $4,695 for level premiums. Or, he could opt for a starting premium of $2,257.50, but that premium would increase by 3% each year, eventually becoming cost-prohibitive. The same policy for a woman would cost 50%-60% more.

The high cost of coverage goes a long way toward explaining why relatively few people carry LTC insurance. According to an Urban Institute analysis of the University of Michigan's Health and Retirement Study, only 11% of people age 65+ have a private LTCI policy. Not surprisingly, wealthier people, who have more net worth to protect and can more easily afford coverage, are more likely to carry it. Among those with a net worth of $500,000 to $1 million, 20% have a policy, as do 25% of those with over $1 million.[2]

Your financial health is an important consideration when deciding whether to buy long-term care insurance. Several years ago, The Society of Actuaries suggested that $2 million is roughly the amount of savings needed to be adequately self-insured against the risk of a costly long-term care need.

On the other end of the spectrum, those with savings of less than $250,000 may be better off *without* long-term care insurance. They will likely find it difficult to afford LTCI premiums. Plus, if nursing home care is needed, their savings would be used up quickly, leaving them eligible for Medicaid.

That leaves people with $250,000 to $2 million in assets as potentially having the greatest need for LTC insurance.

However, these guidelines are only that—general frames of reference. People with more than $2 million in savings may not *need* LTCI, but some may *want* it to protect their assets for heirs or other beneficiaries. By the same token, people with $250,000 to $2 million may prefer to protect themselves from the risk of a costly LTC need by some other means (we'll discuss other options in a minute).

If you decide to buy a LTC policy, key factors that will affect how much you'll pay include:

• **Age.** The younger you are, the more likely you are to qualify and the less expensive your premiums will be, at least initially. Of course, younger people are likely to pay for their insurance over a longer period of time, raising the total cost of coverage. The risk in waiting is that you may develop a medical condition that disqualifies you from coverage.

Generally, 55-64 is the age-based sweet spot for considering LTCI. You should still be healthy enough to qualify for coverage and, depending on the coverage options you choose, a policy still may be affordable.

• **Health.** People with diagnosed memory loss or arthritis are almost always denied. By the same token, survivors of some conditions, including cancer and congestive heart failure, have been able to purchase policies if they can show that their condition is under control.

• **Elimination period.** This is the number of days that you need to qualify for coverage before coverage actually begins. Options typically range from 12 to 52 weeks. The longer the elimination period (and thus, the more you must pay out-of-pocket before benefits begin), the lower your premium.

• **Daily benefit.** Options typically range from $50 to $400.

• **Maximum benefit period.** This is how long the coverage will last once you start using it. Common options range from one to five years.

• **Inflation protection.** Options usually range from no inflation protection to an automatic 5% annual increase.

Scott Olson, a long-term care insurance broker with 23 years of experience, generally recommends buying a policy that provides a large monthly benefit, but forgoing inflation protection. That would help keep the premiums relatively affordable. It would also mean that insurance would cover most, if not all, of the cost of a long-term care need that strikes when you have many years left to live. Over time, as the cost of care rises with inflation, the policy would cover a smaller percentage of those costs. While you'd have to shoulder more of the cost, it would be for a shorter period of time.

• **Shared care.** Ask about a shared-care rider that gives you and your spouse access to each other's benefits if you use up your own. That may make coverage more affordable, but not every company offers such policies.

Whether to buy long-term care insurance doesn't have to be an all-or-nothing decision. You may benefit from buying a relatively small policy that would take the sting out of a costly nursing home stay without requiring an equally stinging monthly premium payment.

If you decide to buy insurance, choose your insurer wisely. Go with a company that's highly rated by A.M. Best, Moody's, and Standard & Poor's, and that conducts significant business in your state. Keep in mind, however, that even strong insurers may raise your rates. While they can't single out individual policyholders, they can seek approval from state regulators to raise rates on groups of policyholders, such as those who opted for a certain level of inflation protection.

Alternatives to long-term care insurance

Here are other ways to pay for long-term care.

• **Hybrid whole life/LTC policies.** Sales of these policies currently outpace sales of pure LTCI policies by a margin of

[1]bit.ly/2K1L1ly [2]urbn.is/2qKgkZh

2-to-1, according to LIMRA, an insurance industry trade group. Their appeal is the certainty of collecting a benefit—the death benefit. Plus, they provide the option to use a portion of that benefit to cover long-term care expenses. Still, such policies are not inexpensive.

For example, it would cost a 55-year-old man about $5,000 per year to buy a Northwestern Mutual policy with a death benefit of $125,000, a portion of which could be used to provide a $4,200 monthly LTC benefit. With dividends reinvested, the death benefit is projected to grow to $235,000 by age 80; the monthly LTC benefit is projected to grow to $8,760.

It isn't the LTC rider that makes the policy so expensive (that accounts for just $280 of the annual premium); it's buying a whole-life insurance policy at age 55.

• **Personal investments (i.e., self-insuring).** Consider how much could be accumulated if the money that would otherwise be spent on insurance were invested instead. For example, if the 55-year-old man from our first example invested the same $2,205 each year and earned a 7% average annual return, by age 80 he'd have nearly $150,000 available to use for healthcare. That's less than the $270,000 total maximum benefit his policy would pay, but by saving on his own, the money is available whether he needs LTC or not.

One of the most attractive ways to self-insure is to use a health savings account (HSA). Accessible to those with high-deductible health insurance policies, an HSA combines the benefits of both a traditional IRA *and* a Roth IRA. Contributions are tax-deductible. Withdrawals are also tax-free as long as the money is used to pay qualified healthcare expenses, including Medicare (and LTCI premiums). Plus, a number of HSA custodians enable customers to *invest* their balances.

If the money isn't needed for healthcare, it can still be withdrawn. However, you'll have to pay income taxes on the money, which means the account will have operated like a traditional IRA. As long as you are 65 or older, there will be no penalties on such withdrawals. (Note: You cannot contribute to an HSA after joining Medicare.)

• **Reverse mortgage.** If you own your home outright or owe very little, you may be able to borrow a large portion of the equity and not have to repay the money as long as you or your spouse remain in your house. If one of you enters a nursing home and the other is able to continue living on his or her own, you can continue using the loan. When the home is eventually sold, any remaining equity would go to you or your heirs. If the loan amount ends up exceeding the value of the house, you would owe nothing.[1]

• **Family support.** People often worry about being a "burden" to their kids. However, there was a time when multi-generational families were the norm and people more readily helped care for their parents or grandparents. Perhaps more families would benefit from open conversations about taking care of each other across generations.

Depending on how much outside help is needed, within-the-family care may cost less than an assisted-living facility and may provide a better quality of life for those needing care in their later years. If you're the one in need of care, it may be difficult to ask an adult child for assistance, but if you're the adult child of a parent or grandparent whose health is in decline, consider what you might do to help.

Get your financial house in order

Being able to afford later-life healthcare will be much easier if you take the following steps.

• **Enter retirement mortgage-free.** Planning ahead to retire your mortgage by the time you retire will provide helpful financial margin.

• **Enter retirement car-payment free.** It is generally wise to avoid financing or leasing a car, and that becomes even more important in retirement. A true story: After Jennie's mom passed away and her dad entered an assisted-living facility due to the debilitating effects of dementia, Jennie took the car her mom had leased and turned it in to the dealership. Even though the dealer sold it, her dad received collection notices saying he owed over $10,000. Jennie sent the agency her mom's death certificate and told them her dad could not afford to pay. The issue still has not been officially resolved, adding undue stress during an already painful time.

• **Shore up your health insurance.** Choose a Medigap plan to pair with original Medicare, or a Medicare Advantage plan. Either option can fill in some of the gaps left when using only original Medicare. For example, if you are hospitalized and then discharged to a skilled nursing facility temporarily for rehab, Medicare will cover all of the costs for 20 days, and then 80% of the costs for another 80 days. Some Medigap policies will cover the remaining 20% of those last 80 days.[2]

• **Consider where to retire.** The costs of long-term care vary greatly, based on where you live. According to Genworth, in Alaska, the median monthly cost of a private nursing home room is over $24,000; the median in Oklahoma is $5,293. Assisted-living facility costs range from a median of $6,015 per month in Delaware to $2,700 per month in Missouri.

If you're able to stay in your home while needing care, remember that the cost of property taxes varies a lot from state to state as well. And, as mentioned earlier, living near an adult child who is willing to provide assistance should you need it could be very helpful—financially and otherwise.

• **Put your paperwork in order.** Make sure you have an advance healthcare directive, which combines a living will, a power of attorney for healthcare matters, a guardian appointment, and possibly a HIPAA waiver.[3]

No easy answers

What should you do to protect yourself from the risk of an expensive long-term care need? As you can see, there is no one-size-fits-all answer. To a great degree, it depends on your health, your family's health history, and your financial situation. Hopefully this article has equipped you with the questions to consider and some viable options.

Thinking about this issue is an essential part of whole-life stewardship. Far better to sort through it before you need long-term care, which can happen at any age. As the Bible cautions, *The prudent see danger and take refuge, but the simple keep going and pay the penalty* (Proverbs 22:3).◆

[1]bit.ly/SMI-ReverseMort [2]bit.ly/SMI-Medigap [3]bit.ly/SMI-EstatePln

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

TIME TO REPLACE YOUR OLD CAR WITH ONE THAT HAS A WARRANTY?

At some point, it'll happen: You'll face a car repair (or two or three) that will make you wonder if you should get rid of that old car and buy another.

The repair-or-replace question isn't necessarily easy to answer. To be sure, if your budget is hemorrhaging money from one car repair after another, replacing that clunker with another car—especially one that comes with a multi-year warranty—can seem especially attractive.

After all, is it better to spend unpredictable amounts on increasing incidents of auto repair? Or to put money toward purchasing another vehicle—even if it requires a monthly car payment—that will incur minimal repair costs over the life of the warranty?[1]

These days, such warranties are available not only on new cars but on many used cars as well.

Do the math

To think through the repair/replace conundrum, it's necessary to do a few calculations—and make assumptions. First, you'll need to make an informed assumption about repair costs.

A 2017 study by AAA found that the average car-repair bill is between $500 and $600. So let's assume you'll have several "average" bills over the course of the next year, or maybe one or two biggies. We'll project a one-year repair cost of $2,000. Of course, that's just a guess, but a guess is all you can make.

Next, find out how much your current car is worth by checking the sites of Kelley Blue Book[2] and/or Edmunds.[3] (Many experts believe Edmunds is a more accurate source, but that's not always the case, which is why averaging the two makes the most sense.)

For purposes of this article, we assumed the current car is a particular 2008 sedan in average condition and with moderate mileage. According to Kelley Blue Book, it likely would fetch about $2,500 if sold to a private buyer (but would be worth less as a trade-in).

"Certified Pre-Owned"

Now, it's time to check the cost of a replacement. Let's assume you want to get a used car, thereby avoiding the rapid depreciation of a new vehicle (new cars typically lose 20% to 30% of their value in the first year!). The two websites mentioned earlier—Kelley Blue Book and Edmunds—are good resources for locating "Certified Pre-Owned" (CPO) vehicles, i.e., dealer-sold used cars that come with a limited warranty. (Narrow the field with "Best Used Cars by Price"[4]—free from *Consumer Reports*.)

The duration of the "powertrain" warranty for CPO vehicles—covering engine and transmission—typically will be based on the date when the car was sold new. So, for instance, if you bought a four-year-old car that had an original six-year warranty, the powertrain warranty would last two more years. Most CPO vehicles also include a "bumper-to-bumper" or "comprehensive" warranty covering a range of other items. (Tires and routine maintenance—such as oil changes—are not included, however.)

For purposes of this article, we searched for a Toyota sedan and found a 2014 CPO Camry with 40,000 miles on it. The vehicle had three years (or 60-thousand miles) remaining on the powertrain warranty, plus it came with a 12-month/12,000-mile comprehensive warranty. The price—at $14,900—was within Kelley Blue Book's "fair-market range."

Let's assume we can indeed sell our current car for $2,500 and we put those proceeds toward buying the Camry for a negotiated price of $14,500. Of course, paying *cash* is the most cost-efficient approach, but for purposes of illustration, we'll finance the remaining $12,000 for three years at 4% interest. That gives us a monthly payment of about $350.

Remember, however, we're now avoiding an estimated $2,000 a year—roughly $167 a month—in car repairs. Therefore, the net monthly cost of replacing the older car is about $183 (i.e., $350-$167). In other words, our monthly automotive outlay has risen $183. The true increase likely will be even higher because of more expensive auto insurance.

Obviously, the cost would go higher still if we chose a *new* car rather than a used one! Although a new car would come with a longer warranty period than a "pre-owned" vehicle, the purchase price would be thousands of dollars more. (To compare the projected cost of buying a new versus a used car—and also to compare the operational cost of various makes and models—use the True Cost to Own® calculator at Edmunds.com.)

Considerations and preparation

Of course, the repair-or-replace conundrum isn't simply a "spreadsheet" decision. Many considerations come into play when making a decision to buy a car—including safety, peace of mind, comfort, gas mileage, and family size. Yet the money aspect is keenly important. Minimizing auto expenses is essential for anyone who wants to give generously, have funds to save and invest, and also enjoy the peace of mind that financial margin helps provide.

That's why it is important to plan and prepare for the day of replacement, rather than waiting until decision time is at hand. To be able to buy a late-model used car that comes with a multi-year warranty, while also avoiding a monthly car payment, start preparing now by setting aside a regular amount each month for car replacement.

When the day comes, you'll be able to make a purchase with cash and then enjoy the best of both worlds: no monthly payment and—for a time at least—limited repair bills. ◆

[1]Car dealers and third-party companies sell "extended" warranties as well. However, a 2014 *Consumer Reports'* study found that most people who purchased such warranties spent more for the coverage than they saved in repair costs. [2]bit.ly/2qrg420 [3]edmu.in/2ElGBw2 [4]bit.ly/2qu5GXj

Developing Your Investing Plan

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

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

THE STOCK MARKET IN "3D"

Movie fans enjoy watching movies in "3D" because they offer depth and perspective beyond what's available in a standard "2D" picture. Viewing the market outlook in "three dimensions" can potentially offer similar depth and perspective.

In this case, the three dimensions are the various time frames one should consider when thinking about investing in stocks. The outlook for stocks over the *short*- or *intermediate*-term may be very different from the *long*-term outlook. It's important to have some understanding about each time-frame so one can have reasonable expectations, which leads to better emotional control and less risk of damaging decisions as the market travels its often bumpy path.

Long-term outlook (10+ years)

Historically, no other asset class has grown like stocks. Over the past century, stocks have grown at a roughly +10% annual clip—significantly higher than other asset classes (for example, government bonds have earned ~5.5% annually, real estate ~3.8%, cash ~3.4%). But those stock-market returns come with a significant amount of volatility, which produces a "two steps forward, one step back" type of path.

That sounds reasonable enough in theory, but as anyone who lived through the -50% financial crisis losses a decade ago will attest, those "step back" periods can sorely test one's emotional fortitude! That's why it's crucial that investors understand the market's normal patterns. Full-blown bear markets with losses exceeding -20% tend to come along at least once per decade or so, while market corrections of at least 10% have occurred roughly every other year, on average. SMI has long recommended that investors have at least a five-year investing horizon when investing in stocks; 10 years is even better. Sometimes it takes that long for stocks to recover the ground they lose during deep bear markets.

Still, if you want to grow your investment capital at a rate significantly higher than inflation—which most people need to do to build up a nest egg capable of helping carry them through their later years—allocating at least part of your portfolio to stocks is usually necessary. Most investors with longer than 10 years to invest should allocate the majority of their portfolio to stocks, while those with less than 10 years before they begin drawing down their investments should scale back their stock exposure.[1]

Short-term outlook (0-3 years)

It's helpful to recognize that the longer one's investing time frame, the more predictable the expected returns from stocks become. The opposite is also true: over the short-term, there is little rhyme or reason to the market's returns. The more willing you are to accept this fact, the easier investing becomes, because you can stop agonizing over every news item and its likely impact on stock prices.

The nearby table illustrates this long-term/short-term difference vividly. Note how over any given one-year period (left column), the range of investment outcomes is spread widely across the six groups, with many periods of +20% gains, -20% losses, and everything in between. But over 10-year holding periods (far right column), the returns cluster together in just two groups, with 98% of 10-year periods providing positive returns, and 70% of those periods generating returns +10% or better.

As we'll discuss in a moment, we believe the market is providing strong clues as to its likely behavior over the intermediate-term (3-10 years). And we've already covered how investors can feel reasonably confident about the market's long-term (10+ years) prognosis, based on the historical consistency of its past long-term performance.

But the short-term? Who knows? SMI's many decades of combined investing experience has persuaded us that consistently predicting what the market will do next is impossible.

As investors, we have to accept that the short-term is unpredictable. That's why SMI focuses on building long-term, all-weather portfolios that adapt to market changes. In other words, you should *already be* in a portfolio that you can live (continued on page 77)

THE PROBABILITIES OF STOCK MARKET SUCCESS

	Invest for 1 Year	Invest for 3 Years	Invest for 5 Years	Invest for 7 Years	Invest for 10 Years
Probability of Annual Gain of 20% or More	**40%**	**25%**	**18%**	**12%**	**6%**
Average value of a $1,000 portfolio	$1,376	$2,044	$2,974	$3,996	$6,798
Probability of Annual Gain of 10% to 20%	**20%**	**38%**	**46%**	**50%**	**64%**
Average value of a $1,000 portfolio	$1,148	$1,516	$1,987	$2,681	$3,895
Probability of Annual Gain of 10% or Less	**15%**	**21%**	**24%**	**32%**	**28%**
Average value of a $1,000 portfolio	$1,050	$1,195	$1,324	$1,532	$1,846
Probability of Annual Loss of 10% or Less	**11%**	**11%**	**8%**	**5%**	**2%**
Average value of a $1,000 portfolio	$953	$864	$807	$806	$754
Probability of Annual Loss of 10% to 20%	**7%**	**3%**	**3%**	**<1%**	
Average value of a $1,000 portfolio	$861	$649	$475	$433	
Probability of Annual Loss of 20% or Worse	**7%**	**2%**	**<1%**		
Average value of a $1,000 portfolio	$653	$279	$277		

[1] SMI members can find step-by-step guidance on how to determine an appropriate personal stock/bond allocation in the *Start Here* section of the SMI website.

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

1ST QUARTER REPORT: THE RETURN OF VOLATILITY

The stock market started the first quarter with a bang, extending the 2017 rally with a January gain of +5.7%. But an unexpected bump in February's wage-inflation report rattled investors, producing a surge in volatility and ushering in the first "correction" (a decline of 10% from a prior high) in two years.

While stocks quickly recovered much of the ground from that February correction, volatility has remained high. In 2017, stock prices moved 1% or more in a day only eight times. By early April of 2018, the market had already experienced *28* such days. This volatility spike has felt particularly jarring given the long stretch of record-breaking *low* volatility that preceded it.

Given that January's action was so different from the rest of the quarter, the cumulative results can be a bit misleading. For example, the -1.0% first quarter loss for the S&P 500 seems mild enough, but belies the fact that it was up big in January (+5.7%), then down -3.7% in February and -2.5% in March.

In many respects, the end of the first quarter found the financial markets at an inflection point of sorts. The stock market was testing its longer-term trend lines, but hadn't broken through them. Many consider those trend lines an indication of whether the overall trend is positive or negative, so a break below would potentially indicate a "regime change" from last year's uptrend. Meanwhile, a similar situation developed for bonds with 10-year Treasury yields rising to near the 3% level that some consider to be a turning point, but then backing off. For both stocks and bonds, the longer-term trends remain intact, but under pressure.

Just-the-Basics (JtB) & Stock Upgrading

Both JtB and Stock Upgrading beat the broad market in the first quarter. JtB lost -0.3% overall, while Upgrading was off -0.1%. Both were aided by their positions in foreign stocks, which continued their strong performance of the past year. The U.S. dollar has been weak relative to other currencies, which boosts the returns U.S. investors get from foreign-stock holdings.

FIRST QUARTER PERFORMANCE OF STOCK FUNDS BY RISK CATEGORY

Risk Category		SMI Funds[1]	Average Fund[2]
Cat 5:	Foreign Stock Funds	1.0%	-0.2%
Cat 4:	Small Company/Growth	-1.0%	2.3%
Cat 3:	Small Company/Value	-3.1%	-2.8%
Cat 2:	Large Company/Growth	4.0%	2.3%
Cat 1:	Large Company/Value	-1.5%	-2.6%

FOOTNOTES: [1] Average of the three recommended funds for each risk category (page 74), assuming any suggested changes were made on the last trading day of each month. [2] An average of all the mutual funds in the SMI risk category shown, including both load and no-load funds.

The other trend worth noting has been the domination of growth stocks over value. In the first quarter, both small- and large-growth stocks had roughly a 5% advantage over their corresponding value counterpart (this is more obvious in the "Average Funds" column of the table above). Over the past year, this advantage has reached about 14% for each growth group over its value counterpart. The situation is reminiscent of the end of the 1990s bull market—the only other time in history that stock market valuations have been as high as they are today.

Bond Upgrading

Inflation is the mortal enemy of bond investors, so its return as a potential foil—after a decade of being completely off the table as deflation concerns reigned—rattled bond markets. All of the funds that Bond Upgrading tracks posted negative first-quarter returns, indicating there wasn't anywhere to hide. (One bright spot: as of April 11, the lone positive 3-month return in our Bond Upgrading universe belonged to our current recommendation. So at least we've been as well-positioned as possible since the bond landscape shifted in early February.) Bond Upgrading's loss of -1.4% for the quarter was slightly ahead of the -1.5% declines of both the Barclays U.S. Aggregate Bond Index and Vanguard's U.S. Total Market Bond fund.

The Federal Reserve hiked interest rates for the sixth time in this cycle on March 21, boosting the short-term rate to 1.50%-1.75% (they target a range now, rather than a specific number). While that's still a low rate by historical standards, it's a considerable boost that is transforming the short-end of the interest-rate curve. Consider the 2-year Treasury bond, which yielded 0.2% five years ago but is now up to 2.3%. And the Fed has clearly stated more rate hikes are forthcoming, with the market expecting at least three, if not four, total hikes this year. This means continued pressure on bond prices as yields "normalize" toward higher levels. As such, we don't feel this is the time to be taking any risks in the bond portion of our portfolios.

Dynamic Asset Allocation (DAA)

DAA's total return of -1.8% may seem lackluster, but it masks the two distinct performance periods within the quarter, each of which provided about what we would have expected from DAA. In January, when stocks were up big, DAA lagged—as it often will in strong markets. But when stocks suffered significant losses in February and again in March, DAA held up much better than the market. In March, for example, the S&P 500 was down -2.5% while DAA dropped just -1.0%.

As is often the case, what DAA *avoids* is often as important as what it owns. As the table on page 78 shows, by avoiding real estate completely, and getting out of bonds at the end *(continued on page 78)*

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

ILL-INFORMED DECISIONS ABOUT SOCIAL SECURITY BENEFITS CAN BE COSTLY

Social Security seems like a simple program: You pay in during your working life, you receive benefits when you retire. In reality, it is anything *but* simple. Social Security is maddeningly complex when it comes to figuring out the best strategy for claiming benefits. It grows even murkier if a claimant is eligible for more than one type of benefit.

Unfortunately, the Social Security Administration (SSA) can't be relied on to identify and explain the best approach for claiming benefits. Case in point: A recent audit by the SSA's Office of Inspector General found that in 82 percent of the cases studied, Social Security failed to inform people who were eligible for both retirement benefits and survivor benefits about their options.

The sad result, according to the audit summary, is that SSA significantly underpaid more than 9,000 beneficiaries who were age 70 and older, and was on track to underpay an additional 1,900 recipients who had not yet reached 70. At the time of the audit, the underpayments totaled more than $130 million.

Ongoing financial harm

In a massive data-intensive operation such as the Social Security Administration, occasional mistakes are inevitable. After all, according to a March report from the Government Accountability Office (GAO), SSA has "67 million beneficiaries, and an average of 420,000 people call or visit one of its 1,200 field offices each day."

That's a lot of accounts and activity to keep straight even if the agency had top-flight systems and state-of-the-art technology. But the picture isn't so bright. According to the GAO, "SSA has struggled to...maintain program integrity, and [to] modernize its service delivery and information technology systems."

Regrettably, SSA errors sometimes inflict serious financial harm on beneficiaries, lowering benefits by tens of thousands of dollars over the course of a person's lifetime. In the cases above that were investigated by the Inspector General, Social Security employees should have told the claimants who were eligible for both retirement and survivor benefits that they would receive significantly more money over time (assuming they lived past age 70) by taking only the survivor benefit at first and delaying retirement payments until later.

That's because a survivor benefit remains steady over time, but an unclaimed retirement benefit will grow. During the time a retirement benefit remains unclaimed, the eventual monthly payout will increase by about 8% percent a year until age 70, even though the person's "Full Retirement Age" (as set by law) is less than 70. In other words, a monthly retirement benefit not claimed until age 70 is significantly greater than one claimed earlier.

Writing at Forbes.com, Boston University economics professor Laurence Kotlikoff[1] offered an example of what could happen if a widow claimed both survivor and retirement benefits at the same time, instead of waiting until age 70 to claim the retirement portion.

"[Suppose there is] retired widow named Sue who just turned 62 and whose husband just died. Sue's full retirement benefit from Social Security, at 66 (her Full Retirement Age), is $2,500 per month. Her monthly widows benefit, if she were to take it starting at Full Retirement Age, is $2,700.

"Sue's best strategy is to file just for her reduced widows benefit now, equal to $2,208 per month [which is larger than her age-62 retirement benefit], and then replace it with her [increased] retirement benefit starting at 70 when it will be $3,049 per month."

However, if Sue, just after becoming a widow, files for both benefits at the same time (which, inexplicably, the SSA application form assumes), then she will receive $2,208 per month for the rest of her life. At age 70, she cannot file for the higher benefit she could have received.

Indeed, Sue will never get her "retirement" benefit at all, only the ongoing survivor benefit. SSA will "deem" her as receiving a retirement benefit because she applied for it at age 62, but Professor Kotlikoff calls this nothing more than a "phantom benefit."

There's more. If Sue discovers she made a bad choice, SSA will allow her to suspend her retirement claim for a period of time. However, she would lose her widows benefit while her retirement benefits are in suspension!

Don't trust, verify

SSA has a legal obligation to inform beneficiaries about the dollars-and-cents impact of different claiming strategies. But in the dual-eligibility audit discussed here, the Inspector General "did not find any evidence that SSA informed claimants of the option to delay their retirement application." Further, "SSA did not have systems in place to alert its employees when they should inform widow(er)s" of their options.

The point here is not to cast stones at the Social Security Administration or its employees, although clunky systems and confusing forms certainly need fixing. Rather, it is to point out that the cost of making an ill-informed decision can be high. Conducting your own careful research about the best course for claiming Social Security could mean a difference of tens of thousands of dollars in lifetime benefits. This is true even for people with seemingly straightforward claim situations.

Such research will require the use of a specialized SS-benefits calculator. MoneyGuidePro®—available to SMI premium members[2]— (continued on page 78)

[1]Mr. Kotlikoff co-authored our Sept. 2016 cover story, *Maximizing Your Social Security Lifetime Benefits*.
[2]For information on how to sign up for MGP, go to bit.ly/SMImoneyguidepro.

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 3/31/2018	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	21.5	-0.2%	-0.4%	-0.2%	4.6%	17.1%	6.9%	1.15	0.11%	20%	16%	12%	8%	VXUS
Extended Market Index ETF	Small company stocks	18.2	0.1%	0.7%	0.1%	4.9%	13.2%	8.0%	1.18	0.08%	40%	32%	24%	16%	VXF
S&P 500 Index ETF	Large company stocks	19.0	-0.9%	-2.5%	-0.9%	5.9%	14.0%	10.8%	1.00	0.04%	40%	32%	24%	16%	VOO
Total Bond Mkt Index ETF	Medium-term bonds	-1.6	-1.6%	0.7%	-1.6%	-1.2%	1.2%	1.1%	1.01	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 3/31/2018[1]	Date Added	E-Trade 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. ☎ Allianz Intl Sm Cap - LW[12]	05/18	NTF	NTF	No	45.8	2.8%	-0.8%	2.8%	10.7%	32.3%	11.1%	1.14	1.25	100	None	AOPAX
	2. Vanguard Intl Growth	09/17	Yes	Yes	Yes	42.1	3.4%	-1.2%	3.4%	7.6%	31.2%	12.3%	1.43	0.45	130	None	VWIGX
	3. Calamos Intl Growth - LW[12]	12/17	NTF	NTF	NTF	34.6	0.1%	-0.8%	0.1%	7.0%	27.5%	7.9%	1.24	1.40	96	None	CIGRX
Category 4 Small/Growth	1. Kinetics Small Cap Oppor	02/18	NTF	NTF	NTF	54.5	5.9%	0.2%	5.9%	13.1%	35.4%	11.5%	1.29	1.66	35	2%30days	KSCOX
	2. Baron Opportunity	03/18	NTF	NTF	NTF	58.4	9.2%	-0.3%	9.2%	15.8%	33.4%	12.4%	1.49	1.41	51	None	BIOPX
	3. Delaware Smid Cap Gro - LW[12]	02/18	NTF	No	NTF	58.8	4.2%	-1.4%	4.2%	22.9%	31.7%	10.8%	1.36	1.21	42	None	DFCIX
Category 3 Small/Value	1. Hodges Small Cap	04/18	NTF	NTF	NTF	24.7	0.7%	-1.0%	0.7%	11.6%	12.5%	3.7%	1.48	1.28	47	1%30days	HDPSX
	2. ☎ Aegis Value	05/18	Yes	Yes	Yes	43.5	1.3%	2.1%	1.3%	23.3%	18.9%	17.6%	2.71	1.50	45	None	AVALX
	3. Alpha Architect US Quant Val	02/18	ETF	ETF	ETF	30.6	-1.5%	-3.5%	-1.5%	11.8%	20.3%	4.5%	1.47	0.79	40	None	QVAL
Category 2 Large/Growth	1. ☎ MS Multi-Cap Gro - LW[12]	05/18	NTF	NTF	NTF	65.2	7.9%	-1.9%	7.9%	18.9%	38.4%	16.6%	1.49	1.24	37	None	CPOAX
	2. iShares Edge USA Momentum	12/17	ETF	ETF	ETF	43.9	3.0%	-3.4%	3.0%	11.3%	29.6%	16.1%	1.04	0.15	129	None	MTUM
	3. PowerShare S&P 500 EW Tech	04/17	ETF	ETF	ETF	44.9	6.0%	-2.3%	6.0%	12.5%	26.3%	19.4%	1.32	0.40	70	None	RYT
Category 1 Large/Value	1. Toreador Core	05/17	NTF	NTF	NTF	24.0	0.1%	-0.6%	0.1%	7.2%	16.6%	10.7%	1.18	1.20	104	2%60days	TORLX
	2. SPDR Dow Jones Industrial	12/17	ETF	ETF	ETF	26.6	-1.9%	-3.3%	-1.9%	9.0%	19.6%	13.4%	1.10	0.17	31	None	DIA
	3. Miller Opportunity - LW[12]	06/17	NTF	Yes[10]	NTF	14.8	-2.6%	-2.2%	-2.6%	2.7%	14.6%	5.1%	2.04	1.36	36	None	LGOAX[10]
Bond Categories	Vanguard Inflation Protect [6]	02/18	Yes[11]	Yes[11]	Yes[11]	-0.3	-0.9%	0.9%	-0.9%	0.2%	0.5%	1.1%	1.13	0.20	7.5[7]	None	VIPSX[11]
	Permanent: Vanguard I-T Bond	Perm	ETF	ETF	ETF	-3.6	-2.0%	0.5%	-2.0%	-2.1%	0.5%	1.1%	1.29	0.07	6.4[7]	None	BIV[8]
	Permanent: Vanguard S-T Bond	Perm	ETF	ETF	ETF	-1.4	-0.6%	0.2%	-0.6%	-0.9%	0.1%	0.7%	0.45	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-April, 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 E-Trade (800-387-2331), 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. **[11]** If available, those investing at least $50,000 should buy the Admiral share (VAIPX) instead. **[12]** Normally is a load fund but is available load-waived (LW) through some brokers. Purchase only if available to you at your broker without paying a load. See original fund write-up for details.

☎ 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 Jan2018:p8.

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

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

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

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).

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	Allianz Intl Small Cap
Stock Cat. 4: Small/Growth	16%	$8,000	Kinetics Small Cap Oppor
Stock Cat. 3: Small/Value	16%	$8,000	Hodges Small Cap
Stock Cat. 2: Large/Growth	16%	$8,000	MS Multi-Cap Growth
Stock Cat. 1: Large/Value	16%	$8,000	Toreador Core
"Rotating" Bond Fund	10%	$5,000	Vanguard Inflation Protected
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	

[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 Jan2018:p8).

MONEYTALK

STOCK UPGRADING — NEW FUND RECOMMENDATIONS

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

All three funds being replaced this month were recommended in June 2017. That 11-month holding period is especially noteworthy for investors using taxable accounts (i.e., not an IRA/401(k) or other tax-advantaged account). For taxable investors who bought last June when these funds were first recommended, holding another month will change the tax status of their gains to *long-term capital gains*, which affords a potentially lower tax rate. Given that all three of the funds being sold are only slightly below the quartile and the gains in each are substantial, this is certainly worth considering. Note your buy/sell dates carefully. If you are using a tax-advantaged retirement account, this does not apply.

The phenomenon of funds being recommended together as part of the same "wave," and now also exiting together, speaks to the big-picture dynamics of the current market. Last summer, when these funds were first recommended, the "Trump rally" was pushing these high-growth funds to the top of the rankings. Now, the impact of the market correction that began in February and has continued through the end of April is being felt in the Upgrading rankings. While these three funds haven't fallen far below their respective category quartile cutoffs, it's interesting to see them continuing to move as a group—first into, and now out of, favor.

◆ **In the Foreign group, Selected International S (SLSSX, 6/2017) is being replaced.$** This fund did a good job for us, gaining +13.2% in the first 10 months it was recommended. That compares favorably to the +9.7% gain of the average fund in SMI's foreign group over the same period.

• **AllianzGI Intl Small-Cap Fund (AOPAX) is being added.[1]** The trend of load funds being made available with their loads waived at certain brokers continues. While this does add a potentially confusing wrinkle to our selection process, it's important to see the big picture—strong funds that were previously unavailable to us are now available. This is a good thing for Upgraders! This Allianz fund is load-waived at Fidelity, E-Trade, and TD Ameritrade, but unfortunately appears to be unavailable to *new* shareholders at Schwab. Perhaps if Schwab account holders call and ask why the fund is available at their competitors but not through Schwab, it might prompt Schwab to make it available.

Performance leadership has recently shifted away from last year's leaders, large-company stocks, and toward smaller-company stocks. This fund change reflects that, replacing a fund focused on large/growth stocks to one focused on smaller growth-oriented companies.

◆ **In the Small/Value group, Royce Opportunity (RYOFX, 6/2017) is being replaced.$** Chalk up another win for Upgrading, as Royce Opp has produced a +15.0% return since being recommended last June. That's well ahead of the +10.6% return of the average fund in Morningstar's small/value group.

• **Aegis Value (AVALX) is being added.[1]** This fund requires some care, as it is quite different from most of its category peers. Aegis Value invests primarily in the smallest (micro-cap) value stocks. It is also quite concentrated in "basic materials" stocks—companies involved in the discovery, development and processing of raw materials (mining/refining of metals, chemical, and forestry products). This accounts for its high 2.71 relative-risk score.

That profile causes the fund to march to the beat of a different drummer, even relative to the rest of its peer group. The fund has been a great recent performer, ranking in the top 1% of small/value funds tracked by Morningstar over the past 1- and 3-year periods. But its 5-year performance falls all the way to the 89th percentile (despite the past three years being great!) due to dismal performance in 2014 and 2015, when it finished in the 100th and 98th percentiles, respectively.

So while the fund currently has the highest momentum score in SMI's small/value rankings, we're debuting this fund as the #2 recommendation because we feel it functions better as a *diversifier* than as the *sole holding* for this risk category. For those who own multiple small/value funds, Aegis Value is a fine addition. But for those who own only one fund in each risk category, the better-diversified Hodges Small Cap may be a wiser choice for that lone holding.

◆ **In the Large/Growth group, Fidelity OTC (FOCPX, 6/2017) is being replaced.$** Despite a -5% drop over the past two months, Fidelity OTC is still up +15.9% since it was recommended last June. That's better than the +14.4% average gain of Morningstar's large/growth category.

Large technology stocks led the market to huge gains last year, but have also taken the hardest hits in this year's correction. Fidelity OTC is still close to the quartile cutoff (thus the "$" designation discussed earlier), but especially given the similar profile of fellow large/growth recommendation RYT (PowerShares S&P 500 Equal Weight Technology ETF), it's clearly time to start lightening our exposure to last year's winners and moving on to the new market leaders.

• **Morgan Stanley Multi-Cap Growth (CPOAX) is being added.[1]** Like the Allianz fund being recommended this month in our foreign risk category, this Morgan Stanley fund

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

normally carries a sales charge (or load) when purchased, but is now available with that load waived through most of the big online brokers. In this case, Fidelity, Schwab, and E-Trade all offer it load-waived, but TD Ameritrade does not. *As with any other load-waived fund recommended by SMI, if you can't buy it at your broker without a load, don't buy it!*

This is a great example of a fund that historically has not been available to us that we're thrilled to add now that the load is waived. Morgan Stanley Multi-Cap Growth ranks in the top 1% of large/growth funds tracked by Morningstar over the past 1-, 5-, and 15-year periods. That's exceptional performance in arguably Morningstar's toughest category, given that the 15-year period includes more than 500 funds, and the shorter periods include over 1,000. More funds to choose from is great for Upgrading and this fund is a strong addition to our fund universe. ◆

LEVEL 2 / CONTINUED FROM PAGE 71:

THE STOCK MARKET IN "3D"

with through a market downturn, because one could begin at any time. But at the same time, your portfolio should be able to participate in any continuing market upside, because that could just as easily be the immediate path forward.

That's a tricky balance, for sure. Thankfully, SMI provides strategies (Dynamic Asset Allocation and Upgrading 2.0) specifically designed to shift along with the market. These strategies provide both upside participation *and* downside protection based on mechanical signals that respond to the market's cues, so no predicting of the future is necessary.

Intermediate-term outlook (3-10 years)

We've established that the short-term market outlook is utterly unpredictable, while the long-term outlook can be anticipated with a fair degree of certainty. What about the intermediate "in-between" period?

This is where the market's *current valuation* provides significant insight, particularly when those valuation measures reach historical extremes. Valuation tells us very little about what the market is going to do in the *short-term*, because a cheap market can always get cheaper and an expensive market can always get more expensive. So valuation is a poor short-term timing device (another reason why the short-term is inherently unpredictable). But market history shows that valuation is a great predictor of what the market's returns are likely to be over the next decade or so.

SMI has written extensively about how today's market valuation indicators clearly show that stocks are very expensive by historical standards. By some metrics, stocks are more expensive than they've ever been, with the lone exception of the dot-com bubble peak in 1999-2000.[1] The key takeaway is that today's market valuation has historically been strongly correlated with future returns of 0-2% annualized over the next 7-12 years (depending on which measure is used). Yuck!

That's hard for some to believe (as these projections always are near bull-market tops), but it's based on decades of past market performance. Recent precedent certainly backs up that type of pessimism. Consider that on April 1, 2000 (near the last comparable valuation peak), the S&P 500 traded at roughly 1,500. A decade later, on April 1, 2010, the S&P 500 traded at 1,030. That's more than a year into the new bull market—remember that the S&P hit its ultimate low of 666 in March 2009, nearly nine years after that dot-com bubble peak. That's a long time to go without gains (and thankfully SMI readers didn't have to—Upgrading gained +6.0% annualized over that same decade).

We've said for years that the current bull market wouldn't end until the Federal Reserve raised interest rates enough to choke off the economic recovery. Consider this, written in May 2014:

> ...I expect this bull market has further to run before its done. For the past few years I've been arguing that *this bull market has been driven primarily by the Fed's easy money policies*. The Fed has gone further with their zero interest rate and quantitative easing policies than any Fed ever has before, and as a result, I've *expected this bull market to go higher and last longer than most would believe*. That's simply based on looking back at past examples of Fed largesse and extrapolating based on their recent, even more over-the-top behavior. I've written a number of times that I *don't think this bull market will end until that monetary policy begins to tighten*. And while the winding down of the Quantitative Easing programs could be interpreted as the beginning stages of that tightening, even after that stimulus ends, we'll still have interest rates at nearly zero. So I think we have a ways to go yet before this bull is finished. (emphasis added)

Unfortunately, today we're at (or at least near) the point we've long been awaiting and discussing. The Fed has boosted short-term interest rates from roughly zero to nearly 2% already, while communicating more rate hikes are planned. Consider that the Fed has undertaken 13 rate raising cycles in the past 70 years. Ten of those 13 have resulted in economic recessions. Combine that fact with today's extreme stock valuations and it's easy to see why our investing narrative has gradually shifted away from a primary focus on maximizing growth to preserving capital.

How to respond

The stage is set for stocks to underperform their long-term averages, probably dramatically, over the next decade or so. We don't know the path that will take: with no signs of recession on the horizon yet, it's plausible the market could shoot higher still in a "melt-up" to the final top. Again, the short-term is inherently unpredictable. But the intermediate-term *is* relatively predictable, because today's high valuations paint a clear historical picture of what total returns are likely to be over the next decade or so as a whole.

[1]See bit.ly/SMIvaluations for a recent review of the market's valuations and their implications for future returns. [2]If your portfolio isn't already allocated this way, bit.ly/SMI50-40-10 discusses what we believe to be a good starting point for most investors.

Investors who are prepared for this outcome (financially and emotionally) will almost certainly fare better than those who aren't. Passive investors who are buy-and-holding index funds are likely to have a miserable experience over the coming decade. We hope SMI's active strategies will do better, as they have in the past (and as they've been designed to through careful construction and verified by past back-testing). But even SMI investors will have to summon emotional courage at times to stick with their plans through what is likely to be a bumpy ride ahead.

Because we've been writing about this slowly unfolding scenario for a while, we expect most members are already properly allocated. For most, relying on strategies such as DAA and Upgrading 2.0 as the core of a long-term plan offers reason to expect solid long-term results. Those strategies should also provide important emotional support during the market declines we believe are likely.

SMI always has believed that "forewarned is forearmed." Long-term investing success is largely determined by the ability to consistently do the right thing at the right time, and avoiding harmful missteps along the way. Many investors made huge mistakes during the last bear market, selling out of fear and then staying on the sidelines as the market eventually bounced back. Those are the types of decisions that can permanently alter your lifetime investing rate of return. "Forearming" SMI readers so they can avoid that type of harmful reaction the next time around is our goal here.

No one can ever say with certainty what the market will do next. But there are times, and we believe now is one of them, when the market gives pretty clear clues as to what is likely ahead, if not immediately, then over the next several years. Investors who pay attention to these historical patterns are likely to perform better and experience less stress than those who are either unaware of—or ignore—the market's cyclical history and what we can learn from it. ◆

LEVEL 3 / CONTINUED FROM PAGE 72:

1ST QUARTER REPORT: THE RETURN OF VOLATILITY

of January—just *before* the big inflation surprise roiled the bond market in early February—DAA was able to sidestep the worst performing classes this quarter.

Sector Rotation (SR)

SR posted another strong gain in the first quarter, gaining +8.7%. But as with the other strategies we've discussed, there's more to that number than meets the eye. SR posted a dramatic +11.0% gain in January, eked out a +0.8% gain in February, and fell -2.9% in March.

But even those numbers fail to communicate the full story of SR's wild first quarter ride. After hitting a new high on January 26, SR proceeded to drop -17.8% over the next *nine trading days*. From that point, on February 8, it then staged a furious +29.1% rally to a new high on March 12—only to then drop -17.6% over the following month before bottoming on April 6. This is the sort of volatility SMI constantly warns investors they must be willing to tolerate to obtain SR's outstanding long-term returns. If you can't stick with SR when the markets fall, the headlines are scary, and your holding appears to be headed to zero, it's not for you!

1ST QUARTER 2018 DAA ETF UNIVERSE

Ticker & Category	1Q Result
SPY U.S. Stocks	-1.0%
EFA Foreign Stocks	-0.9%
VNQ Real Estate	-8.2%
BLV Long-Term Bonds	-3.8%
SHY Money Market	-0.1%
GLD Gold	1.7%

50/40/10

This portfolio refers to the specific blend of SMI strategies—50% DAA, 40% Upgrading, 10% Sector Rotation—discussed in our April 2018 cover article, *Higher Returns With Less Risk, Re-Examined*. It's a great example of the type of diversified portfolio we encourage most SMI readers to consider.[1] As we've seen repeatedly in recent years, the markets can shift suddenly between rewarding risk-taking and punishing it, so a blend of higher-risk and lower-risk strategies can help smooth your long-term path and promote the type of emotional stability that breeds sustained investing success.

A 50/40/10 portfolio would have lost only -0.1% during the first quarter, considerably less than the broad market. While the SR component was dramatically up and down (en route to significant overall gains), the DAA component would have provided an emotional offset, losing less when the rest of the market was at its worst. Overall, the first quarter provided a good illustration of how trading off both return and volatility among the various strategies can produce a smoother ride and solid overall returns. Whether you're using this specific 50/40/10 blend or a different combination, we think most SMI readers can benefit from blending these strategies in some fashion. ◆

LEVEL 4 / CONTINUED FROM PAGE 73:

ILL-INFORMED DECISIONS ABOUT SOCIAL SECURITY BENEFITS CAN BE COSTLY

includes a calculator that can run scenarios for various claiming strategies, such as applying for retirement benefits at age 62, Full Retirement Age, age 70, or any other age you wish to use. You also can test different approaches for husband and wife (such as wife at 62, husband at 70, etc.). The calculator will show side-by-side results of various approaches, estimating both the year-by-year and total lifetime benefits for each scenario.

Alternatively, simplified calculators are available from AARP[2] as well as the Social Security Administration.[3] (To get the best results, input information from your Social Security Statement.[4]) For a more detailed approach to figuring out the best course of action, you may want to consider resources from maximizemysocialsecurity.com, which charges $40 for an annual license.

You simply cannot trust the Social Security Administration to tell you what you need to know to make the best decision. Spending a little bit of time—and perhaps money—to gather reliable information *before* you apply for SS benefits could yield great dividends over the course of your retirement years. ◆

[1]Blending multiple strategies adds complexity. Some members may want to use an automated approach. See bit.ly/SMIPrivateClient. [2]bit.ly/2r1Ue5r [3]www.ssa.gov/planners/calculators/ [4]Available via ssa.gov/myaccount/

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

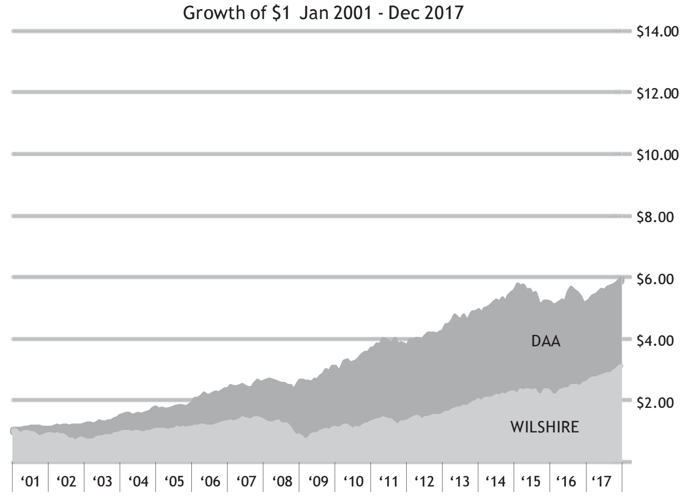
Overview

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 2017



Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Avg[1]	Worst12[1]	Rel Risk[1]
DAA	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%	16.0%	11.0%	-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%	21.0%	6.9%	-43.3%	1.00

SECTOR ROTATION

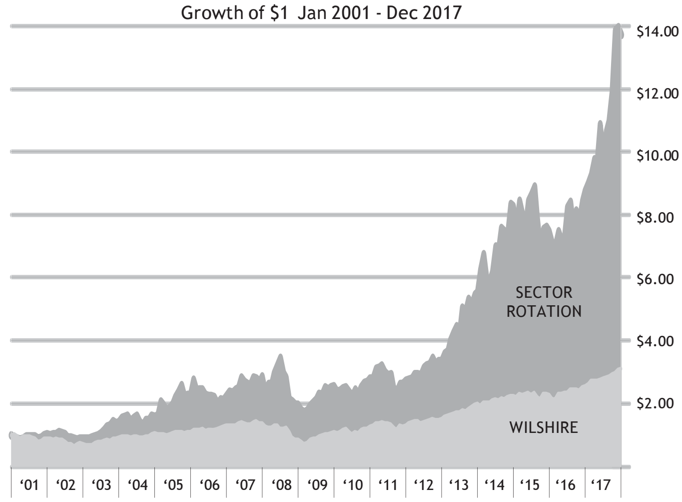
Overview

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 2017



Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Avg[1]	Worst12[1]	Rel Risk[1]
Sector Rotation	3.7%	-13.1%	54.4%	12.6%	46.1%	-1.9%	28.1%	-31.5%	30.5%	9.1%	-3.2%	23.3%	65.7%	49.9%	-9.7%	16.8%	56.7%	16.7%	-38.6%	1.70
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%	21.0%	6.9%	-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 2001-2017. "Worst12" represents the worst investor experience over 181 rolling 12-month periods from 2001-2017.

PERIODICALS POSTAGE
PAID AT LOUISVILLE, KENTUCKY

Dated Investment Material
Please Do Not Delay!

PERFORMANCE DATA

SOUND MIND INVESTING MODEL PORTFOLIOS • DATA THROUGH MARCH 31, 2018

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]	-0.8%	-2.1%	-0.8%	13.7%	10.5%	13.1%	9.6%	10.6%
Just-the-Basics[2]	-0.3%	-0.8%	-0.3%	14.3%	8.9%	11.4%	8.7%	10.8%
Stock Upgrading[3]	-0.1%	-1.7%	-0.1%	13.3%	8.2%	11.0%	8.0%	11.6%
U.S. Bond Market[4]	-1.5%	0.6%	-1.5%	1.0%	1.0%	1.6%	3.5%	3.8%
Bond Upgrading[5]	-1.4%	0.6%	-1.4%	0.2%	0.2%	2.2%	5.5%	6.2%

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]	-1.8%	-1.0%	-1.8%	8.6%	0.9%	5.2%	8.5%	11.4%
Sector Rotation[7]	8.7%	-2.9%	8.7%	52.6%	23.1%	30.0%	18.9%	20.6%
50-40-10 Blend[8]	-0.1%	-1.5%	-0.1%	14.8%	6.1%	10.2%	9.8%	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 April 2018 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 3/31/2018	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	2.32%	-1.41%	2.32%	16.56%	7.00%	9.82%	6.93%
Wilshire 5000	-0.76%	-2.10%	-0.76%	13.69%	10.48%	13.13%	9.65%
S&P 500	-0.76%	-2.54%	-0.76%	13.99%	10.78%	13.31%	9.49%

Quarterly Returns as of 3/31/2018	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	2.32%	-1.41%	2.32%	16.56%	7.00%	9.82%	6.93%
Wilshire 5000	-0.76%	-2.10%	-0.76%	13.69%	10.48%	13.13%	9.65%
S&P 500	-0.76%	-2.54%	-0.76%	13.99%	10.78%	13.31%	9.49%

Total/Gross expense ratio: 2.09% as of 1/19/18 (includes expenses of underlying funds)
Adjusted expense ratio: 1.15% as of 1/19/18 (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).

DATA COPYRIGHTS AND NECESSARY CAUTIONS