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# Sound Mind Investing®

Financial Wisdom for Living Well

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# The Role of SMI's Dynamic Asset Allocation Strategy in Light of Current Market Dynamics

It's been nearly six years since SMI launched the Dynamic Asset Allocation strategy (DAA). It's understandable why some investors have been disappointed with its recent performance relative to the U.S. stock market. Now that we have several years of real-time experience with the strategy, we thought it would be helpful to revisit the original rationale for DAA, examine its recent performance, and—most importantly—assess what role DAA should have in SMI investor portfolios going forward.

**by Mark Biller**

When SMI's Dynamic Asset Allocation strategy (DAA) debuted in January 2013, it may not have seemed particularly revolutionary. But it approached two core investing issues from a totally different perspective than SMI had used up to that point. First, it was the first major departure from our long-held stance that risk could be effectively managed by adjusting a person's stock/bond portfolio allocations. Second, it upended the idea that investors are best served by setting a fixed portfolio allocation and holding it through bull and bear markets alike. In fact, DAA had the potential to shift investors completely out of stocks at times.

By 2012, the handwriting was on the wall regarding the ability of bonds to provide long-term portfolio protection. Radical new policies by the Federal Reserve and other global central banks had shrunk the majority of global government bonds to *negative* yields, and U.S. interest rates were also hovering at historic lows, barely above zero in the case of most shorter-term government debt. Given the fixed mathematical relationship between bond yields and prices—prices have to fall as yields rise—there was virtually no long-term upside left in bonds, but there was plenty of room for bond values to decline if/when yields reversed and moved higher, back toward their historic norms.

For 30 years, declining yields had helped bonds provide the safety net investors relied on within traditional stock/bond portfolios. But with that safety net looking tattered, we needed a new approach. The search for an alternative to bonds as a means of protecting our portfolios drove the research that led to DAA.

Incidentally, our outlook regarding bonds hasn't improved since DAA debuted. The past two years have seen bond yields slowly begin to rise, and as expected, bond returns have been poor. But the bigger issue—and likely to become the dominant financial issue of the *next* decade—is the absolute explosion in global debt over the past decade. With interest rates hovering near zero for so long, debt has cost borrowers very little to service. Not surprisingly, heavy borrowing has ensued. The ramifications of this debt explosion are beyond the scope of this article, but it's hard to imagine how businesses (and governments) will be able to keep making their payments as interest rates rise, especially if economic conditions (continued on page 147)

## 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

## What Does It Mean to Invest With a "Sound Mind"?

Have you ever wondered why SMI founder Austin Pryor named the company based on 2 Timothy 1:7? I certainly did. When I joined SMI in 2012, I had been involved in stewardship ministry for over 20 years, yet had never heard that verse mentioned in relation to managing money. Ever. So why make it the cornerstone verse for a company providing investment advice to Christians?

The answer dates back to Austin's time on staff with Cru in the early 1970s. One of the popular handouts used in the ministry at the time was "The Paul Brown Letter." Ministry founder Bill Bright had written the letter to a new Christ-follower who wanted counsel on how to discern God's will for his life. The answer, Bright wrote, could be found in following what he called "the sound-mind principle" of Scripture:

> In 2 Timothy 1:7 we are told that "God has not given us the spirit of fear; but of power, and of love and of a sound mind." The sound mind referred to in this verse means a well-balanced mind: a mind that is under the control of the Holy Spirit, "remade" according to Romans 12:1-2.
>
> There is a vast difference between the inclination of the natural or carnal man to use "common sense" and that of the spiritual man to follow the "sound-mind principle." [The former,] for understanding, depends upon the wisdom of man without benefit of God's wisdom and power; the latter, having the mind of Christ, receives wisdom and guidance from God moment by moment through faith.
>
> Are your decisions as a Christian based upon unpredictable emotions and chance circumstances, the "common sense" of the natural man? Or do you make your decisions according to the "sound-mind principle of Scripture?"

"My thinking in 1990 when I launched SMI," Austin explained to me, "was that the verse not only points to the resource we have as Christians to make Spirit-led decisions, but also mentions 'fear' (which many have when it comes to investing and which we hope to help them overcome) as well as 'self-control' or 'self-discipline' (which is a requisite for successful investing)."

Bright's letter went on to say,

> …a Christian who has yielded his life fully to Christ can be assured of sanctified reasoning, and a balanced, disciplined mind. Also, God has promised to give His children wisdom according to James 1:5-7. Further, we can know with "settled and absolute assurance" that when we pray according to the will of God, He will always hear and grant our petitions. (1 John 5:14, 15.) Since the Christian is to live by faith, and faith comes through an understanding of the Word of God, it is impossible to over-emphasize the importance of Scripture in the lives of those who would know and do the will of God.
>
> But note a word of caution: The "sound-mind principle" is not valid unless certain factors exist.
>
> There must be no unconfessed sin in your life; following 1 John 1:9 takes care of that: "If we confess our sins, God is faithful and just to forgive us our sins and to cleanse us from all unrighteousness."
>
> Your life must be fully dedicated to Christ according to Romans 12:1-2, and you must be filled with the Holy Spirit in obedience to the command of Ephesians 5:18. As in the case of our salvation, we are filled and controlled by the Spirit through faith.

How's *that* for a guide to discerning God's will for your life—and as Austin has applied it, to taking a truly biblical approach to your finances? Is prayer an integral part of your financial decision-making process? And before praying for financial wisdom, is there any unconfessed sin in your life?

When I started in stewardship ministry nearly 30 years ago, the Parable of the Talents had the greatest influence on my thinking about money and material things. The truth that God owns it all and I'm a steward of everything he has generously entrusted to my care was (and still is) completely counter-cultural, with far-reaching ramifications.

But now that I'm further along in my journey, 2 Timothy 1:7 is challenging me in fresh ways. I pray that it might challenge and encourage you as well. ◆

Matt

MATT BELL
MANAGING EDITOR

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FEATURE ARTICLE

## The Role of SMI's Dynamic Asset Allocation Strategy in Light of Current Market Dynamics

*(continued from front page)*

worsen, as they inevitably will at some point. Suffice it to say, SMI is even less enthusiastic about large bond allocations today than we were six years ago when DAA debuted.

### Winning by not losing

SMI has always approached investing using a *trend-following*, rather than *predictive*, approach. When we embarked on the research that led to DAA, we wanted a system that would help our portfolios hold up under a broad range of economic conditions: inflation, deflation, recession, expansion, and so forth. Expanding on Harry Browne's "Permanent Portfolio" idea from the 1970s, we identified six asset classes that collectively cover the range of economic conditions we were most concerned about.

However, rather than settling for a buy-and-hold approach (as the Permanent Portfolio does with its four asset classes), we added a timing mechanism that would allow us to own only the specific asset classes best suited to the particular economic conditions currently present. Another way to think of this is we found a way to "Upgrade" among asset classes. Our research indicated this would make a huge difference in the risk *and* returns in the portfolio—mostly due to *not* owning certain assets at certain times. This was the genesis of DAA's "*winning by not losing*" tagline.

The specifics of the original research and "nuts and bolts" of how to implement DAA are detailed in the January 2013 cover article, "*DAA: An Investing Strategy for the Risk-Averse*." We recommend reviewing that article if you're unfamiliar with DAA or are interested in more of the theory behind it.

Below you can see the hypothetical growth of a $10,000 investment in DAA from 1982 through the end of last year ($734,000) compared to the S&P 500 with dividends reinvested ($549,000). (The returns shown are backtested through 2012, actual returns after that.)

Summarizing the research, DAA's backtesting showed a strategy that had outperformed the stock market over the prior 30 years (1982-2012), while also being *42% less volatile* than stocks! That is an incredible combination. But while we knew the psychological side of implementing DAA would be challenging, the extent of that challenge would only be revealed later.

| | S&P 500 | DAA |
|---|---|---|
| 1982 | 21.4% | 23.3% |
| 1983 | 22.5% | 13.0% |
| 1984 | 6.3% | 7.9% |
| 1985 | 32.2% | 30.7% |
| 1986 | 18.5% | 28.7% |
| 1987 | 5.2% | 15.4% |
| 1988 | 16.8% | 7.8% |
| 1989 | 31.5% | 13.9% |
| 1990 | -3.2% | -6.6% |
| 1991 | 30.5% | 23.2% |
| 1992 | 7.7% | 10.9% |
| 1993 | 10.0% | 17.1% |
| 1994 | 1.3% | 1.2% |
| 1995 | 37.4% | 20.8% |
| 1996 | 23.1% | 17.8% |
| 1997 | 33.4% | 20.3% |
| 1998 | 28.6% | 11.5% |
| 1999 | 21.0% | 12.5% |
| 2000 | -9.1% | 7.1% |
| 2001 | -11.9% | 4.0% |
| 2002 | -22.1% | 10.4% |
| 2003 | 28.7% | 22.4% |
| 2004 | 10.9% | 19.3% |
| 2005 | 4.9% | 8.6% |
| 2006 | 15.8% | 25.7% |
| 2007 | 5.5% | 10.1% |
| 2008 | -37.0% | 1.3% |
| 2009 | 26.5% | 17.6% |
| 2010 | 15.1% | 20.3% |
| 2011 | 2.1% | 1.4% |
| 2012 | 16.0% | 13.9% |
| 2013 | 32.4% | 16.2% |
| 2014 | 13.7% | 13.0% |
| 2015 | 1.4% | -6.8% |
| 2016 | 12.0% | -0.5% |
| 2017 | 21.8% | 16.0% |
| **36 Yrs** | **11.8%** | **12.7%** |

### Reality bites

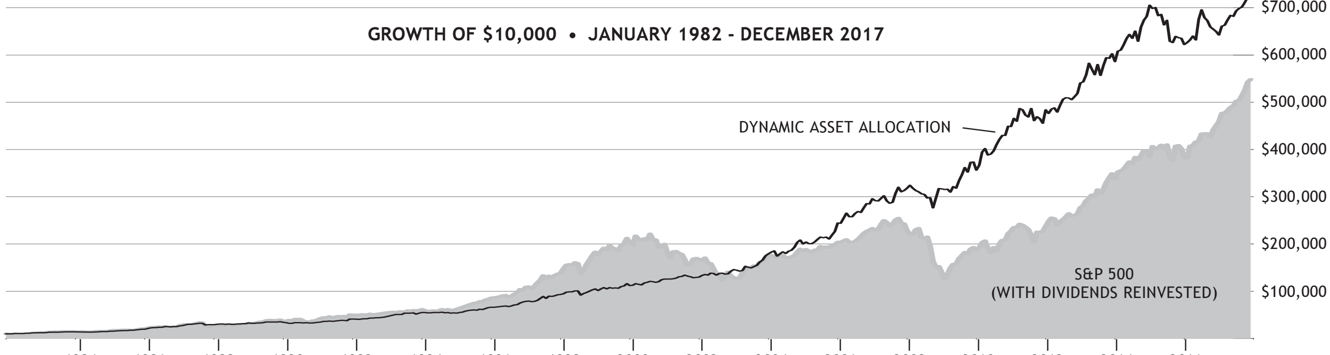
With the benefit of hindsight, there are a few things we wish we had done differently in the initial presentation of DAA. It's not that the original article was inaccurate—we did, in fact, try to caution readers that this was going to be an emotionally difficult strategy to implement, *specifically* drawing attention to the type of extended, late-bull market we've experienced since DAA launched. Despite these admonitions, SMI readers can be excused for coming away from the original article with the following idea: *DAA beats the stock market and doesn't lose money*. Unfortunately, the truth is more complicated than that.

The first two years out of the gate, DAA turned in gains of +16.2% and +13.0% which, while trailing the S&P 500 index, had DAA investors feeling pretty good. But it didn't take long for DAA to do something in live practice that it had never done in the decades of back-tested research: produce back-to-back negative annual returns (2015/2016).

In hindsight, our initial presentation should have focused more attention on rolling periods (*all* 12-month periods, not just those that begin in January) rather than calendar-year returns. The table presented in the 2013 article (and on this page at left) showed only the one small annual loss in 1990. Using rolling periods, DAA has lost as much as -13.7% in its worst 12-month period. Shorter time periods have occasionally been even more volatile. DAA would have lost -14.8% between February-October 2008, despite rallying to finish 2008 with a slight gain (and the most impressive year relative to the stock market in its history).

Given this history, the small annual losses in 2015 (-6.8%) and 2016 (-0.5%) shouldn't have been so surprising. But they were, because the focus of the initial article had been primarily on annual returns and DAA's *long-term* results.[1]

**CHART 1: DYNAMIC ASSET ALLOCATION vs S&P 500 TOTAL RETURN STOCK INDEX**




[1] We've since written more about DAA's shorter-term results and tendencies. See bit.ly/DAA-Short.

In hindsight, the other thing we would have handled differently is to focus even more attention on how challenging a defensive strategy like DAA can be when the stock market is soaring higher. We did note the example of 1995-1999 in the article, the last period resembling today's market. We were trying to help readers understand how emotionally difficult DAA could be in that environment. To some degree, there's an emotional/behavioral aspect of this that suggests words can only impart so much—that it takes actually *experiencing* a period like we've been through in recent years to truly understand its impact. If we could do it over, we'd have presented an analysis of *exactly how DAA wins over the long-term* to try to illustrate more clearly how different DAA is than the other strategies in an SMI portfolio. We turn to that analysis now.

**"Diversification means always having to say you're sorry"**

As the above quote implies (from Brian Portnoy, author of last month's cover article), the idea of diversification *sounds* great, but its actual practice is distinctly less fun. If you're truly diversified, at any given point in time something in your portfolio will be doing well while something else is doing poorly. If everything in your portfolio is doing well simultaneously, you're probably not as diversified as you think!

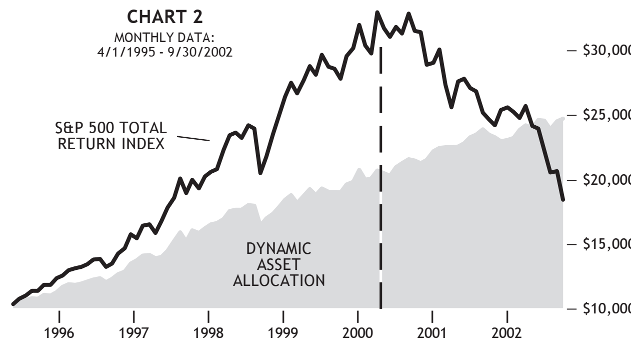
We tend to understand and accept this in the context of the traditional stock-bond relationship. That's because many of us have experience with traditional stock/bond portfolios, plus we have modest expectations of bonds to begin with. But when our expectation for DAA is that it will beat the stock market over time, it's easy for hope to turn to loathing when the strategy significantly lags stock returns for a few years.

The fact that the current bull market recently became the *longest in history* isn't helping DAA. This late-bull period of relative underperformance has gone on and on, just as it did in the late-1990s. Intellectually we may understand that DAA can't be expected to keep up with stocks in this environment, given that it never invests more than one-third of its portfolio in U.S. stocks. But it's still easy to feel disappointed with DAA when the other parts of our portfolio are soaring and it's the sore-thumb laggard of the group.

Thankfully, we've seen this movie before. That late-1990s period in the research shows that DAA isn't broken today. While this type of lagging relative performance happens occasionally, history shows that what *follows* these periods has more than made up for the temporary discomfort we may be experiencing with DAA today. In fact, the type of market/DAA disparity we're seeing now can even be a sign that its presence in our portfolios is more needed now than at any other time.

As Chart 2 (above, right) shows, during the last five years of the 1990s bull market, the S&P 500 index vastly outperformed DAA. Just like today, it would have taken a great deal of discipline to stick with DAA from early 1995 through early 2000 when other strategies were posting much higher returns.

Eventually though, the market cycle turned, as it always does. There was no big event that caused the bull to turn into a bear. But in March 2000 the stock market peaked and embarked on a two-and-a-half year decline. Diversification



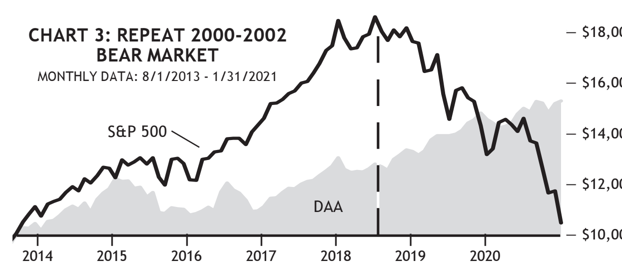

| Table 1 | | S&P 500 | DAA |
|---|---|---|---|
| Last 5 Years of Bull Market: | Apr 95 - Mar 00 | 227.1% | 106.6% |
| Bear Market That Followed: | Apr 00 - Sep 02 | -43.7% | 19.6% |
| Total Results: | Apr 95 - Sep 02 | 84.1% | 147.1% |

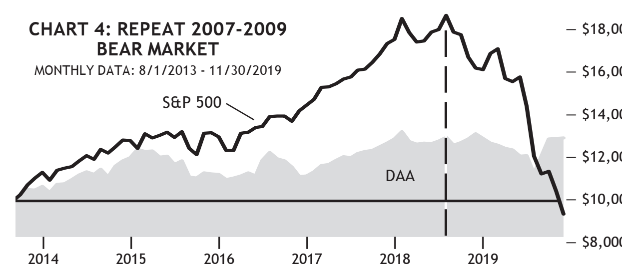
would have meant DAA "saying it was sorry" throughout the late 1990s, but suddenly the situation reversed. By the time the bear market was over, the huge relative performance lead accumulated by stocks was gone and DAA was way ahead. When the entire cycle—up *and* down—was accounted for, DAA posted a "tortoise and the hare" type finish, cruising to victory by a wide margin.

**Peering into the future**

The two charts at the bottom of the page take this idea and apply it to today's situation. Each chart shows the relative performance of the stock market (S&P 500) and DAA over the past five years. This is the area to the left of the dotted line; what has actually happened. Stocks have obviously built up a significant lead during this time.

The area to the right of the dotted line shows how "the rest of the story" would turn out *if*, from here, the stock market were to follow either the path of the 2000-2002 bear market (Chart 3) or the 2007-2009 bear market (Chart 4). In either scenario, DAA would end up comfortably ahead of the stock market *for the period as a whole*, despite stocks being far ahead at the moment.



The main thing we're trying to demonstrate with this analysis is that nothing has fundamentally changed regarding DAA. It's still on track to beat the stock market—but that's only going to happen over full market cycles. Our limited experience with DAA since 2013 has been with the exact part of the market cycle in which DAA looks the worst and is the most emotionally challenging to stick with. Expecting DAA to keep pace during the bull market portion is unrealistic. But as this analysis shows, this pattern of lag-catch up-surpass is built into how the strategy is supposed to work. *That it runs counter to the rest of a stock portfolio is a feature, not a bug*. Knowing that should make it easier to deal with emotionally through the rest of this market cycle. Every day brings us a day closer to the end of this bull market and the eventual reversal of DAA's performance relative to the broad stock market.

**The only point you can act from is here**

From an investing decision-making point of view, the only point in time that matters is right now. In other words, it doesn't matter if a particular holding in your portfolio is "up" or "down"—the question should always be, "How is this investment likely to perform *from this point forward*?"

On that score, the future is clearly bright for DAA. We don't know if we're right on the "dotted line" marking the peak of the current market, or if multiple months (or even years) of further gains might still lie ahead. But we do know this bull market is *already* the longest on record. We do know that stock market valuations are *already* among the highest in history, comparable only to the late-1990s period we've repeatedly drawn parallels to.

So while we can't know *exactly* when the turning point will come, there's a lot of evidence saying it is likely close. Clearly, we want to follow the DAA line on the charts at that point, not the stock-market line. So regardless of how you've felt about DAA over the past few years, it's difficult to deny that its prospects for the immediate future are bright.

**The best way to use DAA**

SMI often has to wrestle with a tension between what's ideal and what's simple enough for members to actually implement. So while we recognize that managing multiple strategies is more work for members, when it comes to DAA, it really needs to be blended in as *part* of a portfolio rather than the whole portfolio.

That's different than what we've said in the past. And it's not because DAA's performance won't ultimately get you where you need to go. It's just that the emotional ride can be so frustrating that we think it's the rare individual that could go 100% DAA and be happy. If you're a set-it-and-forget-it person who never checks the performance of your portfolio relative to the market, DAA would work fine for you, as it really has delivered higher returns than the market with less risk over time. For everyone else, make it a portfolio holding, rather than the whole portfolio.

SMI has written many times about a 50/40/10 type portfolio divided between DAA, Upgrading, and Sector Rotation.[1] While the individual components may vary from person to person, we think some sort of blend among strategies is the ideal because it diversifies both the performance and emotional aspects of your portfolio. It's much easier to be patient with DAA lagging when Upgrading is earning double-digit returns and Sector Rotation has been exploding higher, and vice versa. If you're a newer reader, it's perfectly fine to start with either DAA or Upgrading alone and get comfortable with it before adding more to your plate. But we'd encourage diversifying further eventually.

When DAA was introduced, it was the only defensive tool in our lineup. Now that we've added defensive protocols to Stock Upgrading, that's no longer the case. Naturally, this has caused some SMI members to wonder if DAA is still necessary, or if they could simplify by just using Upgrading.

Big picture, we think a blended portfolio with both approaches is *better*, because no one knows what the future will hold. The diversification benefit of having both strategies navigating via different tools and courses is considerable, in our opinion. But we also understand the complexity issue, so it's acceptable if someone wants to simplify by boosting Stock Upgrading at the expense of DAA—provided they really understand the tradeoff they are making.

As we showed in the January 2018 cover article introducing Upgrading 2.0, its downside protection hasn't been as strong as DAA's historically. This has meant better upside for Upgrading during bull markets, but also greater losses than DAA during bear markets. Specifically, while Upgrading 2.0 would have lost -12.1% in the April 2000-September 2002 bear market, DAA would have *gained* +19.6%. Results were similar between November 2007-February 2009, with Upgrading 2.0 down -17.4% while DAA lost only -1.4%. Both strategies performed dramatically better than the overall market during those bear markets, and both have beat the market over time. They just follow different paths to get there.

**Are you a good fit to manage DAA yourself?**

Experience has shown that not everyone is a good emotional match for DAA. That doesn't mean these folks wouldn't benefit from having it in their portfolio, but it may mean they'd be better off having their DAA portfolio managed by someone else. Thankfully options exist for this: SMIDX is a mutual fund that follows the DAA strategy, and DAA is also available as part of a professionally-managed Private Client portfolio through SMI Advisory Services.[2]

**Conclusion**

Dynamic Asset Allocation has given us a powerful defensive tool that helps reduce our reliance on bonds. By approaching the markets from a totally different path than the other SMI strategies, it adds a significant diversification benefit to a portfolio otherwise comprised of Stock and Bond Upgrading and Sector Rotation. While its *individual* performance path can be emotionally challenging, the impact it has on a portfolio *as a whole* should make it easier for an investor to stick with their plan over the long haul. Avoiding big emotional mistakes is the key to long-term investing success, and DAA can be a valuable ally in accomplishing that goal. ◆

[1]See our April 2018 cover article, *Higher Returns With Less Risk, Re-Examined*
[2]Sep2018:p136

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**

## WISE STEWARDSHIP INCLUDES HAVING A WILL THAT PROTECTS YOUR CHILDREN

**By Will Ertel, CFP®, CPA, PFS**

Many people haven't drafted a will because they think wills are only for the wealthy. Scripture, however, teaches that responsible stewardship isn't a function of the *size* of one's wealth. Stewardship is about obedience and motivation in relation to how a person handles *any* amount of financial resources.[1]

Christians, therefore, should look at a will simply as a means of continuing to be a faithful steward over their lifelong accumulation of wealth and possessions. Ponder this: If you were to die unexpectedly this year, what would the way you've arranged your estate say about how you approached your stewardship responsibilities?

Well-planned estate documents are especially crucial for those with minor children. Parents who die without a will are, in effect, not only allowing the government to decide how to distribute their assets, but are also asking the government to decide who will raise their children!

Perhaps you haven't addressed this issue because the process of preparing a will seems intimidating. Frankly, for the more affluent, it *can* be intimidating—and generally requires advice from lawyers, financial planners, and accountants. For the average family, however, creating estate documents usually is fairly easy. Indeed, the most important decisions are not technical; they're personal.

Here are suggestions for selecting three trusted individuals who will play key roles in settling your estate and providing for your children.

### Choosing an executor

The executor of your will helps complete administrative/legal tasks and manages the assets in the estate during the settlement process. These duties can be time-consuming and complicated but generally are completed within six to 12 months. (The burden on the executor isn't nearly as cumbersome when the will leaves all assets to a surviving spouse.)

Characteristics of an appropriate executor include: integrity, longevity (preferably someone your age or younger), familiarity with your desires, and a certain level of skill in managing financial matters (and/or competence in hiring professionals to assist where needed). Often, a spouse is named as executor, but a trusted friend or family member may also be a good choice.

### Choosing a guardian and a trustee

Parents of minor children are faced with two other important decisions. First, they must choose a guardian in the event both parents predecease their children. This is perhaps the most agonizing decision parents grapple with. For example, you may love your sister, but what if she has a different worldview, dislikes children, or already has four children of her own? Think of the type of home you want your children to grow up in, and who you want to teach your children values and principles most similar to yours. (It is not uncommon—if no family members are suitable choices—to list guardians outside your family.) Prayerfully review your choice at least annually.

In addition to a guardian, a trustee should be named. The trustee is responsible for managing assets left to minor children until they turn 18 (or 21 in some states). If possible, the trustee should be someone *other* than the guardian. This segregation of duties provides security that assets will be used exclusively for the benefit of your children.

The trustee doesn't have to be an investment professional, but he or she should be someone comfortable making financial decisions. These decisions may include working with investment professionals, planning for college, or investing in mutual funds. As with the executor, a trusted friend or family member is ideal. (In fact, since there is no need to segregate the duties of the trustee and the executor, the same person could serve in both roles if you desire.) Often, a trustee must exercise judgment and discernment in approving trust distributions to your beneficiaries. This requires an understanding of your values and priorities, as well as the ability to make thoughtful decisions and communicate effectively.

If you are uncomfortable leaving your children a large sum of money at age 18 (or 21), consider staggering their distributions by having an attorney create a simple trust. You can stagger distributions evenly (with distributions at ages 22, 26, and 30, for example), so that your children take on the responsibility of managing assets gradually. Of course, if the amounts in the estate are modest, you might want them to receive the funds sooner.

Finally, be aware that listing people in your will does not require them to serve. It's important to get permission from your choices of executors, guardians, and trustees before finalizing your will. Also, list a *successor* executor, guardian, and trustee in the event that circumstances prevent any of your first choices from fulfilling their roles. (If all of the people you've listed refuse to serve, the court will name others to fill those roles.)

### Conclusion

As you work through the decisions related to estate planning, don't get discouraged. Discouragement can lead to a failure to complete your will—and an unfinished will is the same as no will (legally, there is no such thing as a "partially completed" will). So pray for encouragement and strength to see that the job gets done (Neh. 6:9). It's all part of being a good and faithful steward. ◆

Will Ertel is President of Tassel Capital Management in Matthews, N.C. He is passionate about helping individuals make financial decisions consistent with both a stewardship perspective and their personal financial goals.



[1]See Mark 12:41-44 where the poor widow's purity of motivation is praised, and Matthew 25:14-30 where the same reward is given to the servants who properly managed five and two talents, respectively.

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**

## FUND COMPANIES CONTINUE TO DROP PRICES, REDUCE COST OF ENTRY

In autumn, many of us enjoy watching the falling leaves. Mutual-fund investors, meanwhile, are enjoying falling *fees*. Although the fund industry's "race to the bottom" probably isn't over (more prices may yet drop), two brokerage firms—the Vanguard Group and Fidelity Investments—have now made it all the way to zero.

In August, Vanguard—the client-owned firm that made its reputation with low-cost index funds—adopted a no-fee (zero-commission) pricing model for about 1,800 of the 2,000 exchange-traded funds (ETFs) offered on its platform, most of which are managed by rival companies. While other brokers have offered free trades on *certain* ETFs, Vanguard became the first firm to move to a free model for *virtually all* ETFs.

Meanwhile, Fidelity—the Boston-based fund giant that once derided Vanguard's low-fee offerings—surprised industry observers by launching two (and a few weeks later, two more) *traditional* mutual funds with annual expense ratios of 0.0%,[1] thus beating Vanguard's lowest-cost index funds, as well as eclipsing low-expense offerings from Charles Schwab and other brokerage firms.

That's not all. Fidelity also did away with the $2,500 minimum investments for its in-house traditional funds, removing a cost-of-entry obstacle that kept new investors with limited resources from being able to invest in Fidelity funds.

The pricing changes—only the latest in a years-long line of investor-friendly reductions—stem from intensifying competition in the brokerage business, and not only among established competitors such as Fidelity, Schwab, and Vanguard. Price pressure also is coming from low-cost, algorithm-driven "robo-advisors" and new entrants such as Robinhood, a tech-friendly start-up firm that allows investors to buy and sell ETFs and stocks commission-free via its mobile app. Essentially, brokerage firms are fighting a battle for the future, hoping to win over millions of millennial investors and (perhaps) turn them into lifelong customers.

### The SMI impact of Vanguard's pricing

• **For DAA investors.** Vanguard's move to a commission-free ETF model is welcome news for SMI investors with Vanguard accounts. Although there is no benefit for those following the Just-the-Basics strategy (because the Vanguard ETFs used in JtB already were free), SMI investors using a Vanguard account to implement Dynamic Asset Allocation will see their costs go down slightly.

As noted in our March 2018 Broker Review,[2] we considered Vanguard an "excellent" option for DAA investors. Now it's even better—because purchase and sale transactions for the four *non*-Vanguard ETFs used in DAA, formerly $7 per trade,[3] are free.

True, that won't amount to a significant savings because DAA doesn't change holdings particularly often. (The strategy follows a total of six ETFs, three of which are owned at any given time). Still, over the course of a year a Vanguard DAA investor might reasonably expect to save between $21 and $35—or more if they have multiple accounts.

• **For Upgraders.** SMI investors implementing Upgrading via Vanguard have been hampered by a less-than-robust lineup of no-transaction-fee (NTF) funds—many fewer NTF funds than are offered by either Fidelity or Schwab. Although Vanguard's line-up of NTF traditional mutual funds remains weak, now that ETFs trade free at Vanguard, any ETF Upgrading recommendation purchased via Vanguard is essentially an NTF fund. Had the free-ETF pricing policy been in place over the past three years, Vanguard Upgraders would have had no-cost (i.e., NTF) access to the 15 non-Vanguard ETFs we recommended during that period.

Again, those commission-free trades wouldn't have translated into a huge cost savings—just over $200 if all 15 ETF recommendations had been purchased and eventually sold. But every bit of savings helps.

Vanguard's commission-free ETF policy still doesn't make Vanguard as attractive as Fidelity or Schwab for Upgraders, but given the new pricing policy on ETFs, we now consider Vanguard a "good" option for Upgraders, rather than simply "fair"—the rating we assigned in this year's Broker Review. (Recognize that SMI's *Bond* Upgrading strategy uses multiple Vanguard funds that trade free at Vanguard but carry a transaction cost at other brokers. That gives Vanguard a price advantage for investors with bonds in their Upgrading portfolios.)

• **For Sector Rotation investors.** We also had rated Vanguard "fair" for those following the SR strategy. The new free-ETF policy doesn't change that recommendation (again, fund availability is an issue at Vanguard). But because we sometimes recommend ETFs for SR (as in the case of our current recommendation), it seems likely that implementing SR via Vanguard will be slightly cheaper than in the past.

### Focus on Fidelity

Although it was Fidelity's unveiling of the first-ever no-expense traditional mutual funds that grabbed the attention from the financial press, the company's policy change on fund minimums may be of more import to SMI investors.

For several years, Fidelity has been at the top of our SMI broker ratings because of its impressive overall fund availability and minimal holding period (only 60 days) to avoid short-term trading fees. The one (continued on page 157)

[1]The four funds are Fidelity Zero Total Market Fund, the Fidelity Zero International Index Fund, the Fidelity Zero Large Cap Index Fund and the Fidelity Zero Extended Market Index Fund. [2]March2018:Cover. [3]Some Vanguard ETF transactions were as high as $20.

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**

## FUNDING A RETIREMENT NEST EGG—BEFORE GRADUATING HIGH SCHOOL

**by Matt Bell**

What if your kids could have their retirement significantly funded before they graduated from high school? An impossible dream? Maybe not.

Consider the following scenario: your son or daughter has $3,000 saved by age 18 and invests it using SMI's Sector Rotation strategy. (With time on their side, young people can afford to be super aggressive with their investments.) If SR continued generating the +17.45% annualized return it has produced since SMI launched it in 2003, by age 70 their account would be worth nearly $13 million!

Of course, $13 million will only go so far in 2070. But after factoring in a 2.5% average annual inflation rate, that's still the equivalent of over $3.5 million in today's dollars—far more than the typical retiree accumulates during a career. And this assumes they never add another penny beyond the initial $3,000 investment.

### Uncommon financial freedom

Imagine the flexibility this would give your kids. With their retirement savings largely done before they even get their first full-time job, they would be free to save for other goals, such as a house or their own business. Perhaps they'd feel freer to pursue a career in full-time ministry—or at least be inclined toward greater generosity in their giving. If they get married, there might be less pressure for both spouses to work, providing more flexibility in child rearing.

### Where will they get that savings?

In one of my favorite *Saturday Night Live* skits, Steve Martin and Amy Poehler play a husband and wife trying to figure out how to get out of debt. Suddenly, an infomercial announcer appears, promoting a new debt management program called, "Don't Buy Stuff You Can't Afford." One of its recommendations is to buy things with savings. Looking very confused, Martin's character says, "And where would you get this *saved money*?"

Where would *your* kids get $3,000 by age 18? If they're very young, just banking a healthy portion of what they receive from relatives each birthday or Christmas may get them most of the way there. If they're older and receive an allowance, have them set aside 50%. By their teen years, earning opportunities expand dramatically as babysitting and eventually part-time jobs become available.

The key is to get them saving early and often, allowing their long time horizon and ultra-high risk tolerance to combine to produce incredible long-term compounding. There are great benefits to having children save their own money (as we'll explore shortly), but this is also a great opportunity for parents or grandparents to be creative, perhaps by matching a youngster's contributions in an effort to ingrain the saving habit and expand their starting investment capital.

### Which broker to use

In the Bell household, our three kids—ages 10, 12, and 14—have custodial accounts at Schwab. We chose Schwab because there's no minimum amount required for opening an account. In addition, with some of the funds used in Sector Rotation, the minimum required initial investment at Schwab is just $100 (at Fidelity it can be as high as $15,000!).

Yes, they may run into some transaction fees or commissions. For example, purchasing a non-NTF mutual fund at Schwab costs $76. As a workaround when these accounts are still small, if a transaction-fee fund is recommended we'll buy the highest-ranked ETF instead for only a $4.95 commission. Even *that* can represent a high percentage of their investment, so we plan to cover their commissions early on.

### Transition to a Roth

As soon as our kids have earned income (from babysitting, mowing lawns, etc.), we plan to open Roth IRAs for each of them and begin transferring the money from their taxable accounts to those IRAs.[1] That way, all of the money eventually will be available to them tax-free.

### Keys to success

The success of this plan largely hinges on the child's commitment to follow the plan for the next 50+ years. As the balance grows, the temptation to tap those funds will likely grow as well. While you might control the account initially, it won't be long until the money is legally theirs. As a parent (or grandparent), this gives you a relatively short window to impress upon them the importance of leaving that money alone!

This is a great opportunity to ingrain right from the beginning the idea that these Roth accounts are *retirement-only* accounts. To drive this point home, consider helping them set up other savings/investment accounts for other goals, such as saving for college.

### Learning by doing

We've seen rapid benefits from having our kids invest their own money. Recently, our 14-year-old wanted to review his account online. There he saw many unfamiliar terms, such as "unrealized gains" and "cost basis." He was sincerely interested in understanding what such terms meant. I doubt he would have been as interested if I had just brought those topics up without him having his own money invested.

That same night, our 10-year-old surprised me by handing over $100 and asking me to add it to her investment account. She had saved up her entire summer's worth of allowances and had recently received money for her birthday. We'd been discussing (continued on page 158)

[1] Investing in an IRA generally requires the account holder to have "earned income" as defined by the IRS.

L E V E L 4 F O U R

# 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**

## DEALING WITH MEDICAL DEBT

Actress Dawn Wells, homespun Mary Ann on the 1960's sitcom *Gilligan's Island*, lost a lot of money in the 2008 financial crisis—a setback compounded this year when she broke her knee in an accident and underwent an expensive surgery. The resulting medical bills left the 79-year-old actress financially strapped. Fortunately, fans rallied to her aid with an online campaign that raised money to pay her medical debt.

A major medical expense can occur without warning, even straining the financial resources of people who don't already have money troubles—and few of us can rely on a fanbase to help us out. Consider the case of Crystal Roberts, who in 2015 was transported to a hospital in Texas for three hours of lab tests and x-rays following a minor car accident. Because she was uninsured, the hospital charged Crystal full price: $11,037.35. (She sued, arguing that the charges were unreasonable—and won.)

According to a 2016 study from the Kaiser Family Foundation, medical debt is an equal-opportunity destroyer, hitting not only the uninsured but the insured as well. It also affects people across the financial spectrum, from low-income to upper-income.

For the insured, unpayable obligations typically result from a combination of high deductibles, uncovered costs, and unexpected out-of-network charges. (An anesthesiologist, for example, might not participate in the same insurance network that covers a surgeon and a hospital.)

Although medical debt most commonly stems from accidents or one-time events, costs also can pile up from chronic health issues, such as diabetes or cancer. Studies suggest medical debt increasingly is a threat to the financial well-being of older Americans. Half of the respondents to a 2015 National Council on Aging poll of counselors and other professionals serving older Americans agreed that "medical debt was the most significant barrier to the economic wellbeing of seniors." A 2018 research study[1] of more than 900 individuals/couples age 65 or older who had filed for bankruptcy found that "medical expenses...were a catalyst for bankruptcy for more than six out of ten respondents."

### An ounce of prevention

Proverbs 27:12 (NLT) observes that "a prudent person foresees danger and takes precautions." What sort of precautions might you take to avoid medical debt? For one thing, if you have a high-deductible health plan, set aside enough savings to meet that deductible. ("High-deductible" typically is defined as $1,500 for an individual or $3,000 for a family.) Likewise, if you know Medicare doesn't fully cover certain expenses, buy supplemental coverage (or set aside savings) to meet those costs.[2]

If a doctor says you need a surgical procedure, ask specific questions about costs and coverage. Also keep in mind that doctors/facilities may charge widely varying prices for the same procedure. You might avoid a debt situation by finding a doctor willing to perform the procedure at a lower cost.

### What to do about medical debt

As with other debt, medical debt won't go away by ignoring it. You must take action—the sooner the better. Here are four ways to take the initiative

• **Check for errors.** Don't assume you've been charged correctly. Medical billing errors—such as miscoding and duplicate charges—are common. (In 2015, ABC News reported that a group of auditors hired by insurance companies found errors on 90% of the hospital bills they examined.) Request an *itemized bill* (not just a statement) and go over it line by line. If something doesn't seem right, speak up.

• **Request a discount.** Federal law requires *nonprofit* hospitals to offer income-related assistance programs. Some *for-profit* hospitals have such programs as well. Ask if you qualify. (Your state also may require medical facilities to offer income-based assistance, including reduced-cost care.)

• **Propose a plan.** Many medical providers are willing to work with patients or caregivers to arrange a payment plan—often without charging interest. But you have to ask. If all you can afford is $100 a month, then simply say, "I can pay $100 a month toward this bill until it is paid off."

Don't wait for your account to be turned over to a collections company. Negotiate as soon as possible directly with the medical provider. If you're still waiting for insurance claims to be processed, ask for a delay in paying until all claims are settled.

• **Hire a patient advocate.** Medical bills can be maddeningly complex and negotiating payment arrangements can be intimidating. A patient advocate can comb through your bills to find any errors and also work out payment agreements with providers. Some advocates charge an hourly rate, others agree to take a percentage of any cost savings. To learn more, go to nahac.com (National Association of Healthcare Advocacy), Advoconnection.com (Alliance of Professional Health Advocates), or Claims.org (the nonprofit Alliance of Claims Assistance Professionals). Also check with your employer. Many companies offer medical-advocate services to employees.

### Three things not to do

• **Don't use a "medical credit card."** A doctor's office may encourage you to transfer your debt to a "medical credit card." Don't. You'll lose the flexibility to work out a plan, plus you'll have to pay interest. Instead, work directly with the billing office *(continued on page 158)*

[1]See "Graying of U.S. Bankruptcy" August 2018. Available at ssrn.com/abstract=3226574 [2]Nov2017:p169

SOUND MIND PORTFOLIOS

# Basic Strategies

The fund recommendations shown for Upgrading accountholders are based primarily on "momentum" scores calculated just before this issue was published (not the earlier end-of-month scores shown on this page). Consistency of performance is also considered, along with the portfolio manager's philosophy and number of years at the helm. Three recommendations are made in each risk category. Select the one(s) most in accord with your preferences and broker availability.

**"Plans fail for lack of counsel, but with many advisers they succeed." Proverbs 15:22**

## RECOMMENDED FUNDS FOR SMI'S JUST-THE-BASICS STRATEGY

| Data through 8/31/2018 | 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 | -2.5 | -3.4% | -2.4% | -2.1% | -3.6% | 3.1% | 8.4% | 1.13 | 0.11% | 20% | 16% | 12% | 8% | VXUS |
| Extended Market Index ETF | Small company stocks | 43.3 | 12.7% | 4.5% | 7.1% | 13.3% | 23.0% | 14.9% | 1.24 | 0.08% | 40% | 32% | 24% | 16% | VXF |
| S&P 500 Index ETF | Large company stocks | 35.3 | 9.7% | 3.2% | 7.7% | 8.0% | 19.6% | 16.1% | 1.00 | 0.04% | 40% | 32% | 24% | 16% | VOO |
| Total Bond Mkt Index ETF | Medium-term bonds | 0.4 | -1.2% | 0.7% | 0.6% | 1.1% | -1.3% | 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 8/31/2018[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. ☎ iShares Curr Hedged EAFE | 10/18 | ETF | ETF | ETF | 13.1 | 1.4% | -1.4% | 1.1% | 3.8% | 8.2% | 8.4% | 0.97 | 0.35 | 45 | None | HEFA |
| | 2. Advisory Res Intl Sm Cp Val | 06/18 | Yes | Yes | Yes | 11.2 | 2.0% | -0.9% | -2.4% | 1.2% | 12.4% | 11.7% | 1.07 | 1.20 | 74 | 2%90days | ADVIX |
| | 3. MS Intl Opportunity - LW[12] | 08/18 | NTF | NTF | NTF | 9.3 | 5.3% | -1.0% | -5.2% | 1.5% | 13.1% | 19.4% | 1.37 | 1.29 | 49 | 2%30days | MIOPX |
| Category 4 Small/Growth | 1. Delaware SmidCap Gro - LW[12] | 02/18 | NTF | No | NTF | 103.3 | 32.7% | 14.4% | 17.0% | 25.6% | 60.7% | 20.9% | 1.67 | 1.17 | 36 | None | DFCIX |
| | 2. Kinetics Small Cap Oppor | 02/18 | NTF | NTF | NTF | 57.9 | 24.0% | 3.1% | 5.1% | 17.3% | 35.5% | 22.9% | 1.28 | 1.66 | 41 | 2%30days | KSCOX |
| | 3. Baron Opportunity | 03/18 | NTF | NTF | NTF | 68.4 | 30.4% | 8.1% | 10.5% | 19.0% | 38.9% | 21.5% | 1.57 | 1.41 | 60 | None | BIOPX |
| Category 3 Small/Value | 1. iShares Core S&P Small Cap | 08/18 | ETF | ETF | ETF | 61.7 | 18.3% | 4.8% | 9.3% | 20.0% | 32.4% | 19.3% | 1.41 | 0.07 | 606 | None | IJR |
| | 2. ☎ AMG RR Small-Mid Cap Val | 10/18 | NTF | NTF | NTF | 35.2 | 10.6% | 3.8% | 8.9% | 10.5% | 15.8% | 17.2% | 1.16 | 1.38 | 61 | None | ARSMX |
| | 3. Hodges Small Cap | 04/18 | NTF | NTF | NTF | 44.2 | 12.8% | 4.4% | 4.7% | 10.9% | 28.5% | 10.1% | 1.60 | 1.30 | 53 | 1%30days | HDPSX |
| Category 2 Large/Growth | 1. ☎ Polen Growth Investor | 10/18 | NTF | NTF | NTF | 53.8 | 21.3% | 5.6% | 10.0% | 15.7% | 28.1% | 18.1% | 1.14 | 1.25 | 21 | 2%60days | POLRX |
| | 2. MS Multi-Cap Gro - LW[12] | 05/18 | NTF | NTF | NTF | 80.2 | 33.0% | 9.5% | 13.1% | 20.8% | 46.3% | 24.9% | 1.64 | 1.24 | 41 | None | CPOAX |
| | 3. Touchstone Sands Cap Sel | 07/18 | No | NTF | NTF | 54.7 | 28.2% | 5.6% | 7.5% | 15.3% | 32.0% | 17.9% | 1.65 | 1.22 | 29 | None | PTSGX |
| Category 1 Large/Value | 1. Miller Opportunity - LW[12] | 06/17 | NTF | Yes[10] | NTF | 84.3 | 25.9% | 9.2% | 20.3% | 26.3% | 37.6% | 15.0% | 2.23 | 1.35 | 37 | None | LGOAX[10] |
| | 2. Pear Tree Quality | 09/18 | NTF | NTF | NTF | 39.6 | 11.1% | 3.8% | 10.1% | 9.3% | 20.1% | 17.6% | 0.98 | 1.29 | 50 | None | USBOX |
| | 3. Oppen S&P Ultra Dividend | 07/18 | ETF | ETF | ETF | 41.2 | 9.3% | 1.6% | 5.4% | 12.6% | 23.2% | 16.0% | 1.22 | 0.39 | 61 | None | RDIV |
| Bond Categories | Vanguard Inflation Protect[6] | 02/18 | Yes[11] | Yes[11] | Yes[11] | 3.1 | 0.0% | 0.6% | 0.8% | 1.9% | 0.4% | 2.0% | 1.10 | 0.20 | 7.7[7] | None | VIPSX[11] |
| | Permanent: Vanguard I-T Bond | Perm | ETF | ETF | ETF | -0.4 | -1.5% | 0.8% | 0.9% | 1.1% | -2.4% | 1.7% | 1.30 | 0.07 | 6.4[7] | None | BIV[8] |
| | Permanent: Vanguard S-T Bond | Perm | ETF | ETF | ETF | 0.8 | 0.1% | 0.4% | 0.5% | 0.9% | -0.6% | 0.9% | 0.47 | 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-September, 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.

SOUND MIND PORTFOLIOS

# 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 iShares Currency Hedged EAFE, the highest-rated Cat. 4 fund available is Kinetics Small Cap Opportunity, and so on. After doing this for each category, the orders are placed and the stock portion of the Upgrading portfolio is complete!

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

### 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 | iShares Curr Hedged EAFE |
| Stock Cat. 4: Small/Growth | 16% | $8,000 | Kinetics Sm Cap Opportunity |
| Stock Cat. 3: Small/Value | 16% | $8,000 | iShares Core S&P Small Cap |
| Stock Cat. 2: Large/Growth | 16% | $8,000 | Polen Growth Investor |
| 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, Vanguard International Growth (VWIGX, 09/2017) is being replaced.$** This Vanguard fund has served us well over the past year. Its gain of +11.0% during the 12 months ended August 31 compares favorably to its average peer in SMI's foreign group, which gained just +4.1%. This is an excellent fund that SMI has used in various capacities for two decades now (it used to be the foreign component of Just-the-Basics before it was replaced by a foreign index fund). We're moving on because it's fallen slightly below the quartile. Those owning it in a taxable account should check their buy/sell dates to make sure they qualify for long-term capital gains tax treatment by holding longer than 365 days.

It's worth noting that another foreign recommendation, Morgan Stanley International Opportunity, is also currently below the quartile. We're opting to hold that fund another month, given that it was recommended only two months ago. It's unusual for SMI to replace a fund after just two months, although we'll do it occasionally when warranted. In this case, we think it's worth giving MIOPX another month, but we wouldn't recommend new purchases in it at this point.

• **iShares Currency Hedged MSCI EAFE ETF (HEFA) is being added.[1]** The name of this ETF is certainly a mouthful, but thankfully there's an easy shorthand way for SMI members to understand it. This fund is essentially EFA—the ETF that SMI uses in DAA when foreign stocks are called for—but with the foreign currency component hedged away.

Here's a fuller explanation. When a U.S. investor buys foreign stocks, there are two variables that contribute to the return. First is the performance of the stocks themselves. In addition to that, the impact of currency fluctuations can significantly affect returns. The dollar has gained about 6% in value over the past eight months relative to a basket of foreign currencies, which has eroded the returns U.S. investors have received from foreign stocks. That's because the gains from the appreciation of those foreign stocks convert to fewer dollars due to the dollar appreciation, reducing overall returns.

This ETF hedges away most of the currency fluctuation, which neutralizes that influence. For example, during the second quarter of 2018, when most of the recent dollar appreciation was taking place, EFA (with no currency hedging) lost -2.0%, while HEFA (with the currency hedging) gained +3.1%.

Thankfully, in Upgrading we don't have to separately consider currency fluctuations in our foreign investing, because the Upgrading process handles it automatically through the selection of funds such as HEFA. The dollar's rise has slowed recently, even declining a bit over the past month, but we're still seeing more hedged foreign funds rising to the top of the foreign-fund rankings. This ETF will give us broad foreign-stock exposure without being impacted by currency fluctuations.

◆ **In the Small/Value group, Huber Capital Small Cap Value (HUSIX, 06/2018) is being replaced.** The whole small/value group has done relatively little in the three months since we first recommended Huber, but Huber has done even less, leading it to fall below the quartile cutoff. Its three-month performance has been roughly flat while the average small/value fund tracked by Morningstar is up +0.9%. So not a huge difference, but there's no compelling reason to hold on either, so we're seeking out a faster runner.

• **AMG River Road Small-Mid Cap Value (ARSMX) is being added.[1]** While the overall returns in the small/value group have been minimal in recent months, there actually has been quite a bit of turnover in the fund rankings for this category. While the majority of the top quartile small/value funds have mild losses over the past month, this AMG fund is one of the few that has posted a solid gain. It's always a bit unnerving selecting a new fund when the category rankings are in flux, but this fund has been climbing quickly. It's a common tendency for larger stocks to outperform smaller ones in the last quarter of the year, so hopefully this fund's slightly larger profile (as evidenced by its "Small-Mid" name) will give it a tailwind relative to the rest of its small/value peers in the months ahead.

◆ **In the Large/Growth group, Invesco S&P 500 Equal Weight Tech (RYT, 04/2017) is being replaced.$** This ETF has done a super job for us since being recommended a year-and-a-half ago. Through the end of August, it had gained +41.7% while the average fund in SMI's large/growth group was up +32.2%, so we're pleased with both the length of time it was recommended and the significant gains it has contributed to Upgrading's performance. That said, RYT had been stuck in the lower part of the top quartile for several months before recently dropping slightly below the quartile cutoff, so we're moving on despite its performance being solid. If you're in a taxable account and are shy of the 365-day holding period required for long-term capital gains tax treatment, feel free to hold this a bit longer in order to qualify.

• **Polen Growth (POLRX) is being added.[1]** SMI has recommended this fund before, owning it through the challenging back-to-back corrections of 2015/2016. Its performance during that time bodes well for it as a current selection. It handled that rocky period well, outperforming its average peer modestly.



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

# MONEYTALK

The reason that's particularly encouraging is two-fold. First, when a fund is recommended based on strong recent performance during a rising market, as Polen is today with a roughly +21% gain over the past six months, we'd normally expect it to be hit relatively hard by a swift market correction. So being able to reach the top of the rankings during rising markets like 2015 and 2018, while still showing the ability to navigate falling markets as it did the last time we owned it, is promising. ◆

**SIGHTING: THE CASE FOR ACTIVELY MANAGED FUNDS**

In the United States, assets have shifted away from actively managed funds and towards passively managed index funds and ETFs; specifically, less than 8% of the assets in equity funds were passively managed in 1997, but over 40% were passively managed in 2017.… The conventional wisdom [is that active management does not create value for investors]. That wisdom is based on [research showing] that: (1) The average fund underperforms after fees. (2) The performance of the best funds does not persist. (3) Some fund managers are skilled, but few have skill in excess of costs.…

Taken as a whole, our review of current academic literature suggests that the conventional wisdom is too negative on the value of active management. [Multiple studies suggest] that active managers have a variety of skills and tend to make value-added decisions, such that, after accounting for all costs, many actively managed funds appear to generate positive value for investors. While the debate between active and passive is not settled and many research challenges remain, we conclude that the current academic literature finds active management more promising for investors than the conventional wisdom claims.

— From "Challenging the Conventional Wisdom on Active Management: A Review of the Past 20 Years of Academic Literature on Actively Managed Mutual Funds," by researchers K.J. Martijn Cremers, Jon A. Fulkerson, and Timothy B. Riley. To read the entire article, go to bit.ly/2Iee6cO. ◆

**SIGHTING: SAFEGUARDING YOUR WEALTH FROM THE EFFECTS OF COGNITIVE DECLINE**

The aging brain isn't well-suited to financial decision-making. A growing body of research shows that cognitive decline starts to reduce our ability to make good decisions about credit in our mid-50s, and our investing decision-making skills fall significantly after 70. This cognitive decline leaves older people vulnerable to financial fraud and abuse. Combine that with several other trends and you have a perfect storm of financial risk: the increasing reliance on self-managed retirement income through individual savings and 401(k) accounts, growing use of debt by older households, and more problems with computer security and hacking.

But there… are proactive steps you can take… to guard against these risks. The protective steps are worth considering for yourself—but also for aging parents who could be vulnerable. Here's a checklist of steps to consider.

• **Get an early start.** Procrastination is your worst enemy, since the onset and progress of cognitive decline is difficult to predict. • **Simplify.** Consolidate accounts and simplify the structure of your portfolio wherever possible, so that a trusted financial adviser or family member can easily keep tabs on things for you if the need arises. • **Manage passwords.** Aside from account monitoring, strong passwords are another must for protection against hackers. Use a password management service such as LastPass or Dashlane. These services serve as a sort of encrypted vault for login credentials. — by Morningstar columnist Mark Miller. Read more at bit.ly/2MUYnVB. ◆

LEVEL 2 / CONTINUED FROM PAGE 151:

**FUND COMPANIES CONTINUE TO DROP PRICES, REDUCE COST OF ENTRY**

big downside for newer investors has been that most of Fidelity's traditional funds required a minimum investment of $2,500. A few even required an initial investment of $10,000. The high cost-of-entry wasn't a big deal for established investors, but for those starting out, those fund minimums created a huge hurdle.

Now, Fidelity has removed the minimums (undercutting Schwab's already-low $100 minimum), making it easier for investors with a small pool of money to start a diversified Upgrading portfolio right away. Whereas fund minimums used to be a primary focus for new investors, now among our recommended brokers only Vanguard continues to require high ($3,000) minimums for its traditional funds. (Note: Those minimums don't apply to ETFs purchased via Vanguard.)

Whether Vanguard will be able to sustain its higher minimum-investment requirements in light of Fidelity's new policy change (and the earlier adoption of lower minimums at Schwab) remains to be seen.

**A word about expense ratios**

Although the four new zero-expense funds from Fidelity are notable, there's no guarantee their investors will ultimately be better off than if they'd used similar index funds with tiny expense ratios. For one thing, the new Fidelity funds will be tracking in-house Fidelity indexes. No one knows if those indexes will perform in exactly the same manner as more-established indexes.

It's possible that an investor could come out ahead investing in a fund that charges, say, 0.03% ($3 a year on a $10,000 investment) than in one that charges zero expenses. It depends both on how the benchmarks perform and also how well the funds track their respective benchmarks (broad-based index funds commonly experience a slight "tracking error," meaning a fund doesn't get precisely the same return as the index it is following due to the difficulty of replicating it perfectly).

Fidelity's zero-expense funds may perform better than other similar funds, or they may not. Time will tell. The point is simply that the difference between an expense ratio of 0.03% and 0.00% is so slight that the cost advantage of Fidelity's new "zero" funds could easily be overcome by other factors. ◆

# MONEYTALK

LEVEL 3 / CONTINUED FROM PAGE 152:

**FUNDING A RETIREMENT NEST EGG — BEFORE GRADUATING HIGH SCHOOL**

investing quite a bit recently and apparently she got inspired!

While our kids' early returns have been positive, I've been reminding them that the market doesn't always move upward, and Sector Rotation is an especially volatile strategy. They may understand this *theoretically* at this point, but going through some actual market downturns *while their personal stakes are still low* should help build the emotional fortitude they'll need to be successful long-term investors.

Realistically, it's unlikely (though not impossible) that the savings a child accumulates by the end of high school will *completely* eliminate the need for them to save further for retirement as an adult. But if this approach provides enough of a head start to enable a young person to postpone saving for retirement *while their own kids* are young and money is tight, that's a huge win in itself. And the investing lessons they are likely to learn through their experience will put them far ahead of the typical investing curve, which will serve them well for the rest of their lives. ◆

LEVEL 4 / CONTINUED FROM PAGE 153:

**DEALING WITH MEDICAL DEBT**

to set up a payment plan.

• **Don't pay with an existing credit card.** Paying medical debt with an existing card typically will mean a double-digit rate of interest, as well as no forbearance or flexibility. Transferring your debt to a *zero-rate promotional card* might be an option, but only if you can pay the balance in full before the promotional period ends. (If you use a zero-rate card for your medical debt, do not charge anything else on that card!)[1]

• **Don't take out a personal loan or home-equity loan.** As noted, medical providers typically are willing to work with patients to set up payment plans, often at no interest. That's a much better "type" of debt than a personal or home-equity loan that charges interest and has no flexibility. ◆

## MARKET NOTES, QUOTES, AND ANECDOTES

**Taking the bad with the good**

• "From Sept. 12, 2008 to yesterday, the S&P 500 is up +185.9%, or +11.08% annualized. Your money nearly tripled in 10 years. [But] from Sept. 12, 2008 to March 9, 2009, the S&P 500 lost -45.15%. You lost almost half your money in less than six months. You can't have one without the other."
– *Wall Street Journal* columnist Jason Zweig in a 9/12/18 tweet.

**Minding the gap**

• "Could the deductible be $200, $1,000 or $2,000? Who's to say what the government will do?" – Adam Wasmund, who advises health insurance brokers, quoted in a 9/19/18 Reuters article about upcoming changes to Medigap policies. The popular Plan F will soon no longer be available to new enrollees, which Wasmund believes will lead to less favorable terms for current users of the plan. Read more at reut.rs/2DszcoW.

**Investor, know thyself**

• "A reasonable-level of anxiety is a sign that you take investing seriously and are on guard against complacency and overconfidence. Meanwhile, too much anxiety is a sign that you're investing in a way that just doesn't suit you."
– Daniel Grioli, writing on his *Market Fox* blog on 9/19/18 on the importance of factoring your risk tolerance into your investment decisions. Read more at bit.ly/2xGoy8c.

**A bond is not a bond is not a bond**

• "… not all bonds are created equal. Their diversification potential occupies a spectrum from great to lousy. The best diversifiers are the most boring." – Ben Johnson, Morningstar's director of global exchange-traded fund research, writing on 9/19/18. What you want, he wrote, are bonds that don't correlate very well with the return of stocks. Treasury bonds fit that definition. High-yield bonds, not so much. Read more at bit.ly/2xtAnym.

**Regrets, we've had a few**

• "When it comes to money, people usually have a lot of regrets. Some of the most common ones are spending when they should be saving, not looking for a less-expensive alternative when it might have taken only a few extra minutes and, unfortunately, not having saved enough money for retirement when it's almost too late. Americans tend to wish they had saved more for their future: [In a Charles Schwab survey of 1,000 401(k) plan participants] about two-thirds said they wish they had saved more of the money they spent on the nonnecessities, such as dining out, expensive clothing, new cars and vacations. They did not, however, regret spending on a home, wedding or an education for themselves or children." – Alessandra Malito in a 9/17/18 *MarketWatch* article on the need to figure out how much you should save for retirement, and the need to *act* on that information. Read more at on.mktw.net/2NPmVza.

**The best way for retirees to give?**

• "What if I told you that you could give to charity using pre-tax dollars, even if you don't itemize your deductions, and even if you don't want to hassle with a Donor Advised Fund, *and* reduce the taxes due on your Required Minimum Distributions (RMDs) at the same time? Impossible you say? Nope. All perfectly legal, perfectly reasonable, and commonly done." – Jim Dahle, writing on his blog, *The White Coat Investor*, about Qualified Charitable Distributions. Read more at bit.ly/2O3ng19. ◆

[1] Just be sure to read the fine print. Some zero-rate cards have requirements that may make their use unwise.

# 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**

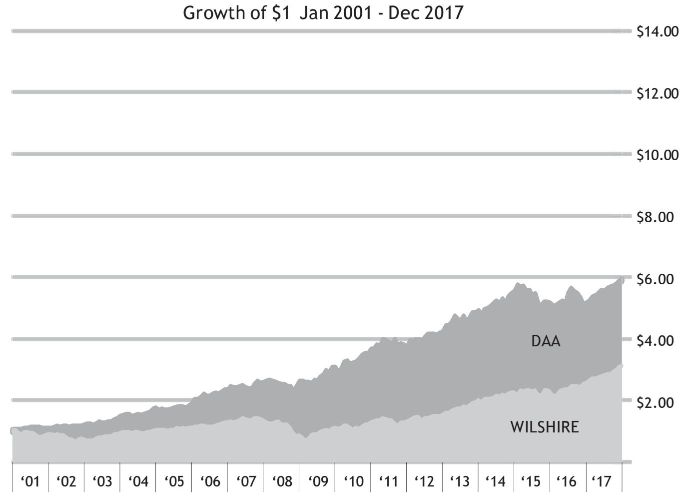
This is a stand-alone strategy that can be used in combination with (or in place of) SMI's basic strategies. DAA is designed to help you share in some of a bull market's gains, while minimizing or even preventing losses during bear markets. It's a low-volatility strategy that nonetheless has generated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

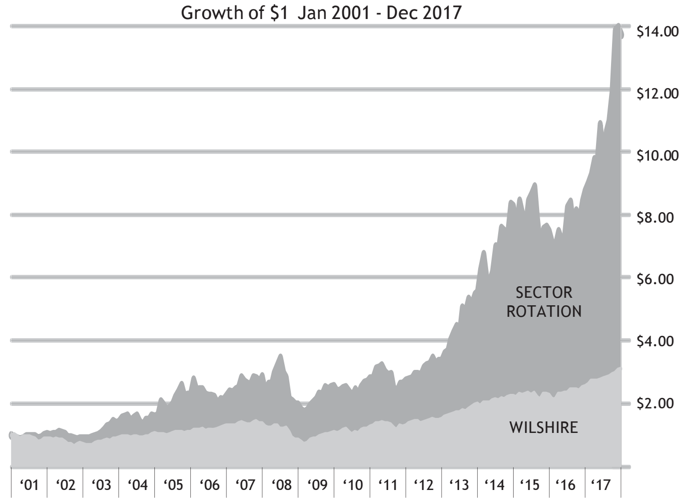
This high-risk strategy involves investing in a single special-purpose fund that focuses on a specific sector (such as biotech, energy, or financial services). Because these stock funds invest in a narrow slice of the economy, they carry a higher degree of risk. Only one fund, selected based on having 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-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 AUGUST 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] | 10.4% | 3.5% | 7.8% | 20.2% | 16.1% | 14.4% | 10.9% | 9.9% |
| Just-the-Basics[2] | 8.3% | 2.7% | 5.6% | 17.6% | 14.2% | 12.3% | 9.7% | 9.8% |
| Stock Upgrading[3] | 10.9% | 4.6% | 6.0% | 19.7% | 13.6% | 11.9% | 9.2% | 10.3% |
| U.S. Bond Market[4] | -1.2% | 0.5% | 0.6% | -1.3% | 1.6% | 2.3% | 3.5% | 3.9% |
| Bond Upgrading[5] | -0.6% | 0.6% | 0.8% | -1.5% | 1.7% | 2.6% | 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] | 2.9% | 2.1% | 4.6% | 8.0% | 6.2% | 6.3% | 9.8% | 11.3% |
| Sector Rotation[7] | 13.5% | 4.2% | -2.9% | 41.8% | 25.3% | 26.0% | 18.5% | 18.1% |
| 50-40-10 Blend[8] | 7.2% | 3.3% | 4.3% | 16.1% | 11.2% | 10.7% | 10.9% | 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 8/31/2018** | Year to Date | 1 Month | 3 Months | 12 Months | 3 Year Annual | 5 Year Annual | 10 Year Annual |
|---|---|---|---|---|---|---|---|
| SMIFX | 13.82% | 5.32% | 5.83% | 22.48% | 13.05% | 10.75% | 8.38% |
| Wilshire 5000 | 10.35% | 3.50% | 7.80% | 20.24% | 16.13% | 14.39% | 10.91% |
| S&P 500 | 9.94% | 3.26% | 7.76% | 19.66% | 16.11% | 14.52% | 10.86% |

| **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).

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