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Sound Mind Investing®

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The High Cost of Fear

Unwarranted fear may be your most dangerous investing enemy. It can prompt you to make emotionally driven decisions that end up hurting rather than helping your portfolio. In this excerpt from his book *Your Money and Your Brain*, financial author Jason Zweig notes that such fear often flows from inaccurate perceptions about risk. Learning to recognize and resist unwarranted fear is a key aspect of becoming a successful long-term investor.

by Jason Zweig

Here are a few questions that might, at first, seem silly.

• Which is riskier: nuclear reactors or sunlight?

• Which animal is responsible for the greatest number of human deaths in the U.S.—alligator, bear, deer, shark or snake?

• Match the causes of death (on the left) with the number of annual fatalities worldwide (on the right):

1.War	a. 310,000
2. Suicide	b. 815,000
3. Homicide	c. 520,000

Now let's look at the answers.

The worst nuclear accident in history occurred when the reactor at Chernobyl, Ukraine, melted down in 1986. According to early estimates, tens of thousands of people might be killed by radiation poisoning. By 2006, however, fewer than 100 had died. Meanwhile, nearly 8,000 Americans are killed every year by skin cancer, which is most commonly caused by overexposure to the sun.

In the typical year, deer are responsible for roughly 130 human fatalities—seven times more than alligators, bears, sharks, and snakes combined. How could gentle Bambi cause such bloodshed? Unlike those other, much more fearsome animals, deer don't attack with teeth or claw. Instead, they step in front of speeding cars, causing deadly collisions.

Finally, most people think war takes more lives than homicide—which they believe kills more people than suicide. In fact, in most years, war kills fewer people than conventional homicides do, and the number of people who take their own lives is almost twice the number of those who are murdered. (In the list above, the causes and the number of deaths are already matched correctly.) Homicide seems more common than suicide because it's a lot easier to imagine someone else dying than it is to imagine killing yourself.

None of this means that nuclear radiation is good for you, that rattlesnakes are harmless, or that the evils of war are overblown. What it does mean is that we are often most afraid of the least likely dangers, and frequently not worried enough about the risks that have the greatest chances of coming home to roost. It also reminds us that much of the world's misfortune is caused not by the things we are afraid of, but by being afraid. The most terrible devastation wrought by Chernobyl, for example, did not come out of its nuclear reactors. Instead, it came from the human mind. As panicky business owners fled the area, unemployment and poverty (continued on page 19)

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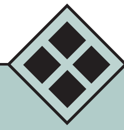
"FOR GOD HAS NOT GIVEN US THE SPIRIT OF FEAR BUT OF POWER, AND OF LOVE, AND OF A SOUND MIND."



EDITORIAL

SMI Introduces *Multiply: A Biblical Guide to Investing*

We're excited to announce the release of *Multiply*, a four-part video-based study designed to equip people with the knowledge, confidence, and biblical foundation they need to invest well. Intended for use by small groups or in a workshop setting, *Multiply* marks the culmination of many years of prayer and hard work.

Multiply is built on the premise that, for many people, investing is the most complicated and frightening aspect of managing money. It can seem complicated because investing has a terminology all its own. "Bull markets" and "bear markets." "Asset allocation" and "exchange-traded funds." To the uninitiated, it's a foreign and intimidating world.

Investing can feel frightening because of the stock market's propensity to move in sudden and unpredictable ways. Just recall the Great Recession, when the stock market lost half its value between October 2007 and March 2009. Or look at last year. After setting an all-time high on September 20, the bottom fell out and stocks plunged nearly 20% by Christmas Eve.

Making matters even more challenging, people are living longer than ever, yet still retiring at the historically typical retirement age of 65. While an increasing number of people are expressing the *desire* to work longer, the reality is quite different. Health issues or the need to care for a loved one often prompts people to leave the paid workforce earlier than planned. As a result, many will live the last 20-30 years of their lives needing something other than a salary to sustain them.

The trend toward longer lifespans, which is leading people to spend more years in retirement, is hitting up against another important trend: The move away from traditional pensions and toward 401(k)-type plans. Today, it's largely up to *you* to figure out how much to set aside for your future and how to invest that money successfully.

Those four issues—that many people see investing as complicated, that investing can be frightening, that people are living longer, and that investors are increasingly on their own—motivated SMI to create a resource that provides practical, hopeful, and biblically informed investment guidance.

More specifically, *Multiply* is designed to help people:

• Appropriately recognize the *importance* of investing—that we all have a biblical responsibility to provide for our families—now, as well as in our later years (1 Timothy 5:8).

• Appreciate the incredible *opportunity* investing represents—to gain the confidence and peace of mind that by consistently investing a portion of all they earn, generating a good return on their investments, and giving it time, they should be able to provide for their family long-term (Proverbs 13:11).

• Take a slow and steady, *long-term* approach to investing (Proverbs 21:5)—because patience is a fruit of the Spirit (Galatians 5:22-23), and market history shows that the longer a person stays invested, the more likely he or she will generate a positive return.

• Avoid succumbing to *fear*, which causes so many investor mistakes (2 Timothy 1:7).

• *Diversify* their investments by determining their optimal asset allocation, and then build an investment portfolio that's designed accordingly (Ecclesiastes 11:2).

• See that the key to choosing good *investments* is choosing a good investment *strategy*—one that is objective, easy to understand and implement, that has a good track record, and that can be trusted no matter what's happening in the markets (Proverbs 20:18).

• Embrace the empowering truth that our task as Christian investors is not only to manage money more *effectively*, but to manage it more *faithfully* (1 Corinthians 4:2).

We'd be honored if you would help get the word out about *Multiply*. You could gather a group of friends in your home and go through the content together. Or bring *Multiply* to the attention of the right person at your church—your senior pastor, the person responsible for stewardship, or the leader in charge of small groups. Encourage that person to review the materials and consider offering a *Multiply* workshop or small group at your church. You could even offer to be the facilitator.

Multiply is available now. To learn more, visit multiplystudy.com. Or, if your church subscribes to RightNowMedia.org, look for it there.

MATT BELL
MANAGING EDITOR

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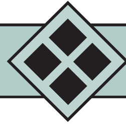


The High Cost of Fear

(continued from front page)

soared. Anxiety, depression, alcoholism, and suicide ran rampant among the residents who could not afford to leave. Fearing that their unborn babies had been poisoned, expectant mothers had more than 100,000 unnecessary abortions. The damage from radiation was dwarfed by the damage from the *fear* of radiation, as imaginary terrors led to real tragedies on a massive scale.

We're no different when it comes to money. Every investor's worst nightmare is a stock-market collapse like the Crash of 1929 that ushered in the Great Depression. According to a survey of 1,000 investors, there's a 51% chance that in any given year, the U.S. stock market might drop by one-third. And yet, based on history, the odds that U.S. stocks will lose a third of their value in a given year are only around 2%. The real risk is not that the stock market will have a meltdown, but that inflation will raise your cost of living and erode your savings. Yet only 31% of the people surveyed were worried that they might run out of money during their first ten years of retirement. Riveted by the vivid fear of a market Chernobyl, they overlooked the more subtle but severe damage that can be dealt by the silent killer of inflation.

If we were strictly logical, we would judge the odds of a risk by asking how often something bad has actually happened under similar circumstances in the past. Instead, explains psychologist Daniel Kahneman, "we tend to judge the probability of an event by the ease with which we can call it to mind." The more recently an event has occurred, or the more vivid our memory of something like it in the past, the more "available" an event will be in our minds—and the more probable it will seem to happen again. But that's not the right way to assess risk. An event does not become more likely to recur merely because its last occurrence was recent or memorable.

Dread and "knowability"

When an intangible feeling of risk fills the air, you can catch other people's emotions as easily as you can catch a cold. Merely reading a brief newspaper story about crime or depression is enough to prompt people into more than doubling their estimates of the likelihood of unrelated risks like divorce, stroke, or exposure to toxic chemicals. Just as when a person has a hangover the slightest sound can seem deafening, an upsetting bit of news can make you hypersensitive to anything else that reminds you of risk. As is so often the case with the reflexive brain, you may not realize that your decisions are driven by your feelings. Roughly 50% of people can recognize when they have been disturbed by a bit of negative news, but only 3% admit that being upset may influence how they react to other risks.

Our intuitive sense of risk is driven up or down by what Paul Slovic, a psychologist at the University of Oregon, calls "dread" and "knowability." Those two factors, he explains, "infuse risk with feelings."

• Dread is determined by how vivid, controllable, or potentially catastrophic a risk seems to be. Repeated surveys have found that people consider handguns a bigger risk than smoking. Because we can choose not to smoke (or choose to quit if we do), the hazards of smoking seem to be under our control. But there's not much you can do to prevent some thug from putting a bullet through your head at any moment, and TV cop shows pump your living room full of gunshots every night—so handguns seem scarier. Yet smoking kills hundreds more people than handguns do.

• The "knowability" of a risk depends on how immediate, specific, or certain the consequences appear to be. Fast and finite dangers (fireworks, skydiving, train crashes, etc.) feel more "knowable" (and less worrisome) than vague, open-ended risks like genetically modified foods or global warming. Americans rate tornadoes as a much more frequent killer than asthma. Because asthma moves slowly and many of its victims survive, it seems less dangerous, even though it kills many more people. If the consequences of a risk are highly uncertain and poorly understood, any perceived problem can trigger a frenzy of publicity. Thus hedge funds, those giant investment pools that operate in almost complete secrecy, become front-page news whenever they lose money.

Dread and knowability come together to twist our perceptions of the world around us: We underestimate the likelihood and severity of common risks, and we overestimate the likelihood and severity of rare risks—especially if we have never personally experienced them. When we feel we are in charge and we understand the consequences, risks will seem lower than they truly are. When a risk feels out of our hands and less comprehensible, it will feel more dangerous than it actually is. It's as if we see the world through warped binoculars that not only magnify whatever is remote but shrink whatever is near.

That's why so many people buy flight insurance at the airport: The chance of dying in a plane crash is almost zero, and most passengers are already covered by life insurance anyway, but air travel still *feels* risky. Meanwhile, roughly three-quarters of all Americans living in vulnerable areas have no flood insurance. Because homeowners can readily see how high the water has risen in the past, and because they can easily invest in drainage systems and other techniques that seem to control the risk of flooding, they feel safer than they really are. Hurricanes Katrina and Harvey exposed how dangerous this feeling of safety can be.

How these tendencies affect your finances

In the stock market, these quirks of risk perception can be a big distraction. On March 22, 2005, a woman named Anna Ayala was eating at a Wendy's restaurant in San Jose, California. She spooned a helping of chili into her mouth, started to chew, and then spat out a human finger. When the news broke, Wendy's stock fell 1% on heavy trading volume, and by April 15, 2.4% had been chopped off the market value of the stock. Customers turned away, costing the company an estimated $10 million in revenues. But investigators soon found that Ayala had planted the finger (which one of her husband's coworkers had lost in an industrial accident) in the bowl of chili herself. Wendy's business recovered steadily, and anyone who sold the stock in the initial panic was left feeling like somebody with ten thumbs, as it nearly

doubled over the coming year.

Much the same thing happened in June 1999, when eBay's website crashed and "went dark" for twenty-two hours. Trading in Beanie Babies and G.I. Joes ground to a halt, costing eBay about $4 million in lost fees and causing consternation among thousands of buyers and sellers. Over the next three trading days, eBay's shares fell 26%, a loss of more than $4 billion in market value. Because the Internet was still relatively young, many investors had no idea when eBay could fix the problem—so the consequences seemed highly uncertain, arousing enormous fear. But eBay's site was soon running smoothly, and the stock almost tripled over the next five years.

In short, overreacting to raw feelings—"blinking" in the face of risk—is often one of the riskiest things an investor can do.

The hot button of the brain

Deep in your brain, level with the top of your ears, lies a small, almond-shaped knob of tissue called the amygdala. When you confront a potential risk, this part of your reflexive brain acts as an alarm system—generating hot, fast emotions like fear and anger that it shoots up to the reflective brain like warning flares.

The amygdala helps focus your attention, in a flash, on anything that's new, out of place, changing fast, or just plain scary. That helps explain why we overreact to rare but vivid risks. After all, in the presence of danger, he who hesitates is lost; a fraction of a second can make the difference between life and death. Step near a snake, spot a spider, see a sharp object flying toward your face, and your amygdala will jolt you into jumping, ducking, or taking whatever evasive action should get you out of trouble in the least amount of time. This same fear reaction is triggered by losing money—or believing that you might.

Does this lightning response of the amygdala make us "irrational"? Of course not. The fear reflex remains a vital survival tool in daily life today: It makes you look both ways before you cross the street and reminds you to hold the railing on high balconies. However, when a potential threat is financial instead of physical, reflexive fear will put you in danger more often than it will get you out of it. Selling your investments every time they take a sudden drop will make your broker rich, but it will just make you poor and jittery.

Finally, the amygdala is sensitive to that uniquely human way of conveying threats—through language. Brain scans show that your amygdala will fire more intensely in response to words like *kill, danger, knife,* or *torture,* than to words like *towel, formation, number* or *pen.* Researchers in France have shown that a frightening word can make you break out in a sweat even if it appears for only 12 one-thousandths of a second—roughly 25 times faster than the blink of a human eye! (No wonder you cringe when someone says, "I got killed on that fund" or "Buying that stock would be like trying to catch a falling knife.")

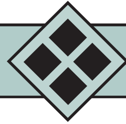
An alarming word or two can even be powerful enough to transform your memories. In a classic experiment by psychologist Elizabeth Loftus, people viewed video footage of car accidents. Some of the viewers were asked how fast the cars were going when "they hit each other." Others were asked how fast the cars were going when "they smashed into each other." Even though both groups saw the same videos, the people who were prompted by the words "smashed into" estimated that the cars were going 19% faster. "Hit" may not sound very scary, but "smashed into" does. That evidently switches on the amygdala, splashing emotion back onto your memory and changing your perceptions of the past.

What does all this tell us about investing? Humans are reflexively afraid not just of physical dangers, but also of any social signal that transmits an alarm. A television broadcast from the floor of the stock exchange on a bad trading day, for example, combines a multitude of cues that can fire up the amygdala: flashing lights, clanging bells, hollering voices, alarming words, people gesturing wildly. In a split second, you break out in a sweat, your breathing picks up, your heart races. This primal part of your brain is bracing you for a "fight or flight" response before you can even figure out whether you have lost any money yourself.

Both actual and imagined losses can flip this switch. Using brain scans, one study found that the more frequently people were told they were losing money, the more active the amygdala became. Other scanning experiments have shown that even the *expectation* of financial losses can switch on this fear center. Traumatic experiences activate genes in the amygdala, stimulating the production of proteins that strengthen the cells where memories are stored in several areas of the brain. A surge of signals from the amygdala can also trigger the release of adrenaline and other stress hormones, which have been found to "fuse" memories, making them more indelible. And an upsetting event can shock neurons in the amygdala into firing in synch for hours—even during sleep. (It is literally true that we can relive our financial losses in our nightmares.) Brain scans have shown that when you are on a financial losing streak, each new loss heats up the hippocampus, the memory bank near the amygdala that helps store your experiences of fear and anxiety.

What's so bad about that? A moment of panic can wreak havoc on your investing strategy. Because the amygdala is so attuned to big changes, a sudden drop in the market tends to be more upsetting than a longer, slower—or even a much bigger—decline. On October 19, 1987, the U.S. stock market plunged 23%—a deeper one-day drop than the Crash of 1929 that ushered in the Great Depression. Big, sudden, and inexplicable, the Crash of 1987 was exactly the kind of event that sparks the amygdala into flashing fear throughout every investor's brain and body. The memory was hard to erase: In 1988, U.S. investors sold $15 billion more shares in stock mutual funds than they bought, and their net purchases of stock funds did not recover to precrash levels until 1991. The "experts" were just as shell-shocked: The managers of stock funds kept at least 10% of their total assets in the safety of cash almost every month through the end of 1990, while the value of seats on the New York Stock Exchange did not regain their precrash level until 1994. A single drop in the stock market on one Monday in autumn disrupted the investing behavior of millions of people for at least the next three years.

The philosopher William James wrote that "an impression



may be so exciting emotionally as almost to leave a *scar* upon the cerebral tissues." The amygdala seems to act like a branding iron that burns the memory of financial loss into your brain. That may help explain why a market crash, which makes stocks cheaper, also makes investors less willing to buy them for a long time to come.

Fighting your fears

When you confront risk, your reflexive brain, led by the amygdala, functions much like a gas pedal, revving up your emotions. Fortunately, your reflective brain, with the prefrontal cortex in charge, can act like a brake pedal, slowing you down until you are calm enough to make a more objective decision. The best investors make a habit of putting procedures in place, in advance, that help inhibit the hot reactions of the emotional brain. Here are some techniques that can help you keep your investing cool in the face of fear:

• **Get it off your mind.** You'll never find the presence of mind to figure out what to do about a risk gone bad unless you step back and relax. Joe Montana, the great quarterback for the San Francisco 49ers, understood this perfectly. In the 1989 Super Bowl, the 49ers trailed the Cincinnati Bengals by three points with only three minutes left and 92 yards—almost the whole length of the field—to go. Offensive tackle Harris Barton felt "wild" with worry. But then Montana said to Barton, "Hey, check it out—there in the stands, standing near the exit ramp, there's John Candy." The players all turned to look at the comedian, a distraction that allowed their minds to tune out the stress and win the game in the nick of time. When you feel overwhelmed by a risk, create a John Candy moment. To break your anxiety, go for a walk, hit the gym, call a friend, play with your kids.

• **Track your feelings.** It's very helpful to keep an investing diary. You should include what neuroscientist Antoine Bechara calls an "emotional registry," tracking the ups and downs of your moods alongside the ups and downs of your money. During the market's biggest peaks and valleys, go back and read your old entries from similar periods in the past. Chances are, your own emotional record will show you that you tend to become overenthusiastic when prices (and risk) are rising, and to sink into despair when prices (and risk) go down. So you need to train yourself to turn your investing emotions upside down. Many of the world's best investors have mastered the art of treating their own feelings as reverse indicators: Excitement becomes a cue that it's time to consider selling, while fear tells them that it may be time to buy. I once asked Brian Posner, a renowned fund manager at Fidelity and Legg Mason, how he sensed whether a stock would be a moneymaker. "If it makes me feel like I want to throw up," he answered, "I can be pretty sure it's a great investment." Likewise, Christopher Davis of the Davis Funds has learned to invest when he feels "scared to death." He explains, "A higher perception of risk can lower the actual risk by driving prices down. We like the prices that pessimism produces."

• **Use your words.** While vivid sights and sounds fire up the emotions in your reflexive brain, the more complex cues of language activate the prefrontal cortex and other areas of your reflective brain. By using words to counteract the stream of images the markets throw at you, you can put the hottest risks in cooler perspective.

In the 1960s, Berkeley psychologist Richard Lazarus found that showing a film of a ritual circumcision triggered instant revulsion in most viewers, but that this disgust could be "short-circuited" by introducing the footage with an announcement that the procedure was not as painful as it looked. Viewers exposed to the verbal commentary had lower heart rates, sweated less, and reported less anxiety than those who watched the film without a soundtrack.

More recent, disgusting film clips—featuring burn victims being treated and closeups of an arm being amputated—have been shown to viewers by the aptly named psychologist James Gross. He has found that viewers feel much less disgusted if they are given written instructions, in advance, to adopt a "detached and unemotional" attitude.

Taken together, these discoveries show that verbal information can act as a wet blanket flung over the amygdala's fiery reactions to sensory input. That's why using words to think about an investing decision becomes so important whenever bad news hits. To be sure, formerly great investments can go to zero in no time; once Enron and WorldCom started to drop, it didn't pay to think analytically about them. But for every stock that goes into a total meltdown, there are thousands of other investments that suffer only temporary setbacks—and selling too soon is often the worst thing you can do. To prevent your feelings from overwhelming the facts, use your words and ask questions like these:

• Other than the price, what else has changed? Are my original reasons to invest still valid?

• If I liked this investment enough to buy it at a much higher price, shouldn't I like it even more now that the price is lower?

• What other evidence do I need to evaluate in order to tell whether this is really bad news?

• Has this investment ever gone down this much before? If so, would I have done better if I had sold out—or if I had bought more?

Conclusion

For most purposes in daily life, your brain is a superbly functioning machine, instantly steering you away from danger while reliably guiding you toward basic rewards like food, shelter, and love. But that same intuitively brilliant machine can lead you astray when you face the far more challenging choices that the financial markets throw at you every day. In all its messy, miraculous complexity, your brain is at its best and worst—its most profoundly human—when you make decisions about money.

When the great investment analyst Benjamin Graham was asked what it takes to be a successful investor, he replied: "People don't need extraordinary insight or intelligence. What they need most is the character to adopt simple rules and stick to them." ◆

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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

ZERO-SUM BUDGETING: GIVING EVERY DOLLAR A JOB

Just as there is "more than one way to skin a cat" (apologies to cat lovers), there is more than one way to manage one's cash flow. Last month in this space, we highlighted four popular online money-management systems and touched on a few of the attributes of each. This month, we focus on the approach to budgeting that three of these systems (You Need A Budget, Every Dollar, and Tiller[1]) have in common—an emphasis on "zero-sum" budgeting.

Conceptually, zero-sum budgeting is akin to the tried-and-true "envelope system" which involves placing predetermined amounts of cash into envelopes each pay period, using one envelope per spending category. At a supermarket, a purchase is made from the "groceries" envelope. At a clothing store, funds come from the "clothing" envelope. And so on. When money is spent, the user notes on the envelope the amount and how much remains.

The envelope system still works, but times have changed. Most transactions these days—many of which are conducted online—are done by debit card, credit card, electronic transfers, or mobile payment services, rather than with cash. (Carrying around envelopes full of cash is also something of a security risk!) Still, the idea behind the envelope method—i.e., separating one's money according to intended use and then deploying it accordingly—remains powerful.

Zeroing in on zero

A zero-sum budget is a means of making the envelope method function in a world of largely *non*-cash transactions. The key principle is to "give every dollar a job"—ahead of time. For example, a specific number of dollars will be assigned the collective task of paying your mortgage. The job of other dollars will be to buy groceries. Still other dollars will be enlisted for savings. Not a single dollar of income will be without a designated, predetermined task.[2]

That said, most of today's web- and app-based budgeting systems skip a helpful initial step in zero-sum budgeting, simply because they start with *net* income (the dollar amount received), rather than with *gross* income (what you are paid by your employer). In other words, most systems don't account for 1) funds withheld from your paycheck for various taxes and (possibly) health insurance, or 2) your contributions to an employer-sponsored retirement plan.

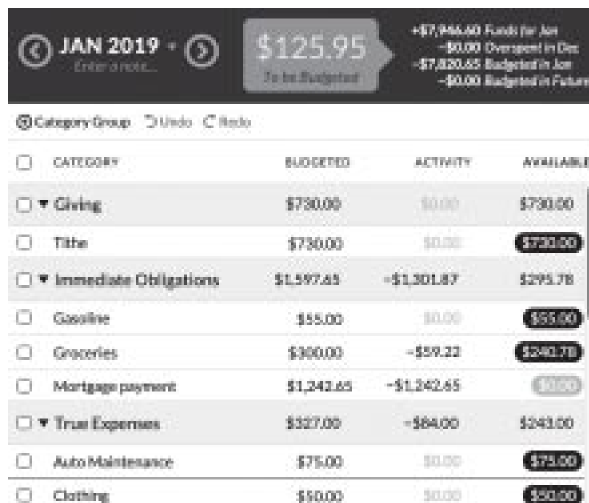
There's nothing wrong with managing a monthly budget based on your net pay—after all, that's all you have to work with! But you'll gain a clearer picture of where your salary goes if you begin with gross income.

From your gross pay, simply subtract the cost of the "jobs" assigned to each and every dollar. Let's suppose, for example, that your gross monthly income is $6,000. If you tithe on your gross, begin by assigning $600 for your tithe. Then account for the total amount of tax-related withholding (you can find this figure on your pay stub), along with any amount you're contributing to an employer-sponsored retirement plant.

In this example, let's assume that what you have remaining at this point (after tithe, taxes, and retirement contribution) is $3,500. Continue to work toward zero as you give each dollar a job. Subtract $1,000 for a house payment, for instance, $350 for groceries, $300 for savings, etc.—using the dollar amounts that fit your situation.

The "bottom line" goal of this planning process is to reach zero—i.e., for *your outgo to equal your income*—with all categories funded and nothing left over. If you haven't given each dollar a job, you haven't finished setting up your budget. You Need a Budget, EveryDollar, and Tiller will urge you to keep planning until every single dollar has a task. (Of course, if you have more tasks assigned than dollars to fulfill them, these systems will alert you to that fact as well.) Once every dollar has a job, *your* job is to follow through, making sure your dollars carry out the tasks you assigned in advance.

Of course, life happens. There will be months when you encounter unusual expenses, such as an (continued on page 29)



"Dashboards" from You Need a Budget (top) and Tiller, each showing that some dollars have yet to be allocated. Tiller also notes that two new transactions need to be categorized.

[1]Tiller can be set up to use either zero-sum budgeting or a different approach. [2]You Need a Budget applies the "every dollar" principle to *all* money at your disposal, including funds already in checking and savings accounts. Other systems apply the zero-sum approach only to monthly income.

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

AFTER JANUARY REBOUND, WHAT'S THE MARKET'S CURRENT STATUS?

On the following page, you'll find a recap of 2018's wild fourth quarter, when the stock market's selling climax came within a hair's breadth of plunging into "official" bear-market territory. But following reassurance from the Fed chairman on January 4, stocks rallied strongly, producing the strongest January start since 1987.[1]

What should we think about the market at this point, given the unusually sharp decline and rebound we've just seen?

High valuations = high risk

Let's quickly review why SMI thinks investors should be cautious toward stocks at this point in the market cycle. After a nearly 10-year bull market that began in March of 2009, valuations are stretched to historically extreme levels. Even after the late-2018 correction reduced stock prices considerably, four valuation methods with solid track records now project stock returns to barely exceed zero over the next decade (and likely be negative after adjusting for inflation).[2] Lest anyone dismiss that as unrealistically pessimistic, consider the S&P 500's total return over the 2000-2009 decade was -0.95% annualized. It's not unreasonable that history could repeat, or at least come close.

It's important to note that there are a nearly infinite number of paths the market could take to reach that type of meager future return. For example, the market could return 0-1% every year for 10 straight years. But the pattern the market has followed in recent decades has been "big boom, big bust."

The 1990s saw the dot-com bubble, followed by a -50% bear market (2000-2002). The real-estate bubble followed, ending in another -50% bear market (2007-2009). Since then we've had a decade-long stock boom—so it's reasonable to suspect that a third significant bear market could follow.

This path seems even more likely when considering the *source* of the past two boom/bust cycles—Federal Reserve policy. Over the past decade, the Fed has pushed monetary policy to even greater extremes than before. So it seems unlikely that the end result of this third trip through the boom/bust cycle will be milder than the last two.

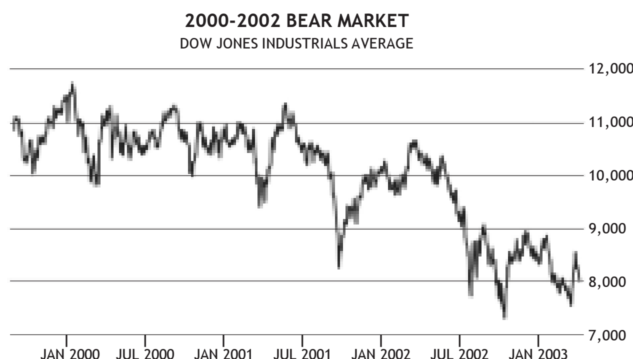
That's the backdrop against which SMI's defensive systems currently are flashing warning lights.

Bear markets don't follow direct paths

If the recent decline is the beginning of an eventual bear market, we shouldn't expect stocks to simply keep dropping until they reach its eventual bottom. On the contrary, bear markets are notorious for containing sharp *rallies* that tempt investors into thinking the worst is over. Consider that *the 10 best single-day market gains have all taken place during bear markets*.

Take a moment to study the chart below. The bear market of 2000-2002 delivered at least six unique "V-shaped bottoms" (plus an extra one in March 2003, after the "official" bottom was in). Investors' hopes rose along with the market on each rebound, only to eventually be dashed anew.

2000-2002 BEAR MARKET
DOW JONES INDUSTRIALS AVERAGE



Follow the system

While stocks have rebounded in 2019, it's impossible to yet determine whether this episode has merely been a sharp correction that is now behind us, or if the market is in the early stages of a bear market. Both possibilities are plausible given the available data.

This type of uncertainty is *perfectly normal* after a sharp market decline. The SMI strategies were designed with periods like this in mind. Consider that both the 1998 correction and the start of the 2000 bear market looked similar to what we've seen in recent months. One *wasn't* a deep bear market, the other *was*. SMI's strategy models can safely navigate today's uncertain conditions precisely because history has provided us with similar past examples to practice on!

Of course, this doesn't mean we'll be on the right side of every market wiggle. But we can trust the system to gradually shift our risk exposure up or down as conditions warrant. Dynamic Asset Allocation has been working through this process since last summer. Upgrading 2.0 is taking small additional steps this month to further reduce our stock exposure (see page 28).

We can rely on these systems to guide us through the resolution of this market episode, whatever it ends up being. Expecting to be on the right side of every market up/down move is unrealistic. But we *can* expect these signals to get us safely to the other side of the eventual bear market—whenever it arrives—where much better investment opportunities will once again present themselves. ◆

[1]We discussed these events on the SMI website in real time—don't forget to check for current analysis throughout the month. Online access is included with your SMI membership! [2]on.mktw.net/2RawNRx

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

4TH QUARTER REPORT: MARKET WEAKNESS TRIGGERS DEFENSIVE ACTIONS

The stock market's fourth quarter correction started innocently enough, but by the end of December investors were bracing for the worst.

After setting an all-time high on September 20, stocks fell close to the "official" correction level of -10% in October, only to rebound sharply. A similar dynamic resumed in November, with losses finally cracking the -10% threshold the day after Thanksgiving, followed by another rally through the end of the month. So despite two relatively sharp declines, the S&P 500 entered December only -5.5% off its high.

Then the trap door swung open. Through December 26, stocks fell nearly 15% further, with the S&P 500 coming within just 2 points of crossing into bear-market territory (-20%). Fear was palpable and the classic rotation out of stocks and into Treasury bonds boosted Treasury prices while slashing their yields.

The depth of December's decline was sufficient to trigger the first phase of Upgrading 2.0's defensive protocols.[1] Dynamic Asset Allocation had already exited Foreign Stocks last summer, so its one-third allocation to cash substantially reduced its fourth quarter losses.

Corrections and bear markets are notoriously tricky to navigate as they unfold. Sharp rallies are interspersed amongst the selling, providing just enough hope to keep investors engaged. Each time stocks bounce sharply higher, investors hope that the worst is over.

2018 PERFORMANCE OF SMI'S RECOMMENDED STOCK UPGRADING FUNDS BY RISK CATEGORY

Risk Category		SMI[1] Funds	All[2] Funds
Cat 5:	Foreign Stock Funds	-14.6%	-16.8%
Cat 4:	Small Company/Growth	-4.8%	-5.8%
Cat 3:	Small Company/Value	-13.6%	-15.5%
Cat 2:	Large Company/Growth	1.6%	-2.1%
Cat 1:	Large Company/Value	-7.9%	-8.5%

FOOTNOTES: [1] Average of the three recommended funds for each risk category (page 26), assuming any suggested changes were made on the last trading day of each month. [2] An average of all the mutual funds in the SMI risk category shown, including both load and no-load funds.

Historically, almost all of the stock market's strongest days have occurred during bear markets and corrections!

This is one reason why SMI feels so strongly about having a *process* that objectively monitors the market's trend as it unfolds. We're willing to be a little late calling the end of a correction or bear market if that means avoiding being tricked into thinking the bottom is in multiple times along the downward slope. It also frees us from the emotional battle of the daily ups and downs, since we know the system will act when market weakness has become a threat.

There's no way to know at this point how the current downturn will resolve. In 2011, the S&P 500 fell -19.4% without triggering a bear market. That's comparable to the -19.8% peak-to-trough drop we witnessed last quarter. So it's possible this correction resolves rapidly, but there's no way to rule out a deeper bear market either.

If this does end up *(continued on page 29)*

A HISTORICAL LOOK AT THE PERFORMANCE OF SMI MODEL PORTFOLIOS

	U.S. Stocks	SMI Basic Strategies			SMI Premium Strategies		
	Wilshire 5000	Just-the Basics[1]	Stock Fund Upgrading[2]	Bond Fund Upgrading[3]	DAA	Sector Rotation	50-40-10 Portfolio[4]
2018	-5.3%	-8.4%	-7.9%	-0.5%	-4.5%	-15.8%	-7.0%
2017	21.0%	21.4%	18.1%	2.3%	16.0%	56.7%	20.9%
2016	13.4%	12.3%	10.4%	3.6%	–0.5%	16.8%	5.6%
2015	0.7%	–1.6%	0.6%	–1.7%	–6.8%	–9.7%	–4.1%
2014	12.7%	7.5%	5.1%	8.4%[H]	13.0%	49.9%	13.6%
2013	33.1%	31.2%	34.5%	1.1%[H]	16.2%	65.7%	28.4%
2012	16.1%	17.6%	14.1%	4.6%[H]	13.9%[H]	23.3%	14.9%[H]
2011	1.0%	–3.4%	–5.4%	6.5%[H]	1.4%[H]	–3.2%	–1.8%[H]
2010	17.2%	20.0%	17.8%	17.9%[H]	20.3%[H]	9.1%	18.2%[H]
2009	28.3%	33.9%	33.6%	13.5%[H]	17.6%[H]	30.5%	25.3%[H]
2008	–37.2%	–39.3%	–38.8%	6.6%[H]	1.3%[H]	–31.5%	–18.0%[H]
2007	5.6%	7.1%	14.3%	8.4%[H]	10.1%[H]	28.1%	13.5%[H]
2006	15.8%	17.2%	17.4%	7.6%[H]	25.7%[H]	–1.9%	19.6%[H]
2005	6.4%	9.0%	12.0%	2.0%[H]	8.6%[H]	46.1%	13.7%[H]
2004	12.5%	15.6%	17.3%	6.3%[H]	19.3%[H]	12.6%	17.9%[H]
Past 15 Years (Total Gain)	217.4%	203.4%	213.0%	128.0%	300.3%	731.3%	314.1%
Dollar Profits on $100,000[5]	$217,392	$203,438	$213,039	$127,968	$300,317	$731,333	$314,133
Annualized Rate of Return	8.0%	7.7%	7.9%	5.6%	9.7%	15.2%	9.9%

Footnotes

Results for all SMI strategies assume all transactions were made on the last trading day of the month. Transaction costs are not included because they vary from broker to broker. **[1]** Results assume the account was rebalanced at the beginning of each year with 40% of the stock allocation invested in the S&P 500 (VFIAX), 40% in Extended Market (VEXAX), and 20% in Total International Stock (VTIAX). **[2]** For a 100% stock portfolio. **[3]** For a 100% bond portfolio. **[4]** For a portfolio allocated 50% to DAA, 40% to Stock Fund Upgrading, and 10% to Sector Rotation. See the April 2018 cover article for details. **[5]** The dollar results show the amount of profits in an account with a $100,000 balance at the beginning of 2004. Results for 15 years are shown rather than the typical 10 years to provide better insight into the return comparisons of various strategies in the years leading up to the last bear market. These seem particularly relevant in view of the present market action. **[H]** Results are hypothetical from backtesting a strategy following a mechanical rules-based system.

[1] Jan2019:p2

LEVEL 4 FOUR

Looking Toward Retirement

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

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

AN OUNCE OF PREVENTION: FREE PREVENTIVE SERVICES FROM MEDICARE

People age 65 years or older account for more than half of all flu-related hospitalizations in the U.S., as well as most flu-related deaths. In many instances, these cases of influenza could have been prevented by simply taking advantage of a benefit offered by Medicare: a flu shot provided at no cost to the recipient.

The federal health-insurance program for people 65 and up pays the full tab for such shots, as well as nearly 20 other screenings and preventive services, including yearly "wellness" exams. And yet millions of people eligible for such benefits—including about a third of people who could get a free flu shot—don't take advantage of them.

Researchers are uncertain as to why so many Medicare beneficiaries forgo these free benefits. Lack of awareness is surely one reason, but likely there are others, including the fact that free screenings often lead to *non*-free treatment. A 2017 study published in the *Journal of the American Medical Association* found that in 44 percent of cases, patients who went in for a free annual checkup ended up being billed—because of deductibles and copayments—for follow-up tests or services.

However, not taking advantage of a free screening because it might lead to other costs is short-sighted. Such costs likely would be incurred eventually anyway—and perhaps would become more expensive due to an untreated condition or ailment remaining undiagnosed for too long. Medical issues identified during preventive care are typically the easiest and least expensive to treat.

Services covered

Medicare's free benefits begin with a "Welcome to Medicare" exam for newcomers to Medicare Part B, the program's *medical* insurance component (Part A is *hospital* insurance). This initial doctor's visit includes a review of one's medical history, measurements of weight and blood pressure, a vision test, and certain shots and screenings. Thereafter, a Medicare beneficiary is eligible for an annual wellness exam that is also covered in full.

Many of the other preventive services covered in full by Medicare are listed below.[1] Note that some of these services require the beneficiary to meet certain eligibility requirements.

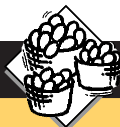
- **Bone mass measurement:** Covered every two years (or more often if medically necessary) for those at risk for osteoporosis.
- **Breast cancer screening/mammogram:** Breast cancer is the second leading cause of cancer deaths among women in the U.S. If found early, it can be treated successfully in most cases. These screening services are covered for women once a year.
- **Cardiovascular heart disease screening:** Available once a year to determine risk. If a person's risk is elevated, Medicare covers a related blood test.
- **Cervical and vaginal cancer screening:** Covered every two years, or once a year for high-risk patients.
- **Colorectal cancer screening:** This is the fourth most common cancer in the U.S.—and risk increases with age. A screening is covered once a year. Related: A flexible sigmoidoscopy is covered every four years and a colonoscopy every 10 years (or every two years for those at high risk).
- **Depression screening:** An estimated two million Americans over age 65 suffer from depression, including many recent widows/widowers. This screening is covered yearly.
- **Diabetes screening:** Covered up to twice a year for those with high blood pressure, abnormal cholesterol and triglyceride levels, or history of high blood sugar.
- **EKG heart screening:** Covered any time recommended by your doctor.
- **Flu shot:** Covered fall and winter.
- **Hepatitis B shots:** Fully covered for people at medium to high risk if the shots are recommended by a doctor.
- **Hepatitis C screening:** Covered one time only for people at normal risk, annually for people at high risk.
- **Laboratory services:** Blood tests and urinalysis are covered whenever ordered by your doctor.
- **Lung cancer screening:** Lung cancer is the leading cause of cancer deaths in the U.S. This screening is covered annually (through age 77) for people with a history of smoking but with no symptoms yet of lung cancer.
- **Obesity screening:** Nearly a third of people on Medicare are estimated to be obese. Obesity screening is covered once a year, with follow-up counseling covered for those who screen positive.
- **Pneumonia shots:** Pneumococcal disease, which can cause pneumonia, meningitis, and bloodstream infection, can be deadly. Shot is covered one time (one is all that is needed in most cases).
- **Prostate cancer screening:** Prostate cancer is the most common cancer among American men, and the average age at the time of diagnosis is 66. This screening is covered annually.

Avoiding costs, protecting your health

As long as your doctor/healthcare provider accepts the Medicare-approved amount as full payment, you'll incur no cost to receive any of the services listed above—i.e., there will be no deductible or copayment. These services are also fully covered under Medicare Advantage plans, as long as you select an in-network provider.

As the old proverb says, "An ounce of prevention is worth a pound of cure." In this case, taking advantage of Medicare's "ounce" of prevention may not only help you avoid a "pound" of future medical expenses, it may also prolong your life. ◆

[1]For a complete list, go to www.medicare.gov/coverage/preventive-screening-services



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 12/31/2018	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	Foreign stocks	-37.3	-14.4%	-4.8%	-11.7%	-11.2%	-14.4%	4.5%	1.03	0.11%	20%	16%	12%	8%	VTIAX/VXUS
Extended Market Index	Small company stocks	-42.2	-9.4%	-10.7%	-18.2%	-14.6%	-9.4%	7.5%	1.30	0.08%	40%	32%	24%	16%	VEXAX/VXF
S&P 500 Index	Large company stocks	-24.8	-4.4%	-9.0%	-13.5%	-6.9%	-4.4%	9.2%	1.00	0.04%	40%	32%	24%	16%	VFIAX/VOO
Total Bond Mkt Index	Medium-term bonds	3.2	0.0%	1.8%	1.6%	1.6%	0.0%	2.0%	1.00	0.05%	None	20%	40%	60%	VBTLX/BND

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 traditional mutual funds (or ETFs) depending on your stock/bond mix. For more on JtB, see Jan2019:p7-8.

RECOMMENDED FUNDS FOR SMI'S FUND UPGRADING STRATEGY

Risk	Data through 12/31/2018[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. Cash	01/19	See Jan2019:p2														
	2. ☎ Cash	02/19	See Feb2019:p28														
	3. Lazard Glob Infrastructure	11/18	NTF	NTF	NTF	-12.4	-4.0%	-3.4%	-4.2%	-4.3%	-4.0%	8.0%	0.83	1.22	34	None	GLFOX
Category 4 Small/Growth	1. Cash	01/19	See Jan2019:p2														
	2. Value Line MidCap Focus	12/18	NTF	NTF	NTF	-7.7	4.7%	-7.5%	-11.4%	-1.1%	4.7%	11.7%	1.00	1.18	35	None	VLIFX
	3. Baron Opportunity	03/18	NTF	NTF	NTF	-18.6	8.1%	-8.9%	-16.6%	-10.0%	8.1%	13.1%	1.50	1.41	60	None	BIOPX
Category 3 Small/Value	1. Cash	01/19	See Jan2019:p2														
	2. Merger Fund	12/18	NTF	NTF	NTF	11.4	7.7%	0.6%	1.9%	1.8%	7.7%	4.2%	0.26	1.91	192	None	MERFX
	3. InvescoS&PMidCapLow Vol	12/18	ETF	ETF	ETF	-12.5	-0.1%	-7.8%	-7.9%	-4.4%	-0.1%	11.4%	0.92	0.25	81	None	XMLV
Category 2 Large/Growth	1. MS Multi Cap Gro - LW[10]	05/18	NTF	NTF	NTF	-11.7	12.1%	-8.7%	-15.9%	-7.9%	12.1%	16.8%	1.59	1.24	43	None	CPOAX
	2. Polen Growth Investor	10/18	NTF	NTF	NTF	-9.3	7.5%	-7.1%	-12.8%	-4.0%	7.5%	10.9%	1.08	1.25	22	2%60days	POLRX
	3. iShares Edge MSCI Min Vol	12/18	ETF	ETF	ETF	-6.6	1.4%	-6.7%	-7.6%	-0.4%	1.4%	10.1%	0.83	0.15	218	None	USMV
Category 1 Large/Value	1. Cash	01/19	See Jan2019:p2														
	2. ☎ Cash	02/19	See Feb2019:p28														
	3. Invesco S&P 500 Low Vol	12/18	ETF	ETF	ETF	-6.0	-0.2%	-6.8%	-5.3%	-0.5%	-0.2%	8.8%	0.84	0.25	102	None	SPLV
Bond Categories	☎ Vanguard I-T Bond[6]	02/19	ETF	ETF	ETF	4.0	-0.2%	2.0%	2.0%	2.2%	-0.2%	2.1%	1.23	0.07	6.2[7]	None	BIV[8]
	Permanent: Vanguard I-T Bond	Perm	ETF	ETF	ETF	4.0	-0.2%	2.0%	2.0%	2.2%	-0.2%	2.1%	1.23	0.07	6.2[7]	None	BIV[8]
	Permanent: Vanguard S-T Bond	Perm	ETF	ETF	ETF	4.5	1.3%	1.0%	1.4%	1.7%	1.3%	1.3%	0.46	0.07	2.7[7]	None	BSV[9]

Upgrading Footnotes: [1] The funds in each risk category are selected (and ranked 1 through 3) primarily based on their momentum scores in late January, 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 this issue's cover article. **[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 Nov2018:p167. **[8]** Those preferring a traditional mutual-fund option can buy VBILX. **[9]** Those preferring a traditional mutual-fund option can buy VBIRX. **[10]** 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 (March2018: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.

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 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 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] Cash is currently recommended in multiple categories. See Jan2019:p2 for a discussion of holding cash in an Upgrading 2.0 portfolio.

After making decisions 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 position in the same risk category that is available at your broker.

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

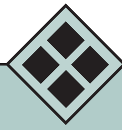
Example uses an 80/20 mix between stocks and bonds		Dollars	Invest In Funds
Stock Cat. 5: Foreign	16%	$8,000	Cash* or Lazard
Stock Cat. 4: Small/Growth	16%	$8,000	Cash* or Value Line
Stock Cat. 3: Small/Value	16%	$8,000	Cash* or Merger Fund
Stock Cat. 2: Large/Growth	16%	$8,000	MS Multi Cap Growth
Stock Cat. 1: Large/Value	16%	$8,000	Cash* or Invesco S&P Low Vol
"Rotating" Bond Fund	10%	$5,000	Vanguard I.T. Bond Index
Intermediate-Term Bond Fund	5%	$2,500	Vanguard I.T. Bond Index
Short-Term Bond Fund	5%	$2,500	Vanguard S.T. Bond Index
Total	100%	$50,000	

*See Jan2019:p2 for thoughts on implementing Upgrading 2.0 cash decisions.

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.]

As this month's Level 2 column explains, the stock market's January rebound has muddied the waters regarding its immediate prospects. On the one hand, the January rally has erased roughly half of the fourth-quarter downturn. It's possible that the correction is over and the market will keep rising from here. But it's also plausible that this bounce is just a temporary interruption in a longer decline. Upgrading 2.0 has mechanical guidelines to steer us through periods such as this, but sometimes they require us to make uncomfortable decisions when shorter- and longer-term trends appear to be in conflict.

It's important to recognize that in these periods, it's not a matter of the system trying to *predict* which trend will win out, but rather trying to adjust our risk exposure given how the market is currently behaving. To that end, we're shifting two more slots to cash this month, which bumps Upgrading's cash allocation from 27% to 40%. Naturally, if the market rises from here, these sales won't look good. But it's an appropriate risk-management move at this point in the market's cycle.

◆ **In the Foreign group, Invesco Dividend Achievers ETF (PID, 11/2018) is being replaced.** This ETF has bounced back strongly from the market's lows in late December, with a +10.8% gain over the past month. Since we bought it three months ago, PID is up roughly +4.3%. These performance numbers would be sufficient to keep PID ranked well above the quartile within the Foreign group. However, once Upgrading 2.0's defensive protocols turned on at the end of December, the system has become more focused on the intermediate and longer-term trends of the various funds and risk categories. Given that foreign stocks started sliding much earlier than U.S. stocks, their negative trend is more firmly established. Said differently, PID's excellent performance over the past month isn't enough to outweigh the 11 months of weakness from foreign stocks that preceded it. So we're selling and shifting the proceeds to cash.

◆ **In the Large/Value group, Pear Tree Quality (USBOX, 9/2018) is being replaced.** Pear Tree has slid down the large/value rankings as stocks have rebounded over the last month, which makes this an easier sell decision than the Invesco ETF above. Pear Tree has had a solid bounce of +10.1% over the last month, but still has negative returns over the past 3-, 6-, and 12-month intervals. Upgrading 2.0's focus on the absolute performance trends of each specific fund means these negative returns over the longer time intervals are a signal to sell and reduce risk. ◆

BOND UPGRADING — NEW FUND RECOMMENDATION

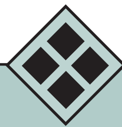
[The SMI Bond Upgrading strategy debuted at the beginning of 2015. *This approach involves investing half of the bond portfolio in two "core" funds which do not change*. These two funds provide stability to the portfolio. The other half of the bond portfolio is invested in a single upgrading recommendation. This is the selection being updated this month. For more details about how the SMI Bond Upgrading strategy works, see Jan2015:p7.]

◆ **Vanguard Short-Term Bond Index (BSV/VBIRX, 11/2018) is being replaced.** This fund has earned a healthy +1.57% over the past three months—largely due to the flight-to-safety response of investors during December's dramatic stock-market decline. As typically happens in such scenarios, nervous *stock sellers* become *bond buyers*, bidding up prices and pushing yields lower. That said, it's a testament to today's higher yields (relative to a year or two ago) that the fund still has earned a positive return so far in January (+0.18% through January 25), despite bond yields drifting slightly higher. With short-term bonds yielding more than 2.5% now, there's more interest income to offset principal fluctuation brought on by changes in interest rates.

• **Vanguard Intermediate-Term Bond Index (BIV/VBILX) is being added.**[1] Given that short-term bonds got a bump in returns from declining interest rates, it's not surprising that bonds with longer maturities got an even greater boost. While BSV (short-term bonds) is up +1.57% over the past three months, BIV (intermediate-term bonds) is up nearly twice that at +3.04%, including +0.55% through January 25. It's a bit surprising to see such a gap in returns, given the flatness of the yield curve means the 5-10-year-maturity bonds in the IT portfolio aren't yielding much more than the 2-3-year-maturity bonds in the ST portfolio. But it makes sense that our Upgrading holding is shifting back to IT bonds, as intermediate bonds have long been considered the "sweet spot" of risk/return in the bond market. With bond yields finally climbing back toward more historically normal levels, this dynamic appears to be reasserting itself.

Note that SMI's Bond Upgrading strategy *always* invests 25% of the total bond allocation in the Vanguard Short-Term Bond Index, as well as 25% in the Vanguard Intermediate-Term Index. This month we're shifting the additional 50% Upgrading allocation from BSV to BIV. So Bond Upgraders will continue to own just two holdings after this change rather than the typical three, but 75% of the total portfolio will now be allocated to Vanguard Intermediate-Term Bond Index, while Vanguard Short-Term Index will revert back to its typical 25% allocation. ◆

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



MONEYTALK

LEVEL 1 / CONTINUED FROM PAGE 22:

ZERO-SUM BUDGETING: GIVING EVERY DOLLAR A JOB

automotive repair that exceeds the money you have on hand for that category. When that happens, you must shift money from other spending or savings categories, i.e., assigning some dollars different jobs than originally intended.

On the other hand, if you end up with *unused* money in a category at the end of the month—let's say you budgeted $100 for clothing expenses but spent only $75—you have two options. You can "roll over" the remaining $25 to that same category for following month (giving you a total of $125 for clothing expenses), or you can assign those 25 dollars a different job—such as helping to fund a savings goal.

Periodic expenses

To be effective, of course, a budget must not only account for *monthly* expenses but also anticipate bills that come due only every so often. Auto insurance, for example, may be billed every six months. Life-insurance premiums typically are due every 12 months. The annual cost of Christmas gift-giving should be planned for as well.

In a zero-sum budget, you prepare for such periodic expenses by assigning some dollars *future* tasks. If your twice-a-year auto premium is $600, then $100 of your "monthly" money would be given the job of paying car insurance—but that money would "wait" (ideally by being transferred to a savings account or money-market fund) until the bill comes due.

Keeping things hands-on

One reason the old-fashioned envelope method works is that it is "hands on." Each time you spend from an envelope, a reminder of your budgetary intentions and the evidence of your spending is literally in your hands, rather than simply being an entry in a computer.

Both EveryDollar and Tiller try to retain some of that hands-on sensibility by *not* automatically categorizing your spending transactions. By design, each system requires you to assign each transaction to a particular category yourself. You Need a Budget is similar in this regard—and for the same reasons—but it *will* auto-categorize repeating transactions, such as a mortgage payment.

Budgeting/tracking systems such as Mint are less rigorous than systems that use the zero-sum approach. Mint certainly can help you match expenses to income, but doesn't go to the granular level of requiring you to give every dollar a job ahead of time.

A less-stringent system is fine for people who are disciplined enough—and have enough financial margin—that they don't need to "sweat the details" required by the zero-sum budgeting approach. However, for people just starting out with a budget, or those still trying to control their spending and stop living paycheck-to-paycheck, the zero-sum approach may be just what is needed. Such an approach fosters careful planning, encourages regular interaction from the user, and helps assure that funds are available in each spending category, not only month-by-month but in the months and years to come. ◆

LEVEL 3 / CONTINUED FROM PAGE 24:

4TH QUARTER REPORT: MARKET WEAKNESS TRIGGERS DEFENSIVE ACTIONS

being a relatively quick "V-shaped" correction, our defensive posture may cost us a bit. But this is where a long-term perspective is crucial. Looking back at this period a decade from now, if we give up a few percentage points in gains by temporarily being defensive, it won't even be a noticeable blip in our total returns. On the other hand, *not* being defensively-oriented in the face of another potential -50% bear market would be a much harder blow to overcome.

Just-the-Basics (JtB) & Stock Upgrading

The Wilshire 5000 index was down a total of -14.3% during the fourth quarter, a result dominated by the perfor-

MARKET NOTES, QUOTES, AND ANECDOTES

How to navigate a bumpy market

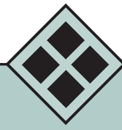
"While no one ever knows for sure how long the volatility will stay with us, it's important to remember that your actions aren't nearly as important as your reactions during a bear market." – Ben Carlson, in a 12/27/18 post on his *A Wealth of Common Sense* blog, reminding readers that during times of market stress it's especially important to be proactive in following your long-term strategy rather than reacting to big short-term market moves. Read more at bit.ly/2DE60tc.

An impossible task

"Forecasting: the attempt to predict the unknowable by measuring the irrelevant; this task employs most people on Wall Street." – *Wall Street Journal* columnist Jason Zweig, one of several financial writers quoted by the *Irish Times* in a 1/15/19 article about the folly of stock market forecasting. Read more at bit.ly/2SfmTm4.

"In the house of the wise…"

"It has been a staple of common-sense morality for centuries that people ought to save for an uncertain future. It would be a shame if such talk is on the verge of becoming politically incorrect because it sounds too much like blaming the victim." – *Bloomberg* columnist Tyler Cowen, in an article about a key lesson to be taken from the recent federal government shutdown, during which there were news reports of furloughed workers heading to food banks because of a single missed paycheck. He argued that today's narrative that the high costs of housing and medical care make it impossible to save has been too readily accepted. Read more at bloom.bg/2FWst7a.



MONEYTALK

mance of the market's largest stocks. The Russell 2000 index fell -20.2%, as small-company stocks fared substantially worse. Foreign shares, which experienced a downturn earlier in the year, had slightly better returns than U.S. Stocks (see DAA table). While larger stocks held up better, the late-year correction still pushed both the Wilshire 5000 and S&P 500 indexes into their first losing year since 2008.

JtB and Stock Upgrading had slightly larger losses than the broad market indexes in the 4th quarter as a result of their greater exposure to smaller stocks. JtB lost -15.1% during the quarter, while Stock Upgrading fell -16.3%.

It can be discouraging seeing these strategies trail the indexes, as they have since 2014, especially when buying an S&P 500 index fund is so easy. At times like this, it's important to evaluate whether our *process* is still working. The small table on page 24 details the risk-category performance of Upgrading vs. the average fund's return in each peer group. It shows that last year the Upgrading process was superior to owning the average fund *in all five risk categories*.

From that, we can clearly see that the Upgrading *process* still worked last year. The question, then, is whether it's still wise to own a diversified portfolio that includes small-company and foreign stocks? Long-time readers will surely recall periods when the performance streaks ran the other way and large stocks lagged these other types badly. SMI still believes diversification is a valuable principle and the prudent way to build portfolios, even when recent results have favored a more concentrated (i.e., S&P 500) portfolio.

Bond Upgrading

After years of weak returns, investors were reminded last quarter why bonds remain valuable even when interest rates are low. As stocks plummeted, investors followed the typical panic playbook by fleeing to the safety of bonds. The 10-year Treasury yield, which had peaked at 3.24% in early November, was pushed all the way down to 2.72% by late December. As always, when rates go down, bond values go up. So while stocks were falling -14.3% during the fourth quarter, Bond Upgrading was up +0.8% despite rates rising during the first half of the quarter. Granted, interest rates remain at historically low levels, so bond returns aren't likely to be exciting any time soon. But the portfolio ballast they provide during stock-market panics still warrants their inclusion in most portfolios.

Dynamic Asset Allocation (DAA)

DAA showed off its potential during the fourth quarter. It didn't have *great* absolute performance, down -6.5% for the quarter. That's not surprising, given DAA started the quarter still positioned for growth, as one would expect a mere 10 days following a new all-time stock market high. But as previously noted, DAA picked up on the weakness in Foreign Stocks earlier in the summer and sold them at that point, switching one-third of the portfolio over to cash. That cash position, plus the fact that Real Estate fell much less than stocks, held DAA's losses (-6.5%) far below those suffered by the stock market (-14.3%) during the quarter (see page 32).

The fourth quarter also provided an example of how quickly DAA can make up performance deficits relative to the market when stocks decline. Entering the fourth quarter, DAA's year-to-date 2018 performance trailed the Wilshire 5000 by a wide margin, +10.5% vs. +2.1%. By the end of the quarter, DAA had claimed the performance lead, finishing +0.8% ahead of stocks for the year. It's a powerful reminder of the way DAA produced a market-beating track record over the 35+ years of our back-testing. And of course, the peace of mind dividend enjoyed by DAA investors during the fourth quarter was significant!

4TH QUARTER 2018 DAA ETF UNIVERSE

Ticker & Category	4Q Result
SPY U.S. Stocks	-13.5%
EFA Foreign Stocks	-12.6%
VNQ Real Estate	-6.5%
BLV Long-Term Bonds	+1.4%
SHY Money Market	+1.3%
GLD Gold	+7.5%

Sector Rotation (SR)

"The bigger they are, the harder they fall," goes the old boxing maxim. And none has been bigger than SR during this bull market. But the first half of SR's high-risk, high-reward profile was certainly validated last quarter, as SR fell -23.4%. That's not out of character for SR, which has recorded three-month declines of -37.9% and -36.2% during the past two bear markets. But it still stings! If there's any consolation, it's that SR remains up +19.4% annualized over the past 10 years, even after this tough quarter, for a +487% total gain.

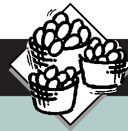
50/40/10

This portfolio refers to the specific blend of SMI strategies—50% DAA, 40% Upgrading, 10% Sector Rotation—discussed in our April 2018 cover article, *Higher Returns With Less Risk, Re-Examined*. It's a great example of the type of diversified portfolio we encourage most SMI readers to consider.[1]

The fourth quarter was a perfect example of the markets shifting suddenly between rewarding risk-taking and punishing it. Blending higher-risk *and* lower-risk strategies in a portfolio can help smooth your long-term path. Last quarter, that approach limited the losses of a 50-40-10 portfolio to -12.3% (compared to -14.3% for the stock market), despite the fact that Upgrading and DAA didn't turn defensive until the end of the quarter. Knowing that 90% of this portfolio would be expected to vastly outperform an indexed portfolio during any deep market decline has played a significant role in helping many investors stay invested in stocks the past few years as the bull market reached its later stages.

Gathering a large percentage of the market's gains during rising markets while avoiding a significant portion of its losses during bear; markets is a recipe for superior long-term returns—plus it provides the type of emotional stability so important to sustained investing success. ◆

[1]Blending multiple strategies adds complexity. Some members may prefer an automated approach. See September's Private Client announcement (Sep2018:p136) or visit SMIprivateclient.com.



PREMIUM STRATEGIES

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

DYNAMIC ASSET ALLOCATION

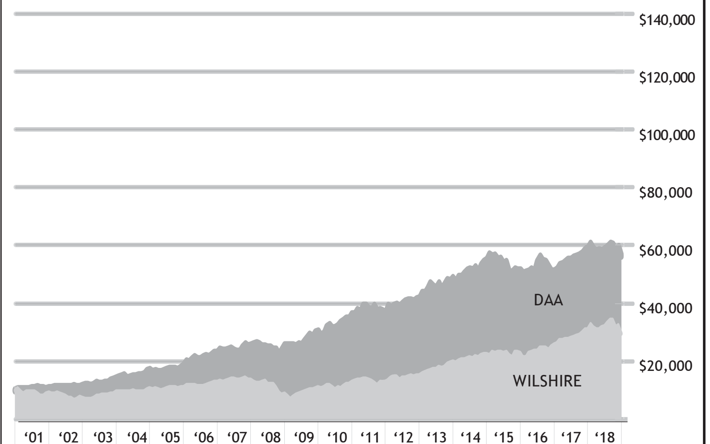
Overview

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

Who Should Consider This Strategy

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

Dynamic Asset Allocation vs Wilshire 5000
Growth of $10,000 Jan 2001 - Dec 2018



Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Avg[1]	Worst[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%	-4.5%	9.9%	-13.7%	0.62
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%	-5.3%	5.2%	-43.3%	1.00

SECTOR ROTATION

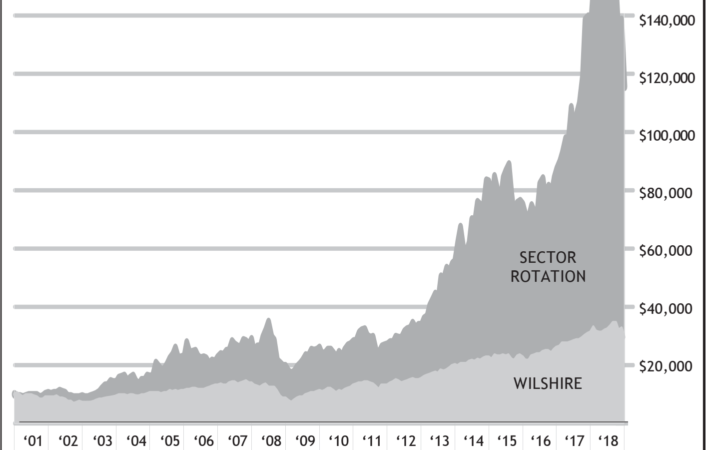
Overview

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 $10,000 Jan 2001 - Dec 2018



Strategy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Avg[1]	Worst[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%	-15.8%	15.7%	-38.6%	1.85
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%	-5.3%	5.2%	-43.3%	1.00

[1]The three data points on the far right in each of the two tables are for the Jan2001-Dec2018 period. "Avg" represents the average annualized return from 2001-2018. "Worst" represents the worst investor experience over 205 rolling 12-month periods from 2001-2018.

PERIODICALS POSTAGE
PAID AT LOUISVILLE, KENTUCKY

Dated Investment Material
Please Do Not Delay!

PERFORMANCE DATA

SOUND MIND INVESTING MODEL PORTFOLIOS • DATA THROUGH DECEMBER 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]	-5.3%	-9.3%	-14.3%	-5.3%	9.1%	8.1%	13.2%	8.0%
Just-the-Basics[2]	-8.4%	-8.9%	-15.1%	-8.4%	7.7%	5.7%	12.2%	7.7%
Stock Upgrading[3]	-7.9%	-8.1%	-16.3%	-7.9%	6.3%	4.9%	11.2%	7.9%
U.S. Bond Market[4]	-0.1%	1.8%	1.6%	-0.1%	1.9%	2.4%	3.3%	3.7%
Bond Upgrading[5]	-0.5%	1.2%	0.8%	-0.5%	1.8%	2.4%	5.4%	5.6%

PREMIUM STRATEGIES

	Year to Date	1 Month	3 Months	12 Months	3 Yrs Annual	5 Yrs Annual	10 Yrs Annual	15 Yrs Annual
DAA[6]	-4.5%	-5.4%	-6.5%	-4.5%	3.3%	3.0%	8.2%	9.7%
Sector Rotation	-15.8%	-16.6%	-23.4%	-15.8%	15.5%	15.9%	19.4%	15.2%
50-40-10 Blend[7]	-7.0%	-7.6%	-12.3%	-7.0%	5.9%	5.3%	10.7%	9.9%

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] 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 12/31/2018	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	-8.70%	-8.78%	-18.69%	-8.70%	4.89%	3.10%	9.87%
Wilshire 5000	-5.26%	-9.30%	-14.29%	-5.26%	9.12%	8.08%	13.20%
S&P 500	-4.38%	-9.03%	-13.52%	-4.38%	9.26%	8.49%	13.12%

Quarterly Returns as of 12/31/2018	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
SMIFX	-8.70%	-8.78%	-18.69%	-8.70%	4.89%	3.10%	9.87%
Wilshire 5000	-5.26%	-9.30%	-14.29%	-5.26%	9.12%	8.08%	13.20%
S&P 500	-4.38%	-9.03%	-13.52%	-4.38%	9.26%	8.49%	13.12%

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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