VOLUME 29 ◆ NUMBER 8

AUGUST 2018

Sound Mind Investing®

Financial Wisdom for Living Well

WWW.SOUNDMINDINVESTING.COM

The Millennial Investing Crisis

The formative scars of the 2008 financial crisis have inclined many millennials (born between 1980-2000) to be more risk-averse than other post-World War II generations, favoring the safety of low-paying savings over "riskier" stock investments. As author Patrick O'Shaughnessy (a millennial himself) explains, this overly conservative approach has huge long-term implications. Whether you're a millennial—or perhaps a parent or grandparent of one—this is an important message to share with the young workers in your sphere of influence.

by Patrick O'Shaughnessy

In 2060, lifelong friends Liam and Grace are attending their fiftieth high school reunion and reminiscing about their lives. In their 68 years, they have seen the world transformed. They watched astronauts land on and colonize Mars, saw President Pierce inaugurated as the first leader of the Global Confederate States, and marveled as the robot population surpassed the human population. They also remembered tumultuous times. Both Liam and Grace had aggressive cancers in their 60s, but survived thanks to organ replacement therapy. They also lived through the student-loan crisis of 2018, the Global Depression of the 2030s, the bioengineering and robotics stock bubble of 2041, and the plutonium and uranium crisis of 2050.

They both enjoyed successful careers and earned similar incomes during their working lives; Grace worked as a publisher and Liam worked in sales. Yet their lives in 2060 are very different. Grace now splits her time between New York City, Montana, and Tuscany; travels twice a year with her grandchildren; and is the chief benefactor of the Botswana Preservation Initiative. Liam lives with his son and daughter-in-law in Delaware, in a house that he helped them buy with some of his savings. He'd always wanted to retire in Oregon but, with the depletion of Social Security (the fund ran out in 2035), he had to abandon his dream and accept his son's support.

Liam and Grace's later years were so different because they took very different approaches to saving and investing. Liam, like many of his millennial contemporaries, didn't start saving in earnest until he was 40, and when he did save, he was very conservative with his money. Because he had watched his parents lose their house and go through bankruptcy, and seen his grandmother's stock portfolio decimated in the crash of 2007-2009, he was very averse to risky investments. He avoided stocks and instead built up his savings account. Because he had all his money in savings and bonds, he easily weathered the market crash of 2031, when a Global Depression hit and dragged the stock market down 75 percent. Liam thought his plan was safe and responsible, but come retirement, the purchasing power of his savings— what he could afford to buy—had eroded. He had saved more than $2,000,000, but it wasn't enough to live on comfortably. The modest apartment he hoped to buy would have cost $300,000 in 2014, but now, in 2060, cost $1,750,000. (continued on page 115)

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

Money & Marriage: It Takes More Than a Spreadsheet

While preparing to do some teaching at my local church about managing money effectively as a couple, my research reminded me once again why money is often such a divisive issue between spouses. Study after study shows that men and women simply think about money in very different ways. As you look at the following examples, please keep this in mind: I'm just the messenger here; I realize the research does not represent *every* marriage.

Different financial beliefs lead to different financial behaviors. When asked how they feel about money in general, men are more likely to say they feel *confident*, whereas women are more likely to say they feel *anxious*.

That may explain why men tend to overstate how much income they earn, whereas women tend to overstate how much debt they have.

Some researchers say confidence is the area of greatest difference between men and women when it comes to money matters. A Merrill Lynch report based on over 10,000 investment personality assessments found that 55% of the women agreed with this statement: "I know less than the average investor about financial markets and investing in general." Just 27% of men agreed with that statement.

That probably explains why women are more likely to seek professional investment advice, whereas men are more likely to prefer a hands-on approach to investing. As Rosanne Rogé, a financial planner who works with many couples said, "It's the men who ask to keep some money on the side to manage on their own; they want to shoot the lights out." It's no surprise, then, that men tend to trade more often than women and are more likely to believe they can successfully time the market.

As for their investment results, one study found men's excessive trading leads to lower returns. Other research has shown men and women generating similar returns, but with women achieving their results with lower risk.

One of the funnier studies I came across (although maybe it *isn't* so funny) found that 41% of women prefer going to the dentist than talking with their husbands about money.

When money becomes a taboo topic, it can lead to problematic assumptions. One study found that 73% of wives believe financial decision-making is shared equally in their household whereas only 45% of husbands believe that to be the case. It's a recipe for disharmony and conflict when one partner thinks they're being consulted on financial matters and the other believes it's unnecessary.

It can also lead to behavior that is counterproductive to a marriage. For example, in one study, 50% of married people admitted making a purchase their spouse was against. A different study found that 30% of married people have hidden purchases from their partner and another 27% have misrepresented how much they spent.

When money is an issue between spouses, there are no easy answers, but here are two steps that tend to help husbands and wives get on the same financial page.

First, figure out each other's temperaments and learn how they impact your beliefs and behaviors around money. It's been my experience that many financial conflicts are not what they appear to be about; they're a clash of temperaments.

A good starting point is the four-temperament plan devised more than 2,000 years ago by Hippocrates: Melancholy, choleric, sanguine, and phlegmatic. Each one comes with some inherent money management strengths *and* weaknesses. Learning how to leverage each other's strengths while minimizing the weaknesses can be hugely helpful.[1]

Second, set up your household's finances in a way that provides financial transparency and encourages communication. In our household, Mint.com helps us do that. It enabled us to plan our cash flow in a way we both agreed on and committed to. Since both of us can (and do) log in regularly to see how our *actual* spending compares to our *planned* spending and how much we have in savings and investments, it gives us plenty of occasions to talk about how we're doing and work through any changes we want or need to make.

If you regularly have financial conflicts in your marriage, keep this in mind: When one fallen human being tries to relate to another (especially one of the opposite sex!) on the emotionally charged subject of money, that's a situation that will require a lot of grace. We would *all* do well to remember that, striving to regularly demonstrate to our spouse that they married well by being the first to extend such grace.

MATT BELL
MANAGING EDITOR

NECESSARY CAUTIONS
It should not be assumed that all investment recommendations will necessarily be profitable. The information published in SMI is compiled from sources believed to be correct, but no warranty as to accuracy is made. SMI is not responsible for any errors or omissions. The counsel given herein is not a substitute for personalized legal or financial planning advice.

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 338 • Volume 29 Number 8. Mailing date: 8/02/2018.

[1] For more on this topic, see the February 2013 cover article at bit.ly/SMImarriagetemperaments.

The Millennial Investing Crisis

(continued from front page)

Grace took a much different approach. She started investing once she was earning her first steady salary at age 22, taking a small amount from each paycheck and investing it in the global stock market. She continued to make investments throughout her life, even after three severe market crashes that each temporarily crippled her portfolio. After the crash of '31, she invested every spare dime she had in the market. She realized early in her career that youth trumps everything in investing, and that stocks are the only logical investment for young investors. Her choices were aggressive, and she built a sizable nest egg by the time she was 50 and a small fortune by the time she was 60.

The large ultimate divergence in lifestyle between these old friends started with two simple decisions early in their lives: when to start investing and what to buy. The choices you make today—and in the years to come—will determine whether you live like Liam or live like Grace. Why did Grace succeed and Liam fail? Grace's secret was investing young and putting all her money into the global stock market. Liam's error was starting later and thinking that savings and conservative investments were safe when they were actually dangerous. As we shall see, fortune favors the young.

The millennial investor

Liam and Grace are two members of the huge millennial generation. Defined as those born between 1980 and 2000, millennials make up the largest generation in history—there are 80 million of us in the United States alone. More than half of millennials have already entered the workforce, and more than 10,000 of us turn 21 every day. Unfortunately, because of the tough times that we have already lived through and the unique challenges that we will face in the future, it will be easy to fall into the same traps as Liam. Like Liam, many of us have grown up watching the stock and housing markets crash bring devastation and even financial ruin to those we love. Student loans hang over our heads and good jobs are still scarce.

The tough environment in which we've grown up has had a huge impact on our investing preferences. In a 2013 Harris Interactive survey—which compared investing preferences across generations—millennials reported a risk tolerance about as low as those in the World War II generation. We may be young and have the highest ability to take risks of any generation, but we are as conservative as our grandparents. In the survey, both baby boomers and Gen Xers had a higher risk tolerance than millennials. The survey report says, "Millennials are the most worried of all generations. But unlike what might be expected, their concerns are very long-term in nature—retirement and their own long-term care—issues that are decades away. They are also worried about their financial situations and avoiding making financial mistakes."

Millennials responding to the survey were so conservative that, on average, they had 52 percent of their portfolio in cash. Even millennials with tons of money—$100,000 or more—had a 42 percent allocation to cash. Non-millennials, by contrast, had a 23 percent average allocation to cash—a much more appropriate number. As the survey report says of our high cash position, "Clearly this allocation is not just based on cash needs, but reflects wariness about financial markets." This entire profile of the millennial investor should sound familiar: this is Liam's attitude writ large. In the spirit of Liam's conservative approach, millennials in the survey only had 28 percent allocated to stocks, while older generations had an average of 46 percent allocated to stocks. This is a vexing contradiction, because to end up like Grace we need to own more stocks and less cash. Cash may seem safe, but as we shall see it is risky in the long run.

The good news is that young people today have more investing advantages than any group in history. Youth itself is our most important advantage, but never before have young people had such easy, cheap, and diverse access to global markets. Thanks to innovation and competition in finance, you can now buy anything you want with the click of a button. From domestic stocks, emerging-market stocks, bonds, and real estate to commodities like gold, silver, palladium, wheat, corn, and livestock (and the list goes on). A huge range of investments is available to us, all for a low fee. The variety of choices can be daunting, but the simplest choices still work the best. Before explaining why stocks are the key to wealth, we must first understand why youth is such a formidable investing advantage.

Compound returns: The great money multiplier

When I was seven years old and in first grade, before realizing how destructive it could be to my playground reputation, I played competitive chess. With time to kill between tournament games, my dad would often tell me the story of the chess master and the emperor. The story went that the inventor of chess was showing the new game to his emperor and the emperor was so impressed that he offered the man any reward that he desired. The man's clever request was that the emperor place one piece of rice on the first square of the chessboard, two on the second, four on the third, and so on, doubling the rice grains until all 64 squares were filled.

Trying to teach me a lesson, my dad would then give me two choices for a reward of my own: I could do the same chessboard doubling with pennies instead of rice grains, or have one million dollars. At the time, I was only able to double numbers up to 32 or 64, and much more concerned with when I was going to be able to play Mortal Kombat again than with his riddles, so I chose the million bucks. Well, when my father explained that if I'd chosen the doubling pennies I would have had $10 million by the 31st square and $92 quadrillion by the 64th, I felt pretty dumb.

This was my first lesson in the miracle of compounding, a very simple, but very powerful, bit of math. Compounding is so important for young people because each year of our lives is like a square on the chessboard—and we have a lot of spaces left ahead of us. Compounding is the engine that will make our stock portfolios grow, and time is the fuel. The key to compounding returns is that they have a much larger influence on our fortunes later in life than they do early on. Even if the percentage gains that we earn stay the same every year, the dollar gains will be much larger in later years. The doubling pennies in the Power of Compounding table reveal why. It takes fifteen chessboard squares to pass $100, but in the next fifteen squares the fortune grows from $163.84 to $5.4 million. Again think of each square as a year of your life. In the early squares—which represent our 20s and 30s—the dollar gains are small. But in the later squares—our 50s and 60s—the same doubling results in massive dollar gains with each new square. Your stock investments won't ever double in value in one year, but even at much lower annual growth rates, compounding is still a powerful force. Because the magic happens later on, the year you start investing has a huge influence on where you end up.

THE POWER OF COMPOUNDING

Square Number	Doubling Pennies
1	$0.01
2	$0.02
3	$0.04
4	$0.08
5	$0.16
6	$0.32
7	$0.64
8	$1.28
9	$2.56
10	$5.12
11	$10
12	$20
13	$41
14	$82
15	$164
16	$328
17	$655
18	$1,311
19	$2,621
20	$5,243
21	$10,486
22	$20,972
23	$41,943
24	$83,886
25	$167,772
26	$335,544
27	$671,089
28	$1,342,177
29	$2,684,355
30	$5,368,709

Imagine that you and two friends all make investments in the stock market at various points in your careers and all earn the same 7 percent annual return, after inflation, that stocks have delivered across history. You start investing $10,000 per year in the stock market at age 22 and your two friends invest the same amount, but one starts at age 30 and the other at age 40. Once they start investing, each makes the same annual $10,000 investment and earns the same 7 percent annual return. The only difference is time spent in the market. If you started at 22, you'd have a portfolio worth $4.7 million when you're 65. Your friend who started at age 30 would have $2.5 million, and your friend who started at 40 would have $1 million. Think of the difference in lifestyle that extra $3.7 million could buy you.

Other than time, the only other variables that could have made a difference to these hypothetical investors are the annual investment amount and the annual return. But neither higher returns nor larger investments can make up for lost time. If the 40-year-old investor somehow managed 10 percent annual returns instead of 7 percent—an enormous improvement—he'd still only finish with $1.8 million, less than half of the total you'd have earned by starting very young. If the 40-year-old investor made $20,000 annual investments instead of $10,000 investments, he'd end up with $2 million—a significant improvement from $1 million, but still well short of $4.7 million. As this example makes clear, each year is precious and there is no substitute for time. Even if you are in your 30s or 40s and haven't started investing, you should start investing now. As the Turkish proverb says, "No matter how far you have gone on the wrong road, turn back." Grace captured youth's potential, and you should too.

Risk redefined

Liam didn't fail because he was too conservative; he failed because the options that he thought were safe (his savings account and bonds) were in fact dangerous long-term investments. Savings and bonds are dangerous for millennial investors because we are the first complete generation born into a world where the value of our money has no anchor. Without an anchor, the value of each dollar (and any cash that you hold) deteriorates over time as our governments print more money.

This is a relatively new problem, because from America's founding until the 1970s, dollars *did* have an anchor: each dollar was defined as some weight in gold or silver. In our lifetimes, dollars have never been fixed to anything concrete. When dollars have no anchor, inflation is a silent killer. Even in my lifetime, inflation has ruined the value of a dollar; a car that cost $10,000 when I was born in April 1985 would cost more than double that ($22,000) in 2014. Dollar devaluation is a key variable pertaining to Liam and Grace's second important decision: what to buy.

Compounding works best if you earn strong annual returns, so the next question is: where should you invest? Following the 2008 global financial crisis, investors cared more about "risk" than they did about "return." Investments that claimed to offer "down-side protection" sold like hotcakes, because everyone wanted to avoid the pain that would come with another crash. Now, later in the bull market, people want growth, but after big bear markets like the one between 2007 and 2009, investors always prefer "low-risk" investments that will "preserve their wealth."

But what does low-risk really mean? Many investors think that a risky investment is one that bounces around a lot over short time periods. We hate to watch our portfolios drop by 10 percent or 20 percent in just three months or by 40 to 50 percent in a year. Cash or bonds will never have short returns that are that bad, so they seem much less risky. But risk should not be defined as how volatile investments are in the short term. Risk is just the odds that each individual's long-term goals will not be achieved.

Stocks are considered the most "risky" investment, at least relative to bonds and cash, because their returns are much more volatile. Stocks bounce around a lot more and have much more extreme best- and worst-case scenarios than do bonds or cash over short periods. But as the time period lengthens, stocks become less and less risky. There is a dangerous misperception that the best way to reduce risk is to own fewer stocks in one's portfolio and own more bonds and cash. That is what investors did in 2009—they sold stocks and bought bonds. They did so because risk is often defined in absolute terms—that is, stocks are riskier than bonds, period.

With risk defined as such, the easiest way to reduce it would be to own fewer stocks. But an absolute definition of risk makes no sense. It should instead be defined relative to each investor's time horizon. Stocks are indeed much riskier than bonds or cash over a one-year time horizon, but we don't have a one-year time horizon! When evaluated over

20 to 30 years—the luxurious time horizon that we millennials enjoy—the story is flipped. For long holding periods, stocks become by far the safest investment, and bonds and cash become very risky.

In the short term, stocks are the riskiest assets by far. Between the summers of 1931 and 1932, in the heat of the Great Depression, stocks declined 64 percent in value in just 12 months. More recently, between February 2008 and February 2009, investors saw their stock portfolios drop an average of 43 percent. By contrast, the worst one-year period (after inflation) for bonds was minus 11.6 percent and minus 5.5 percent for T-bills—much more manageable short-term losses. But as the time horizons lengthen, stocks become safer and safer, and bonds and bills become riskier and riskier. While stocks lose real value in 31 percent of one-year periods, they have never lost money in any 20-year period. Bonds—a perceived safe haven—have negative real returns half of the time during 20-year periods and 40 percent of the time in 30-year periods. Thanks to inflation, T-bills and bonds are often a bad choice over the long term.

We millennials must evaluate risk relative to our long-term horizon and try to ignore short-term volatility. Even if you'd invested in the stock market on the eve of the Great Depression in 1929—the single worst time to invest in the stock market in recorded history—you'd still have made money 20 years later. During the toughest times in the stock market, like 2000-2002 or 2007-2009, investors tend to trade long-term stock returns for the perceived short-term protection of cash and bonds—but this is backward! If anything, we should snatch up stocks during market crashes, because that is when they go on sale. As Ben Graham said, "bear markets are when stocks return to their rightful owners."

Stocks trump bonds

The ultimate irony is that Grace's "risky" choice to invest in the stock market turned out to be the safest and most rewarding option. While cash and savings suffer in an inflationary world, stocks flourish. In real terms, stocks have outpaced all other options in every country for which we have long-term data. In Norway, the United Kingdom, the United States, Germany, Japan, the Netherlands, France, Italy, Switzerland, Austria, Australia, Canada, Sweden, Denmark, Spain, Belgium, Ireland, South Africa, New Zealand, and Finland, stocks have provided positive real returns since 1900. In every one of these countries, stocks have outperformed bonds and bills—usually by wide margins. And while U.S. bills and bonds did provide positive returns after inflation during this period, bonds and bills in some other countries *lost* money between 1900 and 2012. Investments in supposedly "safe" short-term bills lost purchasing power in Germany, Japan, France, Italy, Belgium, Finland, and Austria. In the United States and in other countries, bills and bonds haven't helped investors build much wealth.

Over long periods, stocks have always come out on top, even in the modern era of fiat money [currency without intrinsic value]. Since the Nixon Shock in 1971 [when the U.S. moved to a fiat system], the value of the stock market has grown tenfold, while T-bills have not even doubled. $100,000 invested in the stock market grew to over $1,000,000 of real purchasing power, while $100,000 in T-bills grew to just $147,000.

Owning stocks means owning small slices of global companies that grow with the global economy, and that adapt to a changing economic landscape. Countless thousands of people work for the companies in the stock market, and when you become a shareholder, those people are working for you. America has been so successful because of its entrepreneurial, risk-taking spirit. People become wealthy by owning businesses. With the world working for you, your money multiplies.

The best-case scenario for T-bills was a doubling of purchasing power over a 50-year span from 1952-2001. For stocks, the *worst-case* scenario for every dollar invested in the overall market (as reflected by the S&P 500 index), was an eightfold return, with one dollar turning into $8.45 in real terms over 50 years. During the *average* 50-year stretch, one dollar grew to $30.31, and in the best-case scenario a dollar grew to $96.91. The power of compounding in the stock market may not be as powerful as doubling pennies on the chessboard, but it is the closest thing we have to a real-world money multiplier.

Stocks are thought of as risky because they bounce up and down a lot more than other investment options. As a stock market investor, Grace had to stick her neck out and endure some very tough times. But over a long-term holding period, the broad stock market is the safest place for your money. The United States stock market has provided positive real returns in every single 20-year period for which we have data. As noted earlier, even if you piled your money into the market the month before the great crash of 1929, you still would have made money 20 years later. Today, some people are wary of the market because it has done *too* well—it has roughly quadrupled from the market bottom in March 2009. Some say that the market is in a bubble similar to 1929, 2000, and 2007. In the face of these concerns, remember that there will never be a perfect time to buy, but even if you buy at the worst times, stocks still deliver positive real returns over time.

Buy stocks. Start now

We may never land on Mars or cure every cancer. There may not be another Great Depression, or another energy crisis, or a bioengineering bubble. But no matter what the future holds, you will succeed if you start investing in the market at a young age. Most people don't bother with investing until their 40s, but if we wait until later in our careers, we will squander the power of compounding returns and miss out on the potential for huge accumulation of wealth later in life. Liam thought he had saved responsibly, but was undone by a hidden force—inflation—that demolished his savings. Grace recognized youth's potency and ultimately prospered. Like Grace's road to riches, ours will also be bumpy. But by any measure, Grace's is the more desirable path. By making the right choices now, you can follow in her footsteps. ◆

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

HOMEBUYING? WHAT TO KNOW ABOUT CONVENTIONAL AND FHA MORTGAGES

Buying a house is the largest financial commitment most of us make, and the process can be intimidating. It involves making a series of decisions—typically about unfamiliar matters—that will have a financial impact (for good or ill) for years to come.

Among other things, you must choose whether to apply for a loan insured through the private mortgage market or one insured through the U.S. government's Federal Housing Administration. Or to put it in common parlance, whether to get a "conventional" mortgage or an FHA mortgage.[1]

The conventional-vs-FHA decision will make a difference in 1) whether you qualify for the loan, 2) costs at closing, 3) the down payment required, 4) where the down payment can come from, 5) the size of ongoing monthly payments, and 6) options available when re-selling the property.

The FHA expands homeownership

Congress created the Federal Housing Administration during the Great Depression to make it easier for low- and middle-income Americans to become homeowners. Before the FHA, it was common for mortgage loans to be limited to 50% of a property's value and for repayment schedules to be spread over periods of only 3-to-5 years.

The introduction of FHA mortgage insurance greatly expanded home ownership by giving lenders confidence to lend money to riskier borrowers. (The lenders knew the insurance, guaranteed by the U.S. government, would protect them against loan defaults.) The FHA also gradually re-shaped the mortgage marketplace by extending the length of loans and regulating interest rates.

Today, FHA-insured loans account for about 20% of all mortgage originations, according to the mortgage software company Ellie Mae. Most FHA borrowers are people whose low credit scores prevent them from qualifying for a conventional loan, or first-time buyers with limited credit histories and without much money for a down payment.

Distinguishing factors

While a conventional-loan borrower needs a FICO credit score of at least 620 to qualify, the minimum score for most FHA-insured loans is 580. (It can even be as low as 500 if the buyer is able to put 10% down.) Lenders also tolerate a higher debt-to-income ratio for FHA applicants, sometimes allowing overall debt payments (mortgage, credit cards, etc.) to exceed 50% of income.

Further, FHA lenders take a more lenient approach to previous bankruptcies and foreclosures. To qualify for an FHA-insured loan, only two years must have passed since a Chapter 7 bankruptcy and three years since a foreclosure. (For a conventional loan, the wait times are four years and seven years, respectively.)

Of course, it's the FHA-backed insurance that makes lenders willing to take a chance on higher-risk applicants and buyers with short credit histories. Although the FHA acts as the insurer, the cost of the insurance premiums is borne by borrowers.

FHA borrowers pay a mortgage insurance premium (MIP) as part of their monthly payments, just as most buyers with conventional loans must pay private mortgage insurance (PMI). But FHA borrowers face an additional insurance cost. At closing, an FHA borrower must pay (or roll into the loan) an *upfront* premium equal to 1.75% of the loan amount. In addition, while conventional-loan PMI payments can be discontinued when a borrower reaches an equity level of 80%, FHA insurance premiums continue for the life of the loan.[2]

The insurance costs borne by FHA borrowers typically make FHA loans more expensive than comparable conventional loans over time (depending on a number of other factors, including total closing costs and fees).

One other key difference between FHA loans and conventional loans is that FHA guidelines allow—if the borrower's credit score is 620 or above—for an entire down payment to be a gift from a family member, employer, or charitable organization.[3] With conventional loans, only a portion of the down payment may be from a gift (unless the buyer is putting 20% down).

The FHA's greater flexibility regarding gifts makes FHA loans attractive in cases where parents (or other relatives) want to help a young family buy their first house by giving them money for a down payment.

Other differences

The low down-payment required for an FHA-insured loan—only 3.5% of the purchase price, rather than the 5%-to-20% typically required for a conventional loan—was once the most prominent selling point for FHA mortgages. But that low down-payment advantage no longer exists, having been eclipsed by options in the conventional market.

A decade or so ago, lenders in the conventional marketplace were offering "100% financing" (*no*-money-down) loans. Although that option evaporated with the bursting of the housing bubble, lenders have resumed offering mortgages with high loan-to-value ratios—not quite "100% financing," but close. Loans requiring only 3% down (i.e., 97% financing) are common today, slightly undercutting the 3.5% down-payment requirement on FHA-insured loans.

Another area where there isn't much difference anymore between FHA and conventional loans is in interest rates. For years, FHA-insured loans *(continued on page 125)*

[1]The U.S. government also backs lesser-used VA loans and USDA loans. [2]An exception is made for borrowers who make a down payment of 10% or more, but most FHA borrowers put down only the required 3.5%. [3]A lender will require a "gift letter," signed by the donor, verifying that the money is a gift and not a loan.

LEVEL 2 TWO

Developing Your Investing Plan

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

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

UNDERSTANDING "REGRESSION TO THE MEAN" HELPS MANAGE EXPECTATIONS

In investing, as in life, it's important to manage your expectations. There's nothing quite like an unmet expectation to drive misery and misbehavior. That helps explain why fewer people own stocks today than before the Great Recession (54% now vs. 64% then). Many of those who left the market likely had no idea the market could fall so far so fast. One way to manage your expectations is to have a working knowledge of *regression to the mean*.

While that phrase may roll off the tongues of statisticians more easily than yours, the idea isn't complicated. *Regression* is simply the act of going back to an earlier state, and *mean* is another word for *average*. The phrase implies, therefore, a return to the average. It's another way of saying that everything evens out in the long run.

Here's an illustration from sports. If a basketball team that has a shooting accuracy rate of 55% for the season were to hit 85% of their shots in the first half of a game, would you expect them to do it again in the second half? No, you'd probably expect them to shoot much worse, possibly even below 55%. Why? Because their "true" ability is more accurately reflected in their season-long average of 55%. While they might have an occasional hot hand, luck or just the right circumstances played a role, making it highly unlikely they'll be able to continue to play that far above their normal skill level. You'd expect them to cool off during the second half. In short, you'd expect their shooting accuracy to regress to the mean.

Regression to the mean is a key investing principle

Wall Street Journal writer Jason Zweig, reflecting on the most important lessons conveyed in 250 *Intelligent Investor* columns he wrote, called regression to the mean "the most powerful law in financial physics: Periods of above-average performance are inevitably followed by below-average returns, and bad times inevitably set the stage for surprisingly good performance."

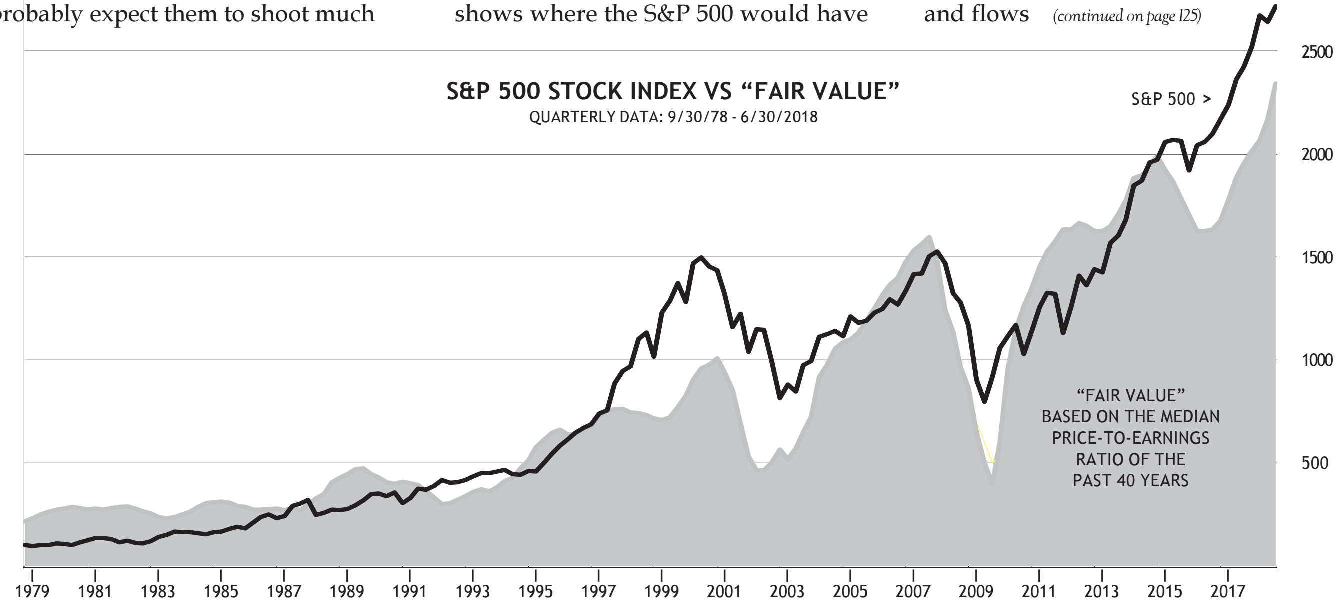
The chart below illustrates this point. The black line shows the actual end-of-quarter price of the S&P 500 index over the past 40 years. The shaded area shows where the S&P 500 would have traded if it had stayed anchored to its median price/earnings (P/E) ratio of 18.8 over the entire period.[1]

This fair value metric is determined by dividing the collective stock prices of all the companies included in the S&P 500 by their collective earnings per share at the end of each calendar quarter, then calculating the median of those quarterly values over the past four decades. That level, where half the P/E values are above and half the values are below is what we've plotted as the shaded area.

Just as the 55% shooting accuracy rate reflects a fair expectation for our hypothetical basketball team's performance, the shaded area reflects a fair expectation of the market's price in relation to earnings.

While the S&P 500 index periodically has risen above or fallen below this long-term fair value due to investors' expectations, it has always returned to fair value in due course.

Ultimately, corporate earnings drive expectations and demand, which drive stock prices. But earnings are prevented from growing to the sky due to the nature of the business cycle, which ebbs and flows (continued on page 125)



[1]When investors are optimistic about stocks, they will pay higher prices for each dollar of company earnings, pushing the market's price-to-earnings ratio higher. Conversely, when they are pessimistic, investors pay lower prices, pushing the P/E ratio down. For more information on P/E ratios, see April2017:p55.

LEVEL 3 THREE

Broadening Your Portfolio

This column goes beyond the investing essentials taught in Level 2, introducing you to a wider range of investment securities and markets. By further diversifying your holdings, you can create a more efficient, less volatile portfolio. We also comment quarterly on the performance of the various markets, and on how SMI's fund recommendations and strategies have fared.

"Divide your portion to seven, or even to eight, for you do not know what misfortune may occur on the earth." Ecclesiastes 11:2

2ND QUARTER REPORT: STOCKS CLIMB THE WALL OF WORRY

After spending the first quarter of 2018 worrying about the return of inflation and volatility, investors found a new concern to obsess over in the second quarter: the possibility of a global trade war. But unlike February, when the stock market responded to those earlier investor concerns with its first -10% correction in two years, stocks largely shrugged off these new worries and moved higher in the second quarter, with the Wilshire 5000 index gaining +3.8%. Volatility has retreated back to historically low levels and from all appearances, the bull market seems to be back on the march.

Just-the-Basics (JtB) & Stock Upgrading

Both JtB and Stock Upgrading posted solid gains during the quarter.[1] JtB gained +3.1%, slightly less than the U.S. market, due to poor performance from its foreign component, which lost -3.3% during the quarter.

In contrast, Upgrading was the star of the quarter, gaining a robust +5.1%, well ahead of the market's +3.8% gain. Like JtB, Upgrading also lost money on its foreign holdings, but only about half as much, and strong gains from both small- and large-growth stocks more than offset those declines. As the table shows, the Upgrading process improved on the average fund's performance in four of the five risk categories during the quarter.

While concerns persist regarding stock valuations and the age of this bull market, investors are being treated to typically strong late-cycle gains in the meantime. Despite the first quarter's correction, the market is still up a very strong +14.7% over the past 12 months, while Stock Upgrading's gain of +15.2% has been even better.

Bond Upgrading

Much as the stock market endured a test of its longer-term trend during the first quarter, with the S&P 500 index dropping to its 200-day moving average before rebounding higher, bonds endured a similar test during the second quarter. The benchmark 10-year Treasury yield pierced the 3% yield level in March and continued rising as high as 3.11% by mid-May. (Remember, when bond *yields* rise, bond prices *fall*.) Many bond-market watchers were holding their breath at those levels, as a further rise would have clearly broken the 36-year declining trend line in interest rates. But bond yields retreated, with the 10-year Treasury dropping back to 2.85% by the end of the quarter.

SECOND QUARTER PERFORMANCE OF STOCK FUNDS BY RISK CATEGORY

Risk Category		SMI Funds[1]	Average Fund[2]
Cat 5:	Foreign Stock Funds	-1.5%	-2.1%
Cat 4:	Small Company/Growth	11.4%	8.5%
Cat 3:	Small Company/Value	3.1%	6.6%
Cat 2:	Large Company/Growth	7.2%	5.1%
Cat 1:	Large Company/Value	5.4%	1.6%

FOOTNOTES: [1] Average of the three recommended funds for each risk category (page 122), 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.

Overall, both short- and long-term yields moved higher in the second quarter, putting pressure on bond returns. The previously mentioned 10-year Treasury yield started the quarter at 2.74% and ended it at 2.85%, while the Federal Reserve hiked its short-term rate once again in June to 1.75%-2.00%. But while most bond investments lost ground (the Barclays US Bond Index fell -0.2%), Bond Upgrading managed to buck the trend and gain +0.4%. This was primarily due to its Upgrading holding (Vanguard Inflation-Protected Securities Fund), which has been the best performing bond fund in our universe both during the second quarter and year-to-date. (This fund is also the only bond fund in our Bond Upgrading universe with a *positive* return over the past six months, as of this writing in mid-July).

Dynamic Asset Allocation (DAA)

The poor performance of foreign stocks during the second quarter was a key reason why DAA's quarterly gain of +1.2% trailed that of the U.S. stock market. In JtB and Stock Upgrading, foreign stocks account for 20% of the portfolio, but in DAA, that allocation is higher at 33%. While U.S. stocks were rising in May and June, foreign stocks were declining. After 18 months of being recommended, foreign stocks were replaced in the DAA lineup at the end of June.

The first quarter's biggest *loser*, Real Estate, rebounded sharply to become the second quarter's biggest *winner*. Bonds lost ground for a second consecutive quarter, but DAA avoided those losses by not having them in the portfolio.

Despite the somewhat disappointing quarterly return, DAA continued to fulfill its role as a portfolio diversifier. While most of SMI's strategies were strongest in May and weakest in June, DAA was the opposite. That +1.0% June gain helped level out the performance of blended strategy portfolios, given that Upgrading and JtB were barely positive and Sector Rotation lost -9.1% in June. So even as DAA has struggled to keep up with the bull market's strong recent returns, it is still providing a diversification benefit within SMI portfolios. And of course, its value will be most evident when the market cycle finally shifts and stocks turn lower.

2ND QUARTER 2018 DAA ETF UNIVERSE

Ticker & Category		2Q Result
SPY	U.S. Stocks	3.6%
EFA	Foreign Stocks	-2.0%
VNQ	Real Estate	8.9%
BLV	Long-Term Bonds	-1.4%
SHY	Money Market	0.2%
GLD	Gold	-5.7%

Sector Rotation (SR)

It feels ungrateful to complain about SR's modest loss of -2.1% during the second quarter when the strategy still shows a +46.5% gain over the past 12 months. But it's true that SR was the laggard among *(continued on page 125)*

[1]Performance updates of all SMI strategies are available each month on the back cover of the print newsletter, as well as on the Performance tab of the SMI Member homepage at soundmindinvesting.com.

LEVEL 4 FOUR

Looking Toward Retirement

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

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

THE NUTS AND BOLTS OF A ROTH IRA CONVERSION

Moving retirement money from a Traditional IRA, 401(k), 403(b), or other tax-deferred account to a Roth IRA is a bit like refinancing a home mortgage: you get long-term benefits, but only if you're willing to bear short-term costs.

The long-term upside includes tax-free income in retirement and more time for your investments to grow (Roths, unlike Traditional accounts, don't have required distributions starting at age 70). The short-term downside? A sizeable tax bill from the IRS.[1]

Fortunately, the tax bite isn't as bad as it once was. The tax law that took effect in January re-worked the federal tax brackets and lowered rates, thus reducing the tax bill on Roth conversions. Last year a married couple filing jointly who together earned $95,000 were in the 25% federal tax bracket. Now they're in the 22% bracket.

Here's an example, in dollar terms, of the difference that makes. In 2017, converting $30,000 from a Traditional IRA to a Roth would have cost the couple $7,500 in taxes. This year, they'll pay $6,600, or $900 less.[2]

The lower income-tax rates aren't permanent, however. The rates are scheduled to expire at the end of 2025, and they could be raised even sooner if Republicans—who enacted the current law—lose control of Congress and the White House in 2020. That means the next two or three years are an optimal time to make Roth conversions.

The conversion opportunity could be further enhanced by a market downturn during that period. Because the IRS taxes assets based on their *value at the time of conversion*, retirement holdings that have temporarily dropped in value because of a market pullback can be converted from a Traditional account to a Roth at a lower tax cost than when valuations are high.

The trade-offs

The reason Roth conversions involve a tax bill is that the money being transferred into a Roth account wasn't taxed when it was earned as income. Funds contributed to a Traditional IRA—or to a tax-deferred plan such as a Traditional 401(k) or 403(b)[3]—are "*pre*-tax." Once you earn the money, you can deposit it directly into a Traditional retirement account and avoid being taxed on it. Roth contributions, in contrast, are "*post*-tax"—account holders pay taxes upfront on any income going into a Roth account.

So when the holder of a *Traditional* account wants to move money from such an account to a *Roth*, the IRS says, "OK, but only if you pay taxes on the converted amount." Many taxpayers are willing to accept that deal because they believe the long-term benefits outweigh the short-term costs.

It is impossible to know for certain if a conversion is the best course of action because future tax rates (and personal longevity) are unknown. But there is at least one circumstance in which most financial advisors recommend *against* a Roth conversion—namely, if the only way to afford the conversion-related taxes is by using proceeds from the Traditional retirement account.

For one thing, if you're under age 59½, any money you take out of a Traditional account to pay the taxes will be subject to a 10% early-withdrawal penalty. (Sorry, but the IRS says you can't get around the penalty by first converting all the money to a Roth and then taking a withdrawal from the Roth to pay the taxes.) Another downside of using retirement funds to pay the tax bill is that any money you withdraw to pay taxes is money that'll no longer be growing in your retirement account. That's an "opportunity cost," as you forfeit years of potential growth on thousands of dollars.

Answers to common questions

• **Will a conversion push me into a higher tax bracket?** Perhaps. If so, part of the converted amount would be taxed at the higher rate. For example, if your regular income is $75,000 this year, you'll be in the 12% bracket (married, filing jointly). A Roth conversion that added, say, another $15,000 to your income would easily push you into the 22% bracket (which for 2018 begins at $77,400). Therefore, you would pay a 22% tax rate, not 12%, on every dollar above the bracket threshold.

Also, if you're on Medicare (or soon will be), the temporarily larger income may trigger higher premiums for Medicare Parts B/D.

• **Can I convert only *part* of a Traditional account to a Roth?** Yes, and converting only a portion is a good way to keep the tax bill from being overwhelming. You may want to consider doing a partial conversion each year for several years.

• **Can I put the converted money into an *existing* Roth IRA?** Sure—or you can open a new Roth for the conversion. Using an existing Roth is better, if you have that option, because it may keep you from running afoul of the IRS's five-year waiting period for withdrawals (more on that below).

• **Can I move actual investment holdings, or do I have to sell them first and move the cash?** Making an "in-kind" transfer—i.e., a direct transfer of current investment holdings—is allowable, but works best if you're keeping your money with the same custodian (Fidelity-to-Fidelity, Vanguard-to-Vanguard, etc.). Upon your instructions, the custodian will simply re-designate any holdings you specify as being in a Roth IRA (with the exception that any fractional shares of stocks or ETFs will be liquidated).

If you're moving your money from one custodian to another, (continued on page 126)

[1] For more on the pros and cons of converting to a Roth, see March2016:p41. [2] Depending on your state of residence, state taxes may apply. [3] In most cases, Roth IRA conversions from employer-sponsored accounts are allowed only if the account holder is no longer working for the employer.

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 6/30/2018	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	0.3	-3.5%	-2.1%	-3.3%	-3.5%	7.1%	5.4%	1.13	0.11%	20%	16%	12%	8%	VXUS
Extended Market Index ETF	Small company stocks	28.7	6.1%	0.8%	5.9%	6.1%	16.7%	10.3%	1.20	0.08%	40%	32%	24%	16%	VXF
S&P 500 Index ETF	Large company stocks	20.7	2.7%	0.8%	3.6%	2.7%	14.5%	12.0%	1.00	0.04%	40%	32%	24%	16%	VOO
Total Bond Mkt Index ETF	Medium-term bonds	-2.7	-1.8%	0.0%	-0.2%	-1.8%	-0.6%	1.7%	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 6/30/2018[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. ☎ MS Intl Opportunity - LW[12]	08/18	NTF	NTF	NTF	39.8	8.4%	-2.4%	3.7%	8.4%	27.7%	17.3%	1.35	1.29	53	2%30days	MIOPX
	2. Vanguard Intl Growth	09/17	Yes	Yes	Yes	24.6	4.1%	-0.2%	0.7%	4.1%	19.8%	12.1%	1.42	0.45	133	None	VWIGX
	3. Advisory Res Intl Sm Cp Val	06/18	Yes	Yes	Yes	19.8	2.1%	-2.3%	0.4%	2.1%	17.4%	9.6%	1.04	1.20	74	2%90days	ADVIX
Category 4 Small/Growth	1. Delaware Smid Cap Gro - LW[12]	02/18	NTF	No	NTF	73.2	17.5%	3.6%	12.8%	17.5%	42.9%	14.6%	1.43	1.21	37	None	DFCIX
	2. Kinetics Small Cap Oppor	02/18	NTF	NTF	NTF	72.2	17.9%	-0.1%	11.3%	17.9%	43.0%	15.7%	1.36	1.66	39	2%30days	KSCOX
	3. Baron Opportunity	03/18	NTF	NTF	NTF	61.8	20.1%	1.9%	10.0%	20.1%	31.7%	15.0%	1.53	1.41	56	None	BIOPX
Category 3 Small/Value	1. ☎ iShares Core S&P Sm Cap	08/18	ETF	ETF	ETF	38.6	9.3%	1.0%	8.7%	9.3%	20.6%	13.8%	1.35	0.07	604	None	IJR
	2. Hodges Small Cap	04/18	NTF	NTF	NTF	35.0	6.1%	-1.4%	5.4%	6.1%	23.5%	5.8%	1.52	1.28	52	1%30days	HDPSX
	3. Huber Capital Sm Cap Val	06/18	NTF	NTF	NTF	32.0	7.1%	-0.6%	8.2%	7.1%	16.7%	5.8%	1.59	1.75	46	1%60days	HUSIX
Category 2 Large/Growth	1. MS Multi Cap Growth - LW[12]	05/18	NTF	NTF	NTF	75.2	21.8%	3.5%	12.8%	21.8%	40.6%	20.4%	1.56	1.24	38	None	CPOAX
	2. Touchstone Sands Cap Select	07/18	No	NTF	NTF	64.2	20.8%	1.2%	10.2%	20.8%	33.2%	13.8%	1.60	1.22	28	None	PTSGX
	3. Invesco S&P 500 EW Tech	04/17	ETF	ETF	ETF	44.2	11.2%	0.1%	4.9%	11.2%	28.0%	22.0%	1.30	0.40	74	None	RYT
Category 1 Large/Value	1. Miller Opportunity - LW[12]	06/17	NTF	Yes[10]	NTF	41.6	11.1%	6.1%	14.0%	11.1%	16.6%	8.9%	2.11	1.35	37	None	LGOAX[10]
	2. Oppen S&P Ultra Dividend Rev	07/18	ETF	ETF	ETF	35.7	6.5%	2.7%	10.1%	6.5%	19.2%	14.7%	1.17	0.39	62	None	RDIV
	3. Toreador Core	05/17	NTF	NTF	NTF	21.1	1.4%	-1.7%	1.2%	1.4%	18.5%	10.9%	1.19	1.20	108	2%60days	TORLX
Bond Categories	Vanguard Inflation Protect[6]	02/18	Yes[11]	Yes[11]	Yes[11]	2.6	-0.1%	0.7%	0.9%	-0.1%	1.8%	1.8%	1.10	0.20	7.6[7]	None	VIPSX[11]
	Permanent: Vanguard I-T Bond	Perm	ETF	ETF	ETF	-4.1	-2.3%	0.0%	-0.3%	-2.3%	-1.5%	1.7%	1.29	0.07	6.4[7]	None	BIV[8]
	Permanent: Vanguard S-T Bond	Perm	ETF	ETF	ETF	-0.5	-0.4%	0.1%	0.2%	-0.4%	-0.3%	0.7%	0.46	0.07	2.7[7]	None	BSV[9]

Upgrading Footnotes: **[1]** The funds in each risk category are selected (and ranked 1 through 3) primarily based on their momentum scores in late-July, 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 Basic Strategies page, the highest-rated Cat. 5 fund available is MS International Opportunity, the highest-rated Cat. 4 fund available is Kinetics Small Cap Opp., and so on. After doing this for each category, the orders are placed and the stock portion of the Upgrading portfolio is complete!

From then on, it's just a matter of checking the Basic Strategies page each month. When an owned fund is *removed* from this page (not when it merely shifts out of the #1 ranking), you should immediately sell that fund and invest the proceeds in the highest-ranked fund in the same risk category that is available at your broker.

❶ PICK YOUR ALLOCATION

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

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

❷ FIND YOUR PORTFOLIO MIX

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

❸ BUY YOUR FUNDS

Example uses an 80/20 mix between stocks and bonds		Dollars	Invest In Funds
Stock Cat. 5: Foreign	16%	$8,000	MS International Opportunity
Stock Cat. 4: Small/Growth	16%	$8,000	Kinetics Small Cap Oppor
Stock Cat. 3: Small/Value	16%	$8,000	iShares Core S&P Small Cap
Stock Cat. 2: Large/Growth	16%	$8,000	MS Multi-Cap Growth
Stock Cat. 1: Large/Value	16%	$8,000	Miller Opportunity
"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	

BOND UPGRADING

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

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

◆ **In the Foreign group, Allianz International Small Cap (AOPAX, 05/2018) is being replaced.$** This fund was recommended three months ago, despite it not being available on a load-waived basis at Schwab. Since then, Foreign stocks have been poor performers, and this fund has been slightly below average. That has pushed the fund barely below the quartile. Given that it was never available to some SMI readers in the first place and its performance has been mediocre, it's an easy decision to replace it despite its short tenure.

• **Morgan Stanley Institutional International Opportunity A (MIOPX) is being added.[1]** Over the past year or so, SMI has chronicled the new phenomenon of funds that have always charged loads to new investors suddenly becoming available on a load-waived basis at certain brokers. Frankly, this has been a bit of a hassle at times, given that each fund family works out separate arrangements with each specific broker, leading to an inconsistent landscape. Certain funds are available load-waived at Fidelity, but not Schwab, and vice-versa. And in the case of Miller Opportunity in SMI's Large/Value group, Fidelity offers a different load-waived share class (with a different ticker symbol) than Schwab or E-Trade. On top of all that, some brokers (we're looking at you, TD Ameritrade!) still haven't figured out how to clearly communicate about load-waived funds on their websites.

This added complexity has been a challenge for Upgraders, who haven't had to deal with these sorts of nuances in the past. But this month's recommendation of Morgan Stanley International Opportunity provides a good example of why we think the occasional extra effort has been worthwhile. This is the *second* load-waived Morgan Stanley fund on our current Recommended Funds list (along with Morgan Stanley Multi-Cap Growth in the Large/Growth group), and in both cases the fund is currently ranked #1 in its respective risk category. In fact, a quick review of the Basic Strategies page reveals that load-waived funds are currently the top recommendation in *four* of SMI's five stock risk categories.

There's certainly nothing inherently better about load-waived funds, and no reason to believe their current leadership positions are likely to persist. But in Upgrading, more choices is almost always better, because it gives us a broader field from which to select top-performing funds. Comparing the returns of the two recommended Morgan Stanley funds to those of the other recommended funds in their peer groups (which you can do by looking at the Basic Strategies page), they've clearly been outstanding performers over the past 3-, 6-, and 12-month intervals. So we're glad to have the additional load-waived choices within our fund universe.

◆ **In the Small/Value group, Aegis Value (AVALX, 05/2018) is being replaced.** This is another fund that was recently recommended despite not having great availability: it charges a transaction fee at all of SMI's recommended brokers, and has a high minimum investment requirement at some brokers. In addition, as we noted three months ago when it was recommended, it has an unusually high relative risk score for the small/value group. So given its lackluster performance that has pushed it below the quartile, we're replacing it quickly and moving on to a better performing (and more accessible) option.

• **iShares Core S&P Small Cap ETF (IJR) is being added.[1]** We're taking advantage of the breadth of our stock risk categories with this choice. As the quarterly report on page 120 shows, small/growth stocks have been the hottest segment of the market in recent months. While Morningstar tracks a separate "blend" category of funds that don't fit neatly into either the true "growth" or "value" camp, SMI includes those blend funds into our value categories for simplicity. Right now, the fact that growth stocks have been outperforming value means that these "growthier" blend funds are particularly attractive options within our value categories.

This particular iShares ETF is a simple index fund that tracks the S&P SmallCap 600 Index. There are quite a few similar index funds and ETFs, many of which can be found in the SMI Fund Performance Rankings (FPR). IJR is one of the largest and most liquid of these options, which translates into lower costs. This shows up in both the obvious costs—like IJR's ultra-low 0.07% expense ratio and the fact that it trades commission-free at Fidelity—and less obvious costs, such as the fact that IJR trades with a tiny spread between its bid and ask price. Higher spreads are an unseen cost that many investors don't even realize they are paying when using some of this fund's competitors.

It's interesting to note how IJR has ranked within Morningstar's Small-Blend category on a year-to-year basis. It demonstrates how the indexing approach experiences swings in performance, just like any other approach. IJR is currently ranked in the top 4% of its category for 2018, which would be its highest finish in the past decade (if it maintains it). In 2009, the fund finished at 75%, its lowest rank. The market's strong performance over the past year has benefited indexing, and we're happy enough to use index funds in Upgrading when they climb the rankings like this. ◆

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

MONEYTALK

LEVEL 1 / CONTINUED FROM PAGE 118:

BUYING A HOUSE? WHAT YOU NEED TO KNOW ABOUT FHA MORTGAGES

were at slightly lower interest rates than conventional mortgages. Now that variance is minimal—or even non-existent. Indeed, FHA rates sometimes are fractionally higher than conventional rates.

Unique buying and selling pros and cons

When it comes to *selling* a property, an owner with an FHA-insured mortgage has an advantage. Unlike most conventional mortgages, FHA loans are "assumable," meaning a buyer (with lender approval) can "take over" an existing loan under the original terms. When interest rates are rising, assumable mortgages become increasingly attractive to buyers because the rate on an assumable loan may be better than a rate available for a new loan.

That advantage, however, must be balanced against a significant downside when trying to *buy* a property using an FHA-insured loan. In a competitive-offer situation, many home sellers will prefer an offer from a buyer using a conventional loan (or paying cash!) over one from a buyer who will use an FHA mortgage. Since FHA buyers tend to have higher-risk profiles, a seller may be concerned that an FHA buyer could run into problems with a loan approval.

Sellers also know that FHA appraisals are more stringent than those for conventional loans. An FHA appraisal not only gauges market value, it requires a thorough inspection of the property to ensure conformity with a range of health and safety standards set by the U.S. Department of Housing and Urban Development.

Ready, or not?

Given other lower-cost, less-regulated options via the conventional-loan marketplace, FHA-insured loans really don't offer much to today's homebuyer—except the ability to use a gift for the total down-payment amount.

Anyone considering an FHA loan solely because of a low credit score would be better off to focus his or her immediate efforts on improving their credit score (by paying off debt and paying current bills on time) and saving for a larger down payment. Doing those two things will help streamline the eventual purchase of a house with a conventional mortgage, resulting in years of lower insurance costs and monthly payments. ◆

LEVEL 2 / CONTINUED FROM PAGE 119:

HOW "REGRESSION TO THE MEAN" CAN HELP MANAGE EXPECTATIONS

through the workings of supply and demand for a company's products or services, which are driven by inflation, unemployment, competition, and other factors.

Notice how during certain periods, such as 1978-1991 and 2010-2014, stocks have been undervalued—that is, they have been priced below this long-term measure of their fair value. And at other times, notably 1996-2005 and 2014-present, stocks have been overvalued as prices have exceeded this measure of fair value.

Periods of subpar performance set the stage for better than average performance later, and vice versa. When market returns are unusually poor for a period of time, investors can expect future returns to be above average. And unfortunately, at least for today's investors, the opposite is also true: periods of outstanding performance are always followed—eventually—by below average performance as the market regresses to the mean.

Implications for today's investor

The strong decade of returns that have driven today's stock prices to such heights mean that below-average returns are a near certainty at some point in the future. In other words, investors need to acknowledge that today's long-running bull market will one day turn into a bear market, with stock prices turning down toward their long-term fair value. And because stock prices often overshoot when swinging between over- and under-valuation (as the chart on page 119 illustrates), it wouldn't be a shock to see stock prices trading below their long-term fair value during the next bear-market cycle.

Sometimes regression to the mean involves an extended sideways movement in stock prices while earnings "catch up" (the late 1960s-early 1980s were such a period). But more commonly, the regression to the mean will involve prices falling in a bear market. The last time stock prices got so far ahead of their long-term average was in 2000. It took the 2000-2002 bear market cutting stock prices by -50% and a strong post-recession recovery for the market to return to our estimate of fair value by 2005.

It's important to recognize that any estimate of "fair value" is just that—an estimate, and there are several different ways to calculate those estimates. The most popular estimates indicate the market would need to fall 16%-30% from today's levels to reach "fair value." That doesn't mean a bear market is imminent. But it does help put the current degree of market risk into historical perspective. Periods of extended overvaluation can last for quite some time, but eventually the piper must be paid.

So, don't be shocked when the market cycle eventually turns and returns are poor for a season. Bear markets inevitably follow bull markets in an endless cycle. A healthy dose of "expectations management" should help keep you from overreacting when this pattern next repeats. ◆

LEVEL 3 / CONTINUED FROM PAGE 120:

2ND QUARTER REPORT: STOCKS CLIMB THE WALL OF WORRY

SMI strategies this quarter, which hasn't happened often in recent years. SR portfolios have more than tripled in value over the past five years, which helps us to be patient when the strategy goes through periods of volatility as it has so far in 2018. It's still up solidly year-to-date for 2018 and has posted strong gains again in early July. So we continue to just

MONEYTALK

reiterate our cautions about the volatility associated with this particular strategy, while acknowledging that its long term results have been outstanding for those willing to tune out the short-term noise and stick with it.

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. (Blending multiple strategies adds complexity. Some members may want to use an automated approach. See bit.ly/SMIPrivateClient.)

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 gained +2.4% during the second quarter, a bit less than the broad market's gain of +3.8%. Stock Upgrading was great, but the rare down quarter for SR coupled with DAA lagging the market a bit brought the overall return down. That said, it's worth pointing out that 50-40-10 investors have earned almost as much as the broad market over the past year (+14.2% vs +14.7%), despite having significant downside protection present via the 50% allocation to the defensively-oriented DAA strategy. The ability of 50-40-10 to keep pace during this powerful bull-market cycle means that if DAA's defensive properties pay off the way we expect during the next bear market, the performance of a 50-40-10 portfolio over the *full market cycle* (bull *and* bear market) should be significantly better than the broad market. Whether you're using this specific 50/40/10 strategy mix or a different combination, we think most SMI readers can benefit from blending these strategies in some fashion. ◆

LEVEL 4 / CONTINUED FROM PAGE 121:

THE NUTS AND BOLTS OF A ROTH IRA CONVERSION

in most cases you'll have to sell your Traditional-account holdings and then use the proceeds to make new investment purchases within the Roth IRA.

• **How do I transfer cash proceeds from my Traditional account to a Roth IRA?** Ask your Roth IRA custodian to initiate a "trustee-to-trustee" transfer, in which the money goes directly from your existing custodian to the company that's holding the Roth IRA. (A note of warning: Making a withdrawal and taking possession of the proceeds, even for a short period of time, is dangerous and inadvisable.) Be aware that some issuing custodians won't do a direct transfer but will instead provide a written check that's made out to the new trustee but is *mailed to you*. It is your responsibility to send that check to the new trustee as quickly as possible.

Timing considerations

Until this year, it was possible to do a Roth IRA conversion and then later reverse (or "recharacterize") it. But with recharacterization now a thing of the past,[1] many financial advisors are recommending that conversions be executed toward the end of the calendar year. That way, you can be fairly confident in projecting your overall income for the year, thus avoiding the problem of having a conversion push you into a higher tax bracket.

Further, a conversion made in any part of the year—even at year's end—is considered by the IRS as if it had been made on January 1 of that same tax year. That is important because of the "five-year rule," which says you must wait five years after a conversion before you can withdraw that money tax-free.[2] Because the IRS looks at "tax years" rather than actual periods of 365 days, a conversion made near the end of a year can be withdrawn in just over *four* years.

It's also important to know that the IRS assumes any withdrawals from a Roth IRA come in this order: 1) contributions, 2) conversions (starting with the oldest), and 3) earnings. So if you have made any direct contributions to your Roth IRA (in addition to your converted amounts), you're less likely to run afoul of the five-year rule because your initial withdrawals would be deemed to come first from your contributions.

Although you can execute a Roth conversion yourself, it's wise to consult with your retirement-account custodian to be sure you understand what's required and if there are any restrictions regarding the account you wish to convert. Since a Roth IRA conversion can have unintended tax consequences, you also may want to seek advice from a financial advisor. ◆

MARKET NOTES, QUOTES, AND ANECDOTES

Stick with your plan

• "If you are going to do better than most, it won't be by continually anticipating a market crash. That has invariably been an exit ramp onto a dead end street. Tuning out noise and consistently following investment rules and hard data is far more challenging than it sounds, but the performance of those that do it can be in the top 5%." – Urban Carmel, writing in *The Fat Pitch* about the importance of following an objective investment process. Read more at bit.ly/2L3IOKw.

Not everything that matters can be measured

• "You can measure everything about a bubble except the most important part: When investors will stop believing in it. The end of the bubble is just the end of enthusiasm. And enthusiasm isn't a tamable statistic. It's a hormone that owes nothing to the logic of your data." – Morgan Housel, suggesting on the *Collaborative Fund* blog on 7/5/18 that spreadsheets and statistics will only get you so far. Read more at bit.ly/2NwM2nf.

[1]The recharacterization deadline for conversions made in 2017 is Oct. 15, 2018. Conversions made on or after Jan. 1, 2018 cannot be recharacterized. [2]Each conversion is subject to a separate five-year waiting period, except in the case of multiple conversions made in the same tax year.

SOUND MIND PORTFOLIOS

PREMIUM STRATEGIES

The strategies described below are available to those with an SMI Premium web membership. These strategies can be used in combination with—or in place of—our Just-the Basics and Upgrading portfolios. They have special characteristics that could make them desirable depending upon your individual goals, risk tolerance, and tax bracket. You can learn more about each strategy in the Premium section of the SMI website.

DYNAMIC ASSET ALLOCATION

Overview

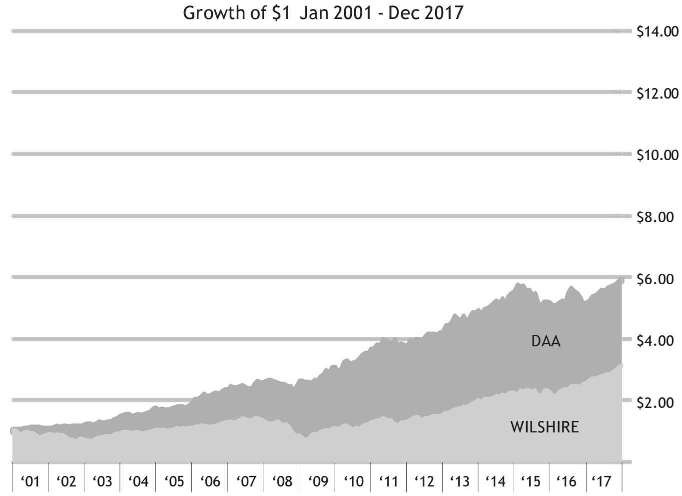
This is a stand-alone strategy that can be used in combination with (or in place of) SMI's basic strategies. DAA is designed to help you share in some of a bull market's gains, while minimizing or even preventing losses during bear markets. It's a low-volatility strategy that nonetheless has generated impressive back-tested results over the long term. DAA involves rotating among six assets classes—U.S. stocks, foreign stocks, gold, real estate, bonds, and cash. Only three are held at any one time.

Who Should Consider This Strategy

Anyone, but especially investors who are more concerned with avoiding major losses during bear markets than they are with capital growth during bull markets. **Pros:** Excellent downside protection during bear markets, reflected in a very low worst-case result and relative-risk score. Great long-term track record. **Cons:** Subject to short-term whipsaws. Lags the market in up years. Making trades promptly and concentrating entire portfolio in only three asset classes can be emotionally challenging.

Dynamic Asset Allocation vs Wilshire 5000

Growth of $1 Jan 2001 - Dec 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

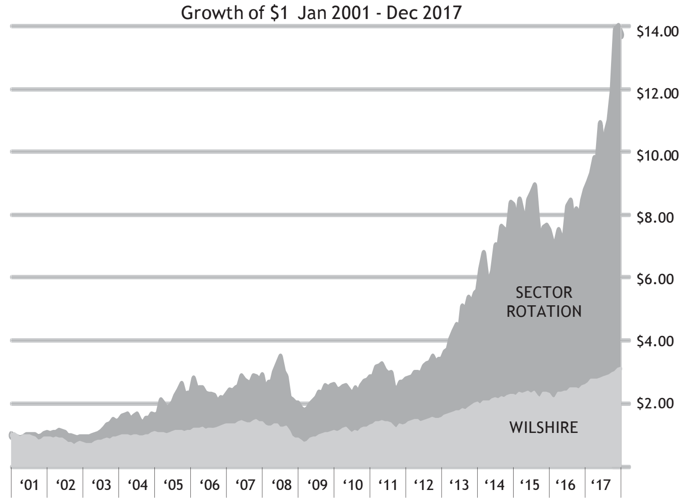
This high-risk strategy involves investing in a single special-purpose fund that focuses on a specific sector (such as biotech, energy, or financial services). Because these stock funds invest in a narrow slice of the economy, they carry a higher degree of risk. Only one fund, selected based on having 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 JUNE 30, 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]	3.0%	0.7%	3.8%	14.7%	11.9%	13.4%	10.2%	9.7%
Just-the-Basics[2]	2.8%	0.2%	3.1%	13.9%	10.0%	11.8%	9.1%	9.8%
Stock Upgrading[3]	5.0%	0.3%	5.1%	15.2%	10.0%	11.4%	8.0%	10.6%
U.S. Bond Market[4]	-1.7%	0.0%	-0.2%	-0.6%	1.6%	2.1%	3.5%	3.6%
Bond Upgrading[5]	-1.0%	0.4%	0.4%	-0.4%	1.5%	2.5%	5.7%	5.9%

PREMIUM STRATEGIES

	Year to Date	1 Month	3 Months	12 Months	3 Yrs Annual	5 Yrs Annual	10 Yrs Annual	15 Yrs Annual
DAA[6]	-0.7%	1.0%	1.2%	6.9%	3.1%	5.5%	9.0%	11.1%
Sector Rotation[7]	6.3%	-9.1%	-2.1%	46.5%	19.0%	27.6%	15.5%	19.1%
50-40-10 Blend[8]	2.3%	-0.4%	2.4%	14.2%	7.6%	10.3%	9.8%	12.1%

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 6/30/2018	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	7.55%	0.00%	5.12%	19.03%	8.97%	10.37%	6.86%
Wilshire 5000	3.04%	0.66%	3.83%	14.66%	11.85%	13.36%	10.23%
S&P 500	2.65%	0.62%	3.43%	14.37%	11.93%	13.42%	10.17%

Quarterly Returns as of 6/30/2018	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	7.55%	0.00%	5.12%	19.03%	8.97%	10.37%	6.86%
Wilshire 5000	3.04%	0.66%	3.83%	14.66%	11.85%	13.36%	10.23%
S&P 500	2.65%	0.62%	3.43%	14.37%	11.93%	13.42%	10.17%

Total/Gross expense ratio: 2.09% as of 4/27/18 (includes expenses of underlying funds)
Adjusted expense ratio: 1.15% as of 4/27/18 (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