VOLUME 29 ◆ NUMBER 9

SEPTEMBER 2018

Sound Mind Investing®

Financial Wisdom for Living Well

WWW.SOUNDMINDINVESTING.COM

The Crucial Role of Behavior in Making Investing Decisions

"Your own behavior is by far the most important factor in investment success." So says Brian Portnoy, author of *The Geometry of Wealth*. In this excerpt from the book, he explains how *automating* your investment decisions whenever possible can help. For nearly three decades, SMI has shown do-it-yourself investors how to "be on their best behavior" by using easy-to-implement, mechanical strategies. And, as the Level 3 article in this issue explains, SMI readers now have the option to fully automate their SMI portfolio management if they so choose.

by Brian Portnoy

The investor's primary problem is not figuring out the market. It is figuring out himself. Success stems not, as markets observer Jason Zweig wrote, from "beating others at their game. It's about controlling yourself at your own game." Psychology, not finance, is most important in achieving our long-term financial objectives.

Acceptance of this perspective has been a long time coming. The world of finance usually appears complicated and technical. And for good reason: Finance is a lucrative industry in which complexity is an important and often unassailable competitive moat. Make things too easy and you potentially lose your customers.

The industry has begun to turn the corner. It's now been well evidenced that our brains are hardwired to make a litany of cognitive and emotional errors. Rectifying them sits at the core of a successful money life. It's no longer acceptable to say that something flatly described as "emotions" interfere with good decisions. Instead, recent achievements demonstrate the rich breadth of insights we now have for individuals to define and reach their goals. For example, Daniel Kahneman's 2011 bestseller, *Thinking, Fast and Slow*, delivered behavioral finance into the mainstream. Michael Lewis' *The Undoing Project* put a human face on the development of this iconoclastic science. Richard Thaler's 2017 Nobel Prize in Economics for his pioneering research in behavioral economics was another validation of this endeavor.

While some will casually claim that the many biases that define us are sources of "irrationality," I disagree. We are not irrational, let alone stupid. We are human. We are *normal*.

A cursory glance at the behavioral finance literature reveals scores of built-in quirks. The "fast" brain is responsible for many of them. While masterfully keeping us safe and well-functioning, it ironically produces systematic errors of perception, judgment, and decision.

The table on page 131 provides a quick summary of common, but impactful, behavioral biases. These biases and many others lead to bad decisions or non-decisions, which can cost significant dollars and cents in investing. The objective here, however, is not to acquire a perfect understanding of all these quirks, for that in itself does not translate *(continued on page 131)*

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

Foundational Pillars of Christian Stewardship

The Bible has a *lot* to say about money. With more than 2,350 verses devoted to it, it's one of the most heavily discussed topics in Scripture. Obviously, *all* of those verses are important, or they wouldn't be included in the canon. But if you were trying to boil all of them down into a workable starting framework, which specific verses would you choose? Here's my attempt to answer that question.

• **God owns it all.** Psalm 24:1 says, *"The earth is the LORD's, and everything in it, the world, and all who live in it."*

• **We are stewards with management responsibilities.** 1 Corinthians 4:2 states, *"Moreover, it is required in stewards that a man be found faithful."* (The Parable of the Talents in Matthew 25 and Luke 19 is probably the clearest picture Scripture offers of the "God as owner—us as stewards" dynamic.)

It's pivotal that we start with these first two points, because a proper understanding and embrace of God's *ownership* and our *stewardship* are the twin rails everything else Scripture teaches about finances run on.

It may seem odd to group these next three points, but as we'll see, they work in harmony.

• **God promises to meet our needs.** Philippians 4:19 places high on the "favorite Bible verse" rankings, stating *"And my God will meet all your needs according to the riches of His glory in Christ Jesus."*

• **We demonstrate our *trust* in Him through giving.** A common thread ties Old Testament *tithing commands* such as Malachi 3:10 (*"Bring the whole tithe into the storehouse, that there may be food in my house. Test me in this…and see if I will not throw open the floodgates of heaven and pour out so much blessing that there will not be room enough to store it."*) to New Testament *generosity principles* as in Luke 6:38 (*"Give, and it will be given to you. A good measure, pressed down, shaken together and running over, will be poured into your lap. For with the measure you use, it will be measured to you."*). The "big picture" message God was communicating to both the Old Testament Jews and New Testament Christians is the same: Trust me—I'll take care of you. More on this crucial trust issue in a moment.

• **Money is a test of our allegiance.** Matthew 6:24 says, *"No one can serve two masters. Either you will hate the one and love the other, or you will be devoted to one and despise the other. You cannot serve both God and money."* Clearly God intends this to be "either/or," not "both/and."

The underlying issue behind all of the tithing/giving Scriptures in the Bible is **trust**. God's challenge to His people—then *and* now—is simply, "Do you trust me?" In both the Old and New Testaments, God makes this question intensely practical by making the test a physical one involving our money. Do we believe Him when he promises to care for us well on 90% (or less) of our income if we will offer up the other 10% (or more) to Him? For many, giving is where the rubber hits the road and our faith becomes uncomfortably tangible.

The issue of trust is why these three points are inextricably linked. There's 1) the promise of provision, 2) the practical test God has given us to demonstrate our faith in His promises, and 3) a stark reminder that failing the test of cheerful giving may be an indication that our hearts aren't following after God the way we think they are. It's because our giving *is usually a reflection of our deeper heart condition* that SMI regularly encourages readers toward the 2 Corinthians 9:7 goal of being the type of "hilarious" givers that God loves![1]

• **Our specific responsibility is to take care of our family.** 1 Timothy 5:8 says, *"But if anyone does not provide for his own, and especially for those of his household, he has denied the faith and is worse than an unbeliever."* Work typically allows us to accomplish this early in life, and the familiar SMI blueprint provides a safe route for continuing to do so in the future:

1. Get out of debt. *"The rich rule over the poor, and the borrower is slave to the lender"* (Proverbs 22:7).

2. Build savings. *"In the house of the wise are stores of choice food and oil, but a foolish man devours all he has"* (Proverbs 21:20).

3. Invest for the future. *"Steady plodding brings prosperity; hasty speculation brings poverty"* (Proverbs 21:5).

4. Diversify to manage risk. *"Divide your portion to seven, or even to eight, for you do not know what misfortune may occur on the earth"* (Ecclesiastes 11:2).

There are many other important Scriptures that could be added here. These foundational pillars aren't exhaustive, but they go a long way toward establishing both *how* we should handle our money, and more importantly, *why*.

MARK BILLER
EXECUTIVE 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 339 • Volume 29 Number 9. Mailing date: 9/06/2018.

[1] The Greek word typically translated as "cheerful" in 2 Cor. 9:7 is the same word "hilarious" is derived from! The emphasis in this verse of not being *compelled* to give, but *desiring* to go beyond duty in our giving, can help steer us away from legalistic thought patterns in our giving.

FEATURE ARTICLE

The Crucial Role of Behavior in Making Investing Decisions

(continued from front page)

into great outcomes. When Daniel Kahneman, the man who co-invented this entire field of study, was asked what could be done to overcome behavioral biases, he remarked: "Very little. I have 40 years of experience with this, and I still commit these errors. Knowing the errors is not the recipe to avoiding them."

COMMON AND IMPACTFUL BIASES

Loss aversion Losses feel worse than gains feel good, which affects how we seek (or not) to take risk.	**Overconfidence bias** We think we know more than we actually do, leading to unduly bold decisions.
Confirmation bias We seek out information that substantiates our previously held beliefs, thus inhibiting the ability to learn.	**Availability bias** We weigh more heavily readily available information and tend not to seek out that which does not come immediately to mind.
Recency bias In our decisions, we prioritize factors we've most recently encountered.	**Endowment effect** Once we own something, we tend to value it more, making it more difficult to sell something we should.

Thus, success is not about deprogramming yourself. It's about finding ways to mitigate the consequences of inescapable foibles and inevitable mistakes. That starts with recognizing how unique our experience with money and investing really is. We make many of those decisions under time's long shadow. Unlike many other decisions in life, the temporal gap between when we make a money decision and when we are rewarded or punished for it can feel like an eternity. Much of what humans are good at does not center on weighing consequences of a possibility many years in the future.

Imagine the experience of enjoying your favorite cheeseburger. The pleasure starts prior to even sitting down at the restaurant. As you develop a craving, anticipation kicks in and dopamine is released in your brain. Anticipation is central to the enjoyment itself. You've eaten this cheeseburger before, so you have a good sense of what it will taste, smell, look, feel, and even sound like. There is an expected but brief delay between when you order the burger and when it's served. And when you bite into it—bingo. All of your five senses are amped. There is no temporal gap between the bite and your enjoyment. Pleasure is instantaneous.

Investing is also a form of consumption, but it's about the opposite of that wonderful cheeseburger experience in every regard. There is usually no joyful anticipation of purchasing a security. Perhaps if you have a hot tip for a quick winner, your pulse will quicken. Your expectations for what that investment will provide are at best imperfect. Having a clear and up-to-date set of expectations for our investments is elusive, explaining why so many people have poor investment experiences. At the time of "consumption"—the moment you officially own the stock or bond or fund—none of your senses is engaged. Because nothing happens. Indeed, with investment products, what we experience is an interminably long disconnect between purchase and enjoyment, between consumption and utility.

In that vast swath of time, humans have countless opportunities to screw things up.

The behavior gap

The fact that we *systematically buy high and sell low*—the exact opposite of what common sense, let alone finance theory, would tell us to do—is proof that in investing, emotional intelligence trumps financial intelligence.

Overwhelming evidence shows that we underperform our own investments. Over the 20 years through the end of 2015, the U.S. stock market nearly quintupled. An average buy-and-hold investment gained +483% over that stretch. But the average investor in U.S. stock mutual funds gained just +251%. This difference is referred to as the "behavior gap."

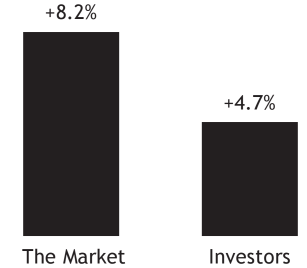
Why did investors leave nearly half their gains on the table? Because of how we're hard-wired. Our survival instincts compel us to run from perceived danger and pounce on perceived opportunity. That's true in all walks of life, including the domain of money. When markets trend upwards, investor sentiment tends to be more positive. Bull markets make for better moods. Because markets tend to trend upwards over long stretches, we hit new highs more frequently than one might casually suspect. For those focused on daily market action, those new highs release dopamine in the brain (new highs physically feel good), which makes us more likely to invest more.

But when the market turns south, watch out. Our brain chemistry sours and we're unlikely to invest more. Who buys "on the dip?" Almost no one. In fact, we're prone to head for the exits when the prospect of losing even more money seems like a big possibility. This is our built-in survival instinct at work.

There is substantial evidence to support this cycle of greed and fear. Look at the two numbers in the following graphic. The number on the left is the annualized return of big company U.S. stocks over the past 20 years. That figure is +8.2% per year.

BUYING HIGH, SELLING LOW

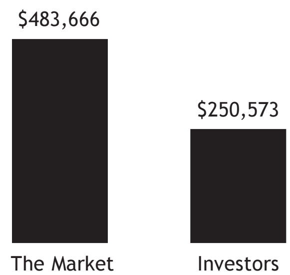
(ANNUALIZED GAINS, 1996-2015)



The number on the right is more complicated because it considers investors' real-world buy-and-sell decisions. Sometimes we choose to put some money into the market; at other times we take it out. Data are available to precisely measure every dollar in motion. Thus, the average investor's investment compounded at just +4.7% over that same 20-year stretch.

Percentages and other financial statistics are cold and abstract. They rarely resonate with normal people. Thus, it's hard to get a mental fix on the relevance of the difference between "+8.2%" and "+4.7%." The impact of buying high and selling low is understood more viscerally when we look at the real-world dollars at stake:

THE DOLLAR COST OF BAD DECISIONS
(DOLLAR RETURNS, 1996-2015)



The gap between the two numbers is large. Based on a $100,000 portfolio, the difference between the "set it and forget it" strategy versus the "let people be people" strategy is $233,093. (You can adjust the starting amount however you'd like, but what won't change is the nearly 2x difference). If you start this exercise at age 45 and stay with it until age 65, better behavior "buys" additional years of a comfortable retirement.

Choosing not to choose

An important distinction when thinking about making good decisions is whether we actually have any choice to begin with—or whether we want any. At times in life, we have a great deal of discretion. We choose to eat out instead of staying in; we then choose one of many restaurants; and we then choose whatever we'd like from an extensive menu. In an opposite scenario, we are obligated to attend someone's dinner party and eat whatever we're served alongside people we didn't choose to be with.

This type of choice regime—discretion vs. not—is something we encounter daily, in all life's domains—consumption, health, work, transportation, education, money. Its structure and its consequences are usually trivial. Our spouse's friend may be a dreadful cook, but we'll survive an overdone steak.

In some areas it's not trivial. For example, some of us participate in our employer's retirement plan. A small portion of our regular paycheck is automatically deposited in the plan. This is effectively putting our investment decisions on autopilot. Those who opt into retirement plans usually don't then later opt out. In contrast, most other types of investing are discretionary, in which you can buy and sell as you see fit.

One striking example of the consequences of these two approaches will bring the point home. In this case, different investors *in the exact same fund* over *the exact same time frame* had dramatically different outcomes:

Investment A over 10 years → Good Outcome
Investment A over 10 years → Bad Outcome

How could this be? The difference is determined by those who *have discretion* over their trip versus those *on autopilot*.

When we compare discretionary versus autopilot versions of the same investment, we often observe wildly different investor outcomes. Take as an example the world's largest mutual fund, the Vanguard 500 Index Fund. With about $665 billion in total assets, the fund comes in two different formats. The portfolio is *identical* in each, but one version is held in autopilot retirement accounts, the other in discretionary accounts. The only practical difference between the two funds is an immaterial difference in cost (a small fraction of a penny on the dollar).

As would be expected, the investment performance of the two funds is nearly identical. Over a 10-year span, the autopilot version (VINIX) returned +6.9% per year while the discretionary version (VFINX) returned +6.8%—a tiny gap explained by that small fee differential.

When we dig into the numbers, the picture grows more interesting. The behavior gap for the discretionary fund is wide. Compared to the actual +6.8% return, the average investor in the fund earned only +4.3%. Because this time span includes 2008, much of the behavior gap is explained by impulsive selling during the crisis and then failure to resume investing after markets calmed down.

THE BENEFITS OF CONSTRAINT

Discretionary Investors (VFINX)			Autopilot Investors (VINIX)		
Actual Return	Investor Return	Behavior Gap	Actual Return	Investor Return	Behavior Gap
+6.8%	+4.3%	-2.5%	+6.9%	+7.7%	+0.8%

Autopilot investors fared much better. While VINIX returned +6.9% per year, the average autopilot investor made +7.7% per year—a negative behavior gap! Why? Because investors in VINIX are dollar-cost-averaging into the market during good times and bad. They were less likely to sell in 2008. They buy more shares when the market is lower and fewer when it is higher; a slight twist on buying low and selling high. As a result, investors in VINIX outperformed their own fund.

All in, autopilot investors had a much better experience than discretionary investors. The real dollar consequence of this good versus bad decision-making is large. Here, the average $100,000 investor in VFINX ended up with $160,630 over the following decade, compared to $260,087 in VINIX—a 62% difference. This isn't pie-in-the-sky finance. These are significant dollars that can make a difference in our lives.

In this case, one group of investors wasn't "smarter" than the other. They weren't more likely to have an MBA or a degree in finance. Instead, one group had a lot of flexibility—and abused it. The other forfeited that choice by going on autopilot and came out way ahead.

With investing, an itchy trigger finger invites trouble. When markets get shaky, we can't but help feel the urge to bolt. And once we step aside, we greatly underestimate the fortitude it takes to get back in. This is only natural—our brains are wired this way.

However, impulse control is, to some extent, manageable. Through proper parenting, coaching, and socializing, individuals can buttress their willpower. Better outcomes are possible, even though much of the available data point to worse ones. As we just saw, one solution is to eliminate discretion altogether. When we sign up for automatic savings plans, we tend to achieve much better outcomes.

One of the most successful savings programs in U.S. history has done just that. By a small but important design tweak, the behaviorists behind the "Save More Tomorrow" program have driven billions of dollars in extra savings by individual investors.[1] That tweak was introducing "negative consent" to corporate retirement plans: Rather than asking people to *opt in* to a regular savings plan, they automatically enrolled them and then asked people to *opt out* if they so chose. The choice set and constraints were identical, but one paradigm has worked much better than the other.

Oftentimes we don't have the luxury of such structures, nor self-control. In these cases, it's important to partner with good counselors and associate with good role models. We take direction well from those we respect; and we mimic the behavior of those we like. Individuals who work with good financial advisors tend to have better outcomes, not because those advisors are more market savvy, but because they are skilled at providing a check on bad investment behavior, such as selling during market choppiness. Likewise, if we run with a fast money crowd, we're more likely to try to keep up, especially in terms of conspicuous consumption: My neighbor just got that new Audi, so why shouldn't I upgrade? Associating with those who have healthier money habits produces healthier outcomes. The classic money book, *The Millionaire Next Door*, told tales of frugal millionaires who lived in communities where there was less urge to keep up with the Joneses.

> "The discipline which is most important in investing is not accounting or economics, but psychology."
>
> Howard Marks

Pursuing investing simplicity

Amid the overwhelming complexity of modern life, we seek to find simplicity, a break from the noise. Perversely, we are naturally attracted to the complex, especially in technically challenging domains like money. We sometimes assume that what appear to be thorny problems are best addressed by elaborate solutions.

In the context of our money lives, simplicity means having a limited number of clearly articulated concepts that both make sense of a noisy world and drive sharp, reasonable decisions; and an awareness that those concepts can weather the inevitable forces of change that disrupt even the best made plans.

Even more deeply, we strive to transform decisions into habits: Rendering sound money decisions into routines that we no longer think about. We just do them (such as regular savings) or don't do them (such as living beyond our means). Finding better habits is an important expression of adaptive simplicity, for it means that we can eliminate the psychic strain of self-control, frequent decisions, and the additional consumption of (often useless) information.

When the noise in our minds collides with time's quiet expanse, we struggle. We hold the keys to our own long-term success, even though we sometimes forget. Regular, consistent, disciplined investing is awesome—especially when we're not thinking about it. A much better experience with money is within anyone's reach.

The Geometry of Wealth: How to Shape a Life of Money and Meaning by Brian Portnoy is published by Harriman House. Retail price $19.99. It's available via Amazon and other booksellers. Learn more about the author at shapingwealth.com/author.

SMI Editor's Note

We thought it might be helpful to frame a few of the author's points in an "SMI context." First, do the author's closing comments regarding simplicity mean we should be streamlining our portfolios down to a collection of index funds? Perhaps—*if* you think that approach will be as effective in the future as using a blend of SMI's active strategies. We definitely don't believe that, *especially* with the market's high valuations implying significant pain for indexers over the next decade.

Rather, we would encourage you to strive for simplicity *within the context of the best portfolio for your current situation*. SMI has taken significant steps in this direction. For example, SMI used to rely on individual readers to apply the Bear Alert indicator to their own portfolios in an effort to provide downside protection. But the type of behavioral research cited in this article has convinced us that a much better approach is to bring those discretionary decisions into the actual SMI strategies themselves. Now, SMI's defensive efforts are built directly into our DAA and Upgrading 2.0 strategies. No extra decisions to make; just keep following the strategies as they unfold each month. This is a deliberate application of the principles discussed in this article.

Second, the author forcefully establishes that investors with a "hands off" approach outperform those that are "hands on." The implication is that "hands off" means working with an advisor. But in many respects, SMI fills the role of an advisor for SMI members—providing specific investment instructions at regular intervals, while supplying the ongoing emotional support and education to help you stay the course.

While this approach has proven sufficient for many SMI members across the past three decades, some may benefit from being *even more* hands off. Thankfully, those members can now have the SMI strategies implemented for them via SMI Advisory's Private Client service. See page 136 for details. — Mark ◆

[1] May2017:p71

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

BEFORE YOU INVEST

With the stock market near its all-time highs, it's easy to get complacent. There's a tendency to forget the pain of the last bear market, take on more risk than we should, and minimize the importance of basic financial blocking and tackling. For example, why keep so much emergency-fund money in a low-interest savings account when there's seemingly *easy* money to be made investing?

Of course, the problem with that line of thinking is that good times don't last forever. That's why maintaining a solid financial foundation is just as essential in good times as in bad.

Step by step

SMI has always maintained that investing is *not* the first step of the financial journey for a good steward. Three others should be taken first:

1. Build an initial emergency fund of roughly *one month's* essential living expenses. Essential expenses are those you'd have to continue paying even in a financial emergency, such as the loss of your job. In that situation, you wouldn't have to pay for vacations or new clothes, but you *would* have to pay your mortgage or rent, buy groceries, and cover your utility bills. Use the *Cash Flow Plan* found in the Resources section of the SMI website to identify and quantify how much one month's worth of essential expenses is for your household.

2. Get out of debt—at least all debt other than a reasonable mortgage.[1]

3. Enlarge your emergency fund to *three-to-six months* of essential living expenses. Which end of this range is right for you? It depends on your circumstances. Married people with kids need more in reserve than do singles, homeowners need more than renters, and those with less secure jobs need a larger cushion than those with more secure jobs.

Once those three steps are complete, a person's financial foundation is strong enough to focus on investing. Skipping the steps in pursuit of better returns carries the risk of having to sell temporarily depressed investments during a market downturn to cover an emergency.

How to, and where?

The easiest way to build savings is to set up an automatic monthly transfer from your checking account to a savings account. Doing so means having to make the decision and commitment to save *one time* (when you set up the automatic transfer) instead of every month.

The bank or credit union where you have a checking account may be the most convenient place to maintain a savings account. However, online banks generally pay quite a bit more interest than brick-and-mortar banks. (For example, Capital One currently pays 1% on its no-minimum savings account, or 1.85% on its money-market account, which has a $10,000 minimum. By contrast, Chase is paying only 0.01%!) Another option, which fell out of favor during the Great Recession but is now quickly becoming attractive again, is a money-market mutual fund.[2]

Multiple savings accounts

In addition to having a dedicated savings account for emergencies, it can be helpful to maintain a second savings account where you set aside money for *irregular* bills or expenses. Examples include semi-annual or annual insurance premiums, property taxes (if paid separately from your mortgage), an annual vacation, and Christmas gifts.

Set up an automatic monthly transfer from checking to this savings account in the amount of one-twelfth of the annual cost of all such bills and expenses. When the bills come due, you'll be glad to have the money set aside. You also may want to have an *accumulation* savings account for a replacement automobile or other big-ticket items.[3]

The timeless wisdom of saving

In life, surprises happen. Home or car repairs sometimes cost more than you've budgeted. Medical bills could exceed what your insurance will cover. Or, you could face an extended period of unemployment. Having money set aside to protect against such possibilities is simply good stewardship. Proverbs 21:20 says, "Precious treasure and oil are in a wise man's dwelling, but a foolish man devours it."

Keeping a savings reserve isn't just good for your financial life. It's good for your health and relationships as well. People with a savings cushion tend to experience less stress than those without savings. A national survey conducted by the market research firm Synovate found that people with at least six months' worth of living expenses in savings were 60% less likely to report feeling stressed about their finances than those with no emergency fund. Similarly, research conducted at Utah State University found that marital conflict tends to decrease as household assets, such as savings, increase.

A work-related exception

The one common exception to the *save-before-investing* rule involves those eligible to participate in a 401(k) plan that *includes an employer match*. If your employer will match contributions, that's a great deal. If you can build savings *while also* contributing to your workplace plan to get the match, do so.

Building savings and eliminating debt will never score high on life's thrill-o-meter. But having a well-stocked emergency fund and being debt-free will contribute mightily to your peace of mind as you pursue your investment goals. So, build savings and ditch debt first; *then* invest.◆

[1]See the January 2018 newsletter article, *The Essential Steps for Getting Out of Debt*, and *Making Sure Your House Doesn't Own You* from April 2013. [2]June2018:p86 [3]March2018:p38

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

SMI'S APPROACH TO INVESTING IN "LATE-CYCLE" BULL MARKETS

Most of the investing world hailed the current bull market taking over the crown as the "longest bull in history" on August 22. While there were a few dissenters arguing over that distinction, by most measures, the current bull market began on March 9, 2009, putting us well into its ninth year and now surpassing the length of the 1990s bull market.

There probably are better measures of a bull market's vulnerability than simply the number of days since the last bear market ended. We prefer to measure market valuation and assess whether a catalyst is in place that's creating the conditions for its eventual end. And judging by all those indicators, the current bull market looks old, overvalued, and potentially ready to roll over into a bear market. That doesn't mean it will do so imminently, just that the necessary conditions of why it could are in place.

Why investors won't walk away

So why don't investors recognize when a bull market is over-extended and walk away? It's not an information issue, as the market's record bull length, its historically high valuations, and the "catalyst" of Federal Reserve actions have all been well chronicled.

No, the reason people stay invested as risk rises late in bull-market cycles is because that's when the stock market tends to deliver some of its best returns! Look no further than the recent performance of SMI's most aggressive strategies. As we noted last month, over the 12-months ended June 30, Stock Upgrading was up +15.2% while Sector Rotation soared a ridiculous +46.5%!

It's hard to walk away from that type of potential upside, especially when it's a well-documented fact that valuation is a poor timing indicator. The past few years have reinforced what investors also saw in the late 1990s: high returns can continue long after the market's valuation indicators start flashing warning signs.

SMI's approach to aged bull markets

Trying to *predict* when bull markets will end doesn't work. So what can investors do instead? Here's SMI's approach to dealing with late-cycle bull markets:

1. Stay invested. This assumes you're using an appropriate blend of SMI's strategies,[1] some of which have defensive properties that we believe will help reduce (not eliminate) the impact of a future bear market.

2. Have reasonable expectations. This applies both to your overall portfolio, as well as each individual component. We know that by continuing to invest late-cycle, we're almost guaranteed to give back a portion of our late gains when the market finally shifts from bull to bear. Hopefully, you've made peace with that idea so it won't be upsetting when it eventually occurs. The defensive properties of the SMI strategies are intentionally designed to kick in *slowly*, ideally triggering only occasionally, during particularly damaging conditions.

There's always a trade-off with defensive efforts: either the protocols trigger quickly, causing us to endure numerous false alarms that cost money and frustrate everyone along the way, or they trigger slowly and infrequently, which requires us to absorb some degree of pain at the end of the bull market cycle. This happens as our fully-invested portfolios work their way down from the prior highs to the levels where the defensive protocols kick in and start getting us out of stocks.

Regarding the individual strategies, understand what each is expected to do. Upgrading, and especially Sector Rotation, are supposed to perform great in the current environment. Dynamic Asset Allocation isn't. It's supposed to do okay now, but be great in the opposite environment—bear markets. Over *full market cycles* and the long-term, DAA's historical performance has been better than the overall market. But it gets there by outperforming during bear markets despite lagging the market at the end of bulls.

3. Play good defense. Before discounting DAA too quickly in the current environment, consider the vital role it plays in *incrementally* playing defense within a portfolio. Psychologically, it's tough to make significant changes to one's stock allocation all at once. That's one reason why traditional market-timing approaches don't work for most people: apart from it being extremely difficult to figure out accurate signals, those trades are emotionally brutal to execute.

Contrast that with DAA, which never has more than two-thirds of its holdings in stocks at any given time. DAA recently sold its foreign stock holdings after owning them roughly a year and a half. That wasn't a particularly hard move for SMI members to make: it was only a portion of the portfolio and DAA makes similar changes fairly regularly. While it likely didn't feel like a "big deal" to readers, the result was to lower DAA's stock allocation to just a third of the portfolio.

Who has the easier emotional path from here, if the market declines and it becomes clear we're in the early stages of a bear market? The DAA investor who simply has one more incremental step of eliminating a one-third position in U.S. stocks at a pre-established interval, or an investor who has been heavily invested in stocks for years and has to figure out when and how much to trim that heavy stock allocation?

Another key development in our ability to play good defense was the introduction of Upgrading 2.0 at the beginning of 2018.[2] While the research indicates we shouldn't expect Upgrading's bear-market (continued on page 141)

[1] April2018:Cover [2] Jan2018:Cover

LEVEL 3 THREE

Broadening Your Portfolio

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

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

SMI PRIVATE CLIENT *CLASSIC*: PERSONAL PORTFOLIO MANAGEMENT IS NOW AVAILABLE TO ALL

Six months ago, SMI Advisory Services[1] announced that professional management of *individual accounts* using the SMI strategies was being offered for the first time.[2] SMI members responded enthusiastically, pushing the assets under management in SMI Private Client to nearly $100 *million*!

Until now, Private Client has been available only to those with at least $250,000 to invest. With the debut of Private Client *Classic*, professional management of the SMI strategies within a personal account is now available to anyone with as little as $2,500 to invest!

Why choose Private Client?

Individuals choose to utilize the Private Client service for a variety of reasons. Here are a few of the most common:

1. Automated investing produces better long-term outcomes. This month's cover article makes a persuasive case as to why investors perform better by limiting their own interactions with their portfolio. Anyone who has ever struggled with *following the system* versus freelancing a bit can see why automation and sticking with the plan are consistently cited in investing research as keys to success.

2. Private Client provides continuity for your heirs. Many people have noted this as a specific motivation for moving to Private Client. It's not unusual for an SMI member to know and love the SMI strategies, but worry that their spouse or heirs know nothing about them.

Meanwhile, many of the non-investing spouses have concerns about this potential transition as well. Getting set up with Private Client provides peace of mind *for both* that the investment handoff will be smooth, guided by a knowledgeable, Christian advisor from SMI Advisory Services.

3. Simplifying your life is worth paying for. As Brian Portnoy, author of this month's cover article writes, "Mental energy is not a euphemism. It is literally a limited physical resource, so we want to engage our effortful brain in the most efficient way possible." Some people love managing their own investment portfolio. Others don't. Every day, each of us chooses certain aspects of modern life to outsource, while retaining others to handle ourselves. Portfolio management is no different. So if you don't enjoy it (or feel you don't have time to *do it well*), perhaps it's time to outsource that task and free up your time and mental energy for something else.

How does Private Client *Classic* work?

The *Classic* tier of Private Client functions much like the *Select* and *Premier* tiers described in March, with a couple of key exceptions. Importantly, *all three tiers provide the same professional management of the SMI strategies*. The actual investing decisions and the portfolio managers making them (led by Mark Biller) are the same for all Private Client accounts regardless of tier.

The difference between Classic and the other tiers involves how clients interact with SMI Advisory Services.

Select and *Premier* clients work directly with an advisor to get their accounts set up, and those advisors handle any follow-up questions or issues that come up in the future. *Classic* clients handle these processes online and via email, without speaking directly to an advisor. Rest assured that Private Client's online process for getting set up is state of the art, the portfolio selection process is intuitive and easy to use, and help in getting started is always just an email away. The ability to establish an account and select a portfolio online means you can do it at your convenience, while also allowing SMI Advisory Services to offer fully-featured professional portfolio management to accounts as small as $2,500. That's unheard (continued on page 141)

	CLASSIC $2,500 Minimum Investment (Per Account)	SELECT $250,000 Minimum Investment (Per Household)	PREMIER $1,000,000 Minimum Investment (Per Household)
SMI Strategies			
Stock Upgrading	✓	✓	✓
Dynamic Asset Allocation	✓	✓	✓
Sector Rotation	✓	✓	✓
Just-the-Basics	✓	✓	✓
Bond Upgrading	✓	✓	✓
Features			
SMI Advisory Management	✓	✓	✓
Customized Portfolio	✓	✓	✓
Intelligent Rebalancing	✓	✓	✓
Integrated Financial Dashboard	✓	✓	✓
Tax-Loss Harvesting	✓	✓	✓
Asset Location	✓	✓	✓
Complimentary Planning Tool	☒	✓	✓
Assistance with Planning Tool	☒	✓	✓
Access to Stewardship Advisors	☒	✓	✓
Live Phone Support	☒	✓	✓
Transaction Fees			
Free Trades	✓	✓	✓
Transfer Fees Rebated	✓	✓	✓
Management Fee	1.00%	0.95%	0.85%

[1]Although SMI Advisory Services and the SMI newsletter/website are affiliated, they are separate companies. [2]March2018:p40

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

MANAGED PAYOUT FUNDS: MUTUAL FUNDS THAT PAY LIKE AN ANNUITY

Building your retirement nest egg is a years-long challenge. Then comes another challenge: managing your retirement money in such a way that it lasts for the rest of your life (or even longer) and withstands the corrosive effects of inflation.

Many retirees handle the "deaccumulation" phase by withdrawing from their retirement funds bit by bit as the years go by, following a do-it-yourself or advisor-guided strategy that seeks to avoid depleting the money too quickly.

Another approach is to buy an insurance-company annuity that pays a guaranteed[1] monthly income over the rest of one's life (or over some other contracted period of time).

These two approaches are not mutually exclusive. Some retirees combine them, hoping to maintain the growth potential (and assumed inflation protection) of an investment fund with the reliable payout offered by an annuity.

An all-in-one solution?

Recognizing that many retirees desire simplicity in managing retirement money, several mutual-fund companies—including Vanguard, Fidelity, and Schwab—now offer an all-in-one approach to retirement income: an annuity-like monthly payout from a mutual fund.

These investment vehicles fall under the general headings of "managed payout funds" or "retirement-income funds," but each company has its own approach to naming its funds.

Vanguard has opted simply for the "Vanguard Managed Payout Fund." Fidelity recently rebranded its five retirement-income offerings as "Simplicity RMD Funds" (the payout strategy is based on the IRS formula for Required Minimum Distributions for traditional IRAs). Schwab uses the descriptor "Monthly Income Funds." Other companies with retirement-income funds include Dimensional Fund Advisors, T. Rowe Price, and John Hancock.

The payout particulars and fund design vary from shop to shop, but the idea is the same: make it easy for retirees to convert retirement savings into a monthly income stream—potentially while at least keeping up with inflation—without forcing them (as most annuities do) to give up ready access to their money. At any time, an account holder with a managed payout fund can move money to a different fund (or multiple funds) or simply cash out.

It's been a tough sell

Even though getting a monthly payout from a mutual fund may seem like an attractive proposition for retirees, managed payout funds haven't gained much of a following.

Vanguard has the industry's largest payout fund, but it has amassed only $2 billion in assets. (Compare that to the $400 billion-plus in the retail version of the company's popular Vanguard 500 fund.) The *largest* of the three Schwab payout funds has a scant $89 million in assets.

One reason managed payout funds have failed to attract much money is the risk/reward equation just isn't compelling enough. The simplification is nice, but unlike annuities, such funds don't offer a *guaranteed* payout. Instead, there's typically a payout "target" which a fund may or may not hit. (Fidelity's funds are a bit different in this regard, as explained below.)

Vanguard's Managed Payout Fund, for example, "targets an annual distribution rate of 4%," according to the company's website. As of mid-year, the actual payout was about 3.8%, or roughly $317 per month on a $100,000 investment. The fund's underlying holdings are a mix of Vanguard index funds (both stock and bond), plus commodities and "alternative strategies" investments.

Schwab, instead of offering *specific* targets for its three retirement-income funds, has *ranges*—3%-4% annually for the Moderate Payout Fund, 4%-5% for the Enhanced Payout Fund, and 5%-6% for the Maximum Payout Fund. The prospectus for each fund notes that, under adverse conditions, payouts could drop as low as 1% annually and may include the return of some of an investor's principal. All three funds invest in an underlying mix of Schwab-branded equity and fixed-income funds, along with cash.

In contrast to Vanguard and Schwab, Fidelity *does* offer guaranteed distributions, but only in a certain sense. Fidelity's five Simplicity RMD funds provide holders of Traditional IRAs with payouts that match the IRS's Required Minimum Distributions—distributions the investor must take anyway (starting at age 70½) to avoid tax penalties. An account holder can ask for the payouts to be made monthly or annually.

Four of the five Fidelity RMD funds include a target date in the fund name. The Simplicity RMD2020 Fund, for example, is for anyone reaching age 70½ within five years of 2020 (i.e., retirees born between January 1, 1948 and December 31, 1952). According to Fidelity, "[e]ach Simplicity RMD Fund invests in over 25 underlying funds to provide a diversified age-appropriate asset allocation mix."

Why not just buy an annuity?

An annuity may be helpful as part of an overall plan for retirement income, but there are downsides. Not only does an annuity tie up an investor's money in a long-term contract, annuities typically don't include inflation protection (unless an expensive cost-of-living rider is added). Without such protection, inflation steadily erodes the purchasing power of the monthly payout. As an example, assume inflation hits 3% (continued on page 141)

[1]The guarantee is only as strong as the long-term financial health of the insurance company that issues the annuity.

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 7/31/2018	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	-1.4	-1.0%	2.6%	-1.3%	-6.4%	6.2%	6.5%	1.13	0.11%	20%	16%	12%	8%	VXUS
Extended Market Index ETF	Small company stocks	29.2	7.8%	1.7%	7.5%	4.4%	17.4%	11.0%	1.19	0.08%	40%	32%	24%	16%	VXF
S&P 500 Index ETF	Large company stocks	23.8	6.3%	3.6%	6.9%	0.7%	16.2%	12.5%	1.00	0.04%	40%	32%	24%	16%	VOO
Total Bond Mkt Index ETF	Medium-term bonds	-1.1	-1.8%	0.0%	0.6%	-0.6%	-1.1%	1.4%	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 7/31/2018[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. Vanguard Intl Growth	09/17	Yes	Yes	Yes	14.6	5.6%	1.5%	2.4%	-3.2%	15.4%	13.1%	1.40	0.45	133	None	VWIGX
	2. MS Intl Opportunity - LW[12]	08/18	NTF	NTF	NTF	16.8	6.4%	-1.9%	0.9%	-0.7%	16.7%	17.0%	1.34	1.29	53	2%30days	MIOPX
	3. Advisory Res Intl Sm Cp Val	06/18	Yes	Yes	Yes	10.5	2.9%	0.8%	-2.4%	-1.9%	14.8%	10.3%	1.03	1.20	74	2%90days	ADVIX
Category 4 Small/Growth	1. Delaware Smid Cap Gro - LW[12]	02/18	NTF	No	NTF	59.0	16.0%	-1.2%	10.3%	6.5%	42.2%	13.1%	1.42	1.17	39	None	DFCIX
	2. Baron Opportunity	03/18	NTF	NTF	NTF	45.2	20.6%	0.4%	8.2%	8.0%	29.0%	14.8%	1.51	1.41	60	None	BIOPX
	3. Kinetics Small Cap Oppor	02/18	NTF	NTF	NTF	60.8	20.3%	2.0%	10.0%	11.7%	39.1%	18.4%	1.29	1.66	39	2%30days	KSCOX
Category 3 Small/Value	1. iShares Core S&P Small Cap	08/18	ETF	ETF	ETF	44.3	12.9%	3.2%	11.0%	10.1%	23.2%	15.3%	1.34	0.07	605	None	IJR
	2. Hodges Small Cap	04/18	NTF	NTF	NTF	32.5	8.1%	1.8%	5.7%	3.8%	23.1%	6.5%	1.50	1.30	52	1%30days	HDPSX
	3. Huber Capital Sm Cap Val	06/18	NTF	NTF	NTF	30.6	8.1%	1.0%	5.1%	7.3%	18.1%	7.7%	1.55	1.75	49	1%60days	HUSIX
Category 2 Large/Growth	1. MS Multi-Cap Gro - LW[12]	05/18	NTF	NTF	NTF	60.0	21.4%	-0.3%	11.6%	11.7%	36.7%	18.2%	1.53	1.24	38	None	CPOAX
	2.Touchstone Sands Cap Sel	07/18	No	NTF	NTF	45.3	21.4%	0.5%	8.7%	9.0%	27.6%	12.9%	1.58	1.22	29	None	PTSGX
	3. Invesco S&P 500 EW Tech	04/17	ETF	ETF	ETF	36.1	13.0%	1.6%	6.8%	3.9%	25.4%	22.2%	1.28	0.40	73	None	RYT
Category 1 Large/Value	1. Miller Opportunity - LW[12]	06/17	NTF	Yes[10]	NTF	48.4	15.3%	3.8%	17.0%	10.8%	20.5%	8.2%	2.07	1.35	37	None	LGOAX[10]
	2. Oppen S&P Ultra Dividend Rev	07/18	ETF	ETF	ETF	31.3	7.6%	1.1%	7.8%	5.5%	18.0%	14.1%	1.15	0.39	61	None	RDIV
	3. ☎ Pear Tree Quality	09/18	NTF	NTF	NTF	28.2	7.0%	5.4%	8.9%	1.9%	17.3%	13.7%	0.99	1.30	50	None	USBOX
Bond Categories	Vanguard Inflation Protect[6]	02/18	Yes[11]	Yes[11]	Yes[11]	1.4	-0.6%	-0.5%	0.4%	0.3%	0.7%	1.5%	1.11	0.20	7.7[7]	None	VIPSX[11]
	Permanent: Vanguard I-T Bond	Perm	ETF	ETF	ETF	-1.9	-2.2%	0.1%	0.8%	-0.7%	-2.1%	1.4%	1.29	0.07	6.4[7]	None	BIV[8]
	Permanent: Vanguard S-T Bond	Perm	ETF	ETF	ETF	0.0	-0.3%	0.1%	0.5%	0.2%	-0.6%	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-August, not those shown on this report. The fund ranked third is the one that currently appears most likely to be replaced next. A telephone symbol (☎) next to a fund's name indicates that fund is a new recommendation. See the fund writeups in "MoneyTalk" for more information. **[2]** Fund Availability: NTF means the fund can be bought and sold free of transaction fees as long as you stay within the trading limitations imposed by 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 Vanguard International Growth, the highest-rated Cat. 4 fund available is Baron 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.

❶ PICK YOUR ALLOCATION

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

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

❷ FIND YOUR PORTFOLIO MIX

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

❸ BUY YOUR FUNDS

Example uses an 80/20 mix between stocks and bonds		Dollars	Invest In Funds
Stock Cat. 5: Foreign	16%	$8,000	Vanguard International Gro
Stock Cat. 4: Small/Growth	16%	$8,000	Baron Opportunity
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 Large/Value group, Toreador Core (TORLX, 05/2017) is being replaced.**[$] This was our first experience recommending a Toreador fund and it was a great success. Over the 15 months we owned it (through July 31), Toreador gained +22.5%, considerably better than the +15.9% gain of the average fund in SMI's large/value group. However, it has slowed relative to its category in recent months. With it slipping slightly below the top quartile cutoff in August, it's time to replace it.

Note that the fund has been recommended longer than 12 months and has accumulated significant gains. This is worth paying attention to if you own the fund in a taxable account (this paragraph is irrelevant if you own the fund in a tax-advantaged retirement account). Providing you purchased Toreador when SMI first recommended it, your gains will qualify for preferential long-term capital-gains tax rates. If you purchased it *later*, you should check your holding dates to see if you're close to the minimum one-year holding period. With Toreador so close to the quartile cutoff, it might be worth holding the fund an extra month in order to qualify for better tax treatment.

• **Pear Tree Quality (USBOX) is being added.**[1] This selection is similar in some respects to the situation we explained last month when we recommended the iShares Core Small Cap ETF in our small/value risk category. Like that recommendation, Pear Tree occupies the "blend" area between the true "value" and "growth" funds. Morningstar maintains a separate "blend" category (as they also do for mid-size stocks, between their large and small categories). But for simplicity's sake, SMI uses only four stock-risk categories rather than nine, lumping most of these blend funds into our value risk categories. Growth stocks have been outperforming value stocks by a significant margin in recent months, which has helped these blend funds move up within the value category rankings. SMI already has two top-performing recommendations in the large/value group, but for those desiring a third holding, Pear Tree Quality looks like a solid option. ◆

SIGHTING: RISING AND FALLING UNCERTAINTY

Worries abound, from Chinese trade wars… to midterm campaign-related uncertainty… [But] I've crunched data since long before PCs arrived, [so I know that] the Standard & Poor's 500 index *has been positive in 87% of the fourth quarters of all midterm election years, ever*…. [emphasis added]

It's also been positive in 87% of the quarters that follow—the first calendar quarter after the midterms. That's six months running. It's the most consistent positive streak in all history. Those six months typically render a +14% rise.

Why? Because people always fret the midterms—like they do now—and how this or that could happen that would be bad (never good). One basic rule is that markets don't [care] about the *absolute* level of uncertainty. But they hate *rising* uncertainty and love *falling* uncertainty. Midterms bring falling uncertainty. Always!

It starts before the actual voting. October is routinely strong in midterm years. Why? With time, early-on wild speculation about outcomes fades as ever more individual Congressional races mature and fewer wild cards remain…. [During the primary season and in the weeks that immediately follow,] wild and woolly possibilities catch eyeballs and cause hysteria. That calms, then dies November 6th.

Further, the third year of a president's term, like 2019, hasn't been negative once since the start of World War II. And only twice since S&P 500 data began. It's all about the rising uncertainty heading into the midterms followed by falling uncertainty after. – By investment analyst Ken Fisher, writing in *USA Today*. Full article at usat.ly/2PIP5K9. ◆

SIGHTING: RECORD-HIGH EARNINGS

S&P 500 revenues and earnings soared to record highs during Q2-2018. No wonder the S&P 500 stock price index is back in record-high territory again…. Notwithstanding all the chatter about rising costs, the S&P 500 corporate profit margin rose once again to a record high of 10.9%. It was at a record 10.1% during Q4-2017 before the tax cut. It jumped to 10.5% during Q1-2018 thanks to the tax cut. Yet here it is at yet another record high….

The bears have been warning all year that the flattening of the yield curve increases the risk of a recession. They've cautioned that the escalating trade war could trigger the expansion's downfall…. They've touted the worrisome notion that the growth rate of earnings is bound to slow next year. And of course, the bull could drop dead at any time, they say, simply because it is so old. Consider the following counter-arguments:

• The yield curve is just one of the 10 components of the Index of Leading Economic Indicators, which has been setting fresh record highs for the past 17 months through July….

• President Trump unilaterally has called a ceasefire in his trade war with Europe. Progress…[has been] made in negotiations with Mexico. Talks [are resuming] with China…. Perhaps it's time to stop using the adjective "escalating" to describe the trade war? What if all this leads to less protec-

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

MONEYTALK

tionism once the fog of war clears?....

• There's no doubt that earnings growth will fall from over 20% this year to under 10% next year. So what? Earnings should still be growing in record-high territory in 2019. Stock prices should follow suit. – By economist Ed Yardeni of Yardeni Research, from his blog available at bit.ly/2LAS8AR. ◆

SIGHTING: THE COGNITIVE BIASES TRICKING YOUR BRAIN

Present bias shows up not just in experiments, of course, but in the real world. Especially in the United States, people egregiously undersave for retirement—even when they make enough money to not spend their whole paycheck on expenses, and even when they work for a company that will kick in additional funds to retirement plans when they contribute.

That state of affairs led a scholar named Hal Hershfield to play around with photographs. Hershfield is a marketing professor at UCLA whose research starts from the idea that people are "estranged" from their future self. As a result, he explained in a 2011 paper, "saving is like a choice between spending money today or giving it to a stranger years from now." The paper described an attempt by Hershfield and several colleagues to modify that state of mind in their students. They had the students observe, for a minute or so, virtual-reality avatars showing what they would look like at age 70. Then they asked the students what they would do if they unexpectedly came into $1,000. The students who had looked their older self in the eye said they would put an average of $172 into a retirement account. That's more than double the amount that would have been invested by members of the control group, who were willing to sock away an average of only $80. – By Ben Yagoda from an article in the September issue of *The Atlantic* magazine available at bit.ly/2nf5WqN. ◆

LEVEL 3 / CONTINUED FROM PAGE 136:

SMI PRIVATE CLIENT *CLASSIC:* PERSONAL PORTFOLIO MANAGEMENT IS NOW AVAILABLE TO ALL

of in the industry, where professionally-managed, personally customized, multi-strategy portfolios normally aren't available for those who don't have large accounts.

As the comparison table on page 136 shows, other than advisor interaction, the only other feature not available to Classic clients is complimentary access to the MoneyGuidePro® planning tool (and direct assistance with that tool from SMI Advisory Services). However, access to that same tool is available to any Premium SMI member for a one-time fee of just $50.

Give Private Client a try

Over SMI's nearly three decades, we've seen many readers sacrifice using the SMI strategies in order to outsource their portfolio management. In some cases, the person specifically needed planning or other expertise from an advisor. But more often, the reader simply wanted someone else to manage their portfolio for them.

Thankfully, there's no longer a need to choose between using the SMI strategies and having your portfolio managed by a professional. Private Client offers both at a reasonable price. In addition to the benefits already discussed, you won't have to forgo any SMI strategies because of the added complexity of managing them (as many SMI readers do when managing their own accounts).

Each of us has only 24 hours in the day and a certain amount of mental energy to spread around. If you're not currently keeping up with your portfolio the way you know you should, if you simply don't *want* to handle that responsibility anymore, or if you'd like to ensure financial continuity for your loved ones, check out smiprivateclient.com online. Not sure if it's for you? "Test-drive" the risk assessment and portfolio proposal steps of the process free of charge by clicking the "Get Started" link at the top of the page—with no obligation or officially becoming a client (which doesn't happen until you sign documents).

Private Client makes it easy to have your cake and eat it too, providing flexible options for those who want to use the SMI strategies, without carrying the responsibility of implementing those strategies themselves. ◆

LEVEL 2 / CONTINUED FROM PAGE 135:

SMI'S APPROACH TO INVESTING IN "LATE-CYCLE" BULL MARKETS

defense to be quite as strong as DAA's, it does allow us to confidently keep Upgrading money invested right through the end of a bull market, while still expecting some reduction to the losses inflicted by the ensuing bear market.

SMI members using the type of multi-strategy approach we frequently discuss likely have a good portion of their portfolios covered by some type of defensive protocol. For example, a 50/40/10 portfolio would have 90% of the portfolio covered by either DAA's or Upgrading 2.0's defensive measures. Those actions are built right into the strategies themselves, so members don't have to do anything special. They just keep following the monthly instructions as they normally would. This should help tremendously with actually executing the defensive steps, because those steps won't feel particularly unusual or like they're coming from outside the normal system.

Summary

The bottom line is that SMI's strategies allow us to stay invested through what can be surprisingly long "late" bull market periods—harvesting those gains—while still seeing our downside reduced when bear markets hit. Long-term, we think that approach will lead to better results than trying to anticipate bear markets and reduce stock exposure beforehand. Mentally and emotionally, it's much easier to follow the same strategies long-term: through bull markets, bear markets, and those confusing periods when we're not sure which animal is in charge! ◆

LEVEL 4 / CONTINUED FROM PAGE 137:

MANAGED PAYOUT FUNDS: MUTUAL FUNDS THAT PAY LIKE AN ANNUITY

and stays there for a decade. At the end of the 10 years, a fixed monthly payout would be worth 25% less in purchasing

MONEYTALK

power than when the 10-year period began. (Returns on stock-based investments, in contrast, have tended to outpace inflation, although inflation-beating returns aren't guaranteed.[1])

Many annuities also carry high fees, especially deferred annuities purchased during the accumulation phase of one's life. That's why SMI—in the rare case when it recommends annuities at all—steers readers toward either "immediate" annuities that begin paying a monthly benefit right away in exchange for a one-time investment, or "longevity" annuities, which are purchased with a lump sum around retirement age but with payouts that don't begin until age 80 or later. In essence, a longevity annuity insures against the risk of outliving one's retirement account.

Plan for the long term

For many Americans, the deaccumulation phase of life will be a fairly long period of time. The average man who reaches age 65 will live another 19 years; a woman who reaches 65 can expect an average of 22 more years. The Census Bureau now projects that one in nine baby boomers will live into their *late* 90s.

These potentially long time horizons are one reason to be wary about fixed-income arrangements such as annuities, despite the guaranteed monthly payout. While the monthly distribution from a managed payout mutual fund *isn't* guaranteed, at least your money has the potential to combat the effect of inflation as your investment holdings grow—plus you maintain control over your principal.

That said, a one-size-fits-all product such as a managed payout fund isn't likely to match the performance of a personalized approach. We strongly believe those willing to continue managing their own portfolios during retirement (using SMI's Dynamic Asset Allocation strategy, or something like our 50/40/10 blended approach), are likely to achieve better overall results while also more precisely meeting their individual income needs. Those who prefer a more hands-off approach to managing their retirement portfolio may want to consider the SMI mutual funds[2] or SMI Advisory's Private Client service.[3] ◆

MARKET NOTES, QUOTES, AND ANECDOTES

It's good for you

• "Like vegetables, diversification sounds healthy but doesn't always taste good. With true diversification, there will always be something in your portfolio that stinks." — Brian Portnoy, from his book, *The Geometry of Wealth*. He says diversification is "Sensible…but also annoying."

Tune out the noise

• "News is the cattle prod that transforms sound financial strategies into foolishly frenetic activity. I enjoy following the market's daily drama as much as the next person. But let's be realistic: It's about as meaningful as an episode of the Kardashians." — Jonathan Clements, writing on his *Humble Dollar* blog about the dangers of taking in too much market news. Read more at bit.ly/2NowC49.

Protecting yourself from... yourself

• "There are many steps we can take as investors to shield ourselves from the worst aspects of our emotional behaviour, but one of the most effective, by far, is process, process, process." — Wealth manager Carolyn Gowan, suggesting on her blog, *The Financial Bodyguard*, how investors can avoid overconfidence after such a long bull market. Read more at bit.ly/2Lv9vmL.

What's your Plan B?

• "…planning to delay retirement isn't the life raft it seems to be, and it doesn't always translate into reality." — Steve Wendel, Morningstar's head of behavioral science, warning that planning to work longer is not the solution to a savings shortfall many people believe it is. Morningstar research found about half of people retire *earlier* than planned because of health issues or job changes. Read more at bit.ly/2LASEis.

• "When you consider the modest financial resources that most workers have accumulated and the longer lives we're all living, the math just doesn't add up to workers' expectations about when they can retire and what their standard of living in retirement will be." — *CBS Money Watch* Columnist Steve Vernon, in an 8/24/18 article. He cited research from the Transamerica Center for Retirement Studies, showing that almost two-thirds of today's workers are confident they'll be able to fully and comfortably retire from the workforce while at the same time the median retirement savings is just $71,000. Read more at cbsn.ws/2od6YUX.

It's not a piggy bank

• "Many young retirement savers seem to be missing the point." — *CNBC's* Sarah O'Brien, reporting that 60% of workers ages 18-34 have already taken money from their retirement accounts. More than one-third of those who've borrowed from their accounts or taken early withdrawals said they used the money to 'make a big purchase, go on vacation or spend it on themselves or family.' Read more at cnb.cx/2wgzJnU.

What could go wrong?

"It's hard to bet against this market, but then again, when you can't see any problems, that's usually when the market gets nailed. So we want to be careful." — Richard Weiss, chief investment officer of multi-asset strategies at American Century Investments, quoted in a *CNBC* article. He's been reducing risk in his firm's target-date funds designed for investors with fewer than 20 years until retirement. Read more at cnb.cx/2MBbqeL. ◆

[1]May2017:Cover. [2]www.smifund.com [3]www.smiprivateclient.com

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

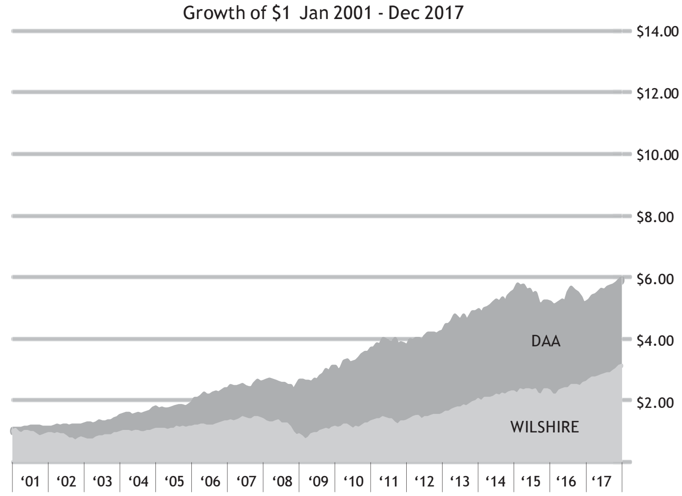
This is a stand-alone strategy that can be used in combination with (or in place of) SMI's basic strategies. DAA is designed to help you share in some of a bull market's gains, while minimizing or even preventing losses during bear markets. It's a low-volatility strategy that nonetheless has generated 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

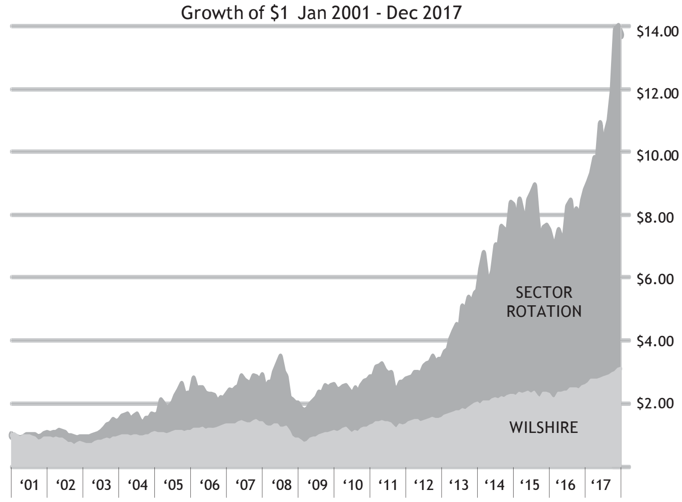
This high-risk strategy involves investing in a single special-purpose fund that focuses on a specific sector (such as biotech, energy, or financial services). Because these stock funds invest in a narrow slice of the economy, they carry a higher degree of risk. Only one fund, selected based on having 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-Dec2017 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 JULY 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]	6.6%	3.5%	7.0%	16.4%	12.5%	12.9%	10.7%	9.8%
Just-the-Basics[2]	5.5%	2.6%	5.5%	14.6%	10.7%	11.1%	9.5%	9.8%
Stock Upgrading[3]	6.1%	1.0%	5.6%	14.2%	9.7%	10.4%	8.6%	10.3%
U.S. Bond Market[4]	-1.7%	0.0%	0.7%	-1.0%	1.3%	2.1%	3.6%	3.9%
Bond Upgrading[5]	-1.2%	-0.2%	0.6%	-1.2%	1.3%	2.4%	5.7%	6.1%

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]	0.8%	1.5%	2.3%	6.5%	3.1%	5.0%	9.3%	11.2%
Sector Rotation[7]	9.0%	2.5%	8.8%	40.3%	18.9%	24.4%	17.6%	18.5%
50-40-10 Blend[8]	3.7%	1.4%	4.3%	13.1%	7.5%	9.3%	10.3%	12.0%

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 7/31/2018	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	8.07%	0.48%	5.53%	16.78%	8.58%	9.09%	7.58%
Wilshire 5000	6.61%	3.47%	7.01%	16.44%	12.48%	12.94%	10.70%
S&P 500	6.47%	3.72%	6.87%	16.24%	12.52%	13.12%	10.67%

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