Making Sense of the Annuity Puzzle

“Defined-benefit” pension plans were once common. You could work for a company for 30 years and retire with 60% of your salary—perhaps with inflation increases and healthcare benefits to boot. Today, most employers have shifted to "defined-contribution" plans, such as a 401(k). You contribute over the course of your career, and then try to manage your nest egg well enough later in life to cover expenses. In light of this change, annuities have a strong appeal. Buying an annuity is, in essence, buying a steady pension. Here’s how to determine if one is right for you.

by Matt Bell

Guaranteed income. Those words sound so appealing, so reassuring. With a promise like that, is it any wonder that annuities hold a lot of appeal for retirees and those getting close to retirement age?

But there is more to consider, such as illiquidity, high fees, and complexity. With issues like these, is it any wonder that annuities make many potential buyers skeptical?

Somewhere in between the compelling promise and the cautionary tales lies the truth about annuities.

How annuities work

An annuity is a contract between you and an insurance company. You put money in, either little by little over time or as a lump sum all at once, essentially investing through the insurance company. In exchange, the company gives you the opportunity to annuitize that money—that is, to receive guaranteed income payments for the rest of your life.

Annuities are often thought of as life insurance in reverse. With life insurance, you make a series of premium payments and in return you are promised a lump sum that goes to your heirs when you die. With an annuity, you trade what is often a lump sum in return for a series of monthly checks you receive while you’re alive. Life insurance helps protect against dying too soon. Annuities help protect against living too long.

In most cases, money invested in an annuity goes in after taxes have been paid on it. When you begin receiving income from the annuity in your later years, only the portion of that income resulting from investment gains is taxed as ordinary income.

However, an annuity also can be purchased with pre-tax dollars. Annuities are a common choice within 403(b) plans (for employees of non-profit organizations such as schools, hospitals, and churches). In fact, when 403(b) plans were first introduced, the only choice for participants was an annuity. Since 1974, these plans have been allowed to offer mutual funds, but a significant portion of 403(b) money continues to be invested in annuities.

Under most circumstances, however, it is not a good idea to purchase an annuity within such vehicles. That’s because an annuity already provides tax-deferral on earnings, so there’s no point in holding a tax-deferred

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EDITORIAL

SMI by the Numbers

SMI celebrated a significant anniversary last month, which got me thinking, as the celebration of such milestones often do. Here are a few brief thoughts regarding a few significant numbers related to SMI’s history and the current market situation.

• 30: Amazingly, last month kicked off SMI’s 30th year. Much has changed since Austin published that inaugural July 1990 newsletter. But SMI’s fundamental reason for being hasn’t changed—we still want to be a trusted guide that Christians can rely on to help them navigate the investment maze. And as we travel together, we hope to incline each member’s heart toward ever-greater generosity, helping you have more so you can give more to further the cause of Christ and bring Him glory!

• 20: This is my 20th year working alongside Austin at SMI, as well as the 20th year of SMI offering web memberships. The timing of our web launch seemed terrible at the time, corresponding as it did to almost the exact moment the market peaked in March 2000. But what eventually became clear to us—particularly once we started blogging regularly in 2003—was that members rely on us much more during market downturns than during the good times. Perhaps God could see wisdom in that timing after all!

• 15: In November 2003, SMI’s first Premium/Advanced strategy launched after many months of research. This was the first strategy Austin and I developed together and it’s turned out pretty well! Even after a few recent missteps, Sector Rotation’s annualized return since launch has been +13.5%, while the overall market has earned just +9.2%. That means every $1,000 invested in SR has grown to $7,281 vs. just $3,989 for the market.

• 10: I’ll transition now to market-focused numbers. Earlier this year, both the current economic expansion and the bull market in stocks celebrated their 10th birthdays. That makes the expansion the longest in history, while the bull market ranks among the longest as well. This “10” number has a bittersweet element to it, however, because of the perpetual cycles that drive both the economy and financial markets. While investors have enjoyed the huge gains the markets have delivered over the past 10 years, the length of these recent uptrends is a reminder that recessions always follow expansions and bear markets always follow bulls. There’s no escaping their cyclical nature.

However, SMI hasn’t been idle during this favorable half of the cycle. In 2013, we released our first truly defensive-oriented strategy, Dynamic Asset Allocation. And last year we introduced defensive protocols to our flagship Upgrading strategy. The combination of these new tools make us confident that SMI member portfolios are better prepared to weather an oncoming bear market than ever before.

• 5: The next five years seem likely to be a transitional period along the lines of 2000-2002 or 2007-2009. The question is less whether change will come during the next five years, but what type and how severe will the change be? In hindsight, while the depth of the bull markets referenced above were similar, 2000-2002 was a more “routine” bear than 2007-2009, which revealed significant problems in the financial markets and led to dramatic changes (such as the Central Bank takeover of the markets) in its aftermath. Will the massive global debt buildup of the past decade come to a head as an emerging crisis, or will it be kicked down the road to be dealt with later? Whatever the answer, we’ll be here to help interpret and navigate whatever the markets throw at us.

1: The most important number—one—is you! We’re committed to helping you get whatever degree of assistance you need to succeed financially. For many, that’s “do-it-yourself—with help” through this newsletter, with the relationship looking much as it has for the past 30 years. Many have already built on that by adding a deeper level of personal financial planning via the MoneyGuide Pro® software that has been available to Premium SMI members in recent years.2 And a growing number (nearly 400 households already!) have decided to outsource their investing to the Private Client team at SMI Advisory Services, enjoying a new level of personal service.3

It’s been a great joy spending the past 20 years helping to build out the array of choices now available to SMI members. Whatever level of engagement you decide is best for your current situation, we appreciate your choosing us to walk alongside you on your financial journey!
Making Sense of the Annuity Puzzle

(continued from front page)

savings vehicle within a tax-deferred savings vehicle.

Annuities and risk management

Annuities are designed to address two (possibly three) key financial risks people face as they age. First, there’s the risk of living so long that the money saved for retirement simply runs out. This is called longevity risk. An annuity could pay income for life, no matter how long you live.

As life expectancy has gone up, that “no matter how long you live” benefit can seem especially appealing. The life expectancy for both men and women has increased consistently in recent decades. As can be seen in the nearby table, a man who reaches age 65 has a life expectancy of nearly 18 more years (and a woman more than 20 years).

The research is even more optimistic for couples reaching age 65—there’s a 50% chance that at least one of you will live to age 92.

Many people underestimate the possibility that their lifespan may put them at financial risk. A Society of Actuaries survey of adults age 45 to 80 found that more than half “estimated their personal life expectancy well below actuarial estimates.”

It’s easy to see why the possibility of an unexpectedly long life is referred to as longevity risk. In retirement planning, estimating that you’ll live to 80, but then living to 90, can present a serious financial problem!

The second risk annuities can help mitigate is market risk. Depending on how a person’s nest egg is invested, a stock-market decline could put a serious dent in retirement savings, which would lower retirement income. While an investor continues to bear some market risk with a variable annuity (described later), a fixed annuity removes market risk; the policyholder continues receiving the same amount of income no matter what the market does.

The third risk an annuity may help manage (depending on whether an expensive rider is included) is inflation risk. Annuities with inflation riders provide payouts that rise with inflation. The cost of this option comes in the form of reduced monthly income initially.

The types of annuities

Today’s annuities are available in a wide array of configurations. A good starting point for understanding annuities is to consider the following two key distinctions.

• Immediate vs. deferred. With a single premium immediate annuity (SPIA), a lump sum of money is invested and monthly income payments begin arriving right away. A deferred annuity is funded with either a lump sum or smaller sums invested over time, with the income set to begin at some point in the future. With an immediate annuity, there’s no changing your mind after annuitizing in order to get your money back, but optional payout guarantees can be included. For example, you could add a refund rider that would pay a beneficiary the difference between what was initially contributed and the total sent back out in monthly payments, but this would significantly lower the amount of your monthly income.

With most deferred annuities you can get the premium back, reduced by a hefty surrender fee. In a typical arrangement, a company may charge a 7% early surrender fee that decreases by one percentage point per year. That’s in addition to a 10% penalty the IRS will impose on earnings if money is taken out of an annuity before age 59½.

• Fixed vs. variable. Fixed annuities offer the appeal of knowing how much income is going to be received each month. However, in a low interest-rate environment, payment amounts will be relatively modest. Variable annuities offer different investment options, called sub-accounts, which are similar to mutual funds. The investor is allowed to move in and out of these investment options to a degree. The growth received depends on the performance of the sub-accounts.

While variable annuities offer the potential to earn a better return than what’s offered by fixed annuities, the downside is having to make investment-management decisions and facing the risk of loss due to market fluctuations. (Some variable immediate annuities also offer guaranteed minimums, but they come at the expense of lower income payments.)

Along with the immediate vs. deferred and fixed vs. variable distinctions, two key phases must be understood as well.

The accumulation phase

The accumulation phase, also known as the deferral phase, occurs before the account is annuitized. People younger than 59½ who are trying to save for their later years should think twice before investing in an annuity for the following reasons:

• Transaction costs and fees. Variable deferred annuities, the type usually purchased in the accumulation phase, can be complex and costly. In addition to the management fees paid for the investments within them, many variable deferred annuities charge high administrative fees. And don’t forget about the generous commissions often paid to annuity salespeople—3% to 5% of the purchase price. Those commissions typically come from hefty surrender fees, and they create an inherent conflict of interest; it’s difficult for a salesperson not to be influenced by the prospect of earning as much as $5,000 on the sale of a $100,000 annuity.

• Limited investment choices. Companies that provide variable deferred annuities usually restrict how the investments are managed within the annuity. For example, some do not permit monthly investment changes.

For those still in the wealth accumulation phase of life, there are better options than an annuity, such as the funds available through a workplace retirement plan or an IRA.

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Additional Years of Life Expectancy

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<tr>
<th>Age</th>
<th>Men</th>
<th>Women</th>
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Source: Social Security Administration
Typically, such accounts charge lower fees, offer a wider range of investment choices, and provide easier access to the money should it be needed prior to retirement.

The main reason to consider using an annuity as a wealth-building vehicle is that you have maxed out all other tax-advantaged retirement savings options but still have money to invest, although you could opt to put your additional money in a taxable investment account.

The annuitization, or payout, phase

While an annuity is not the best wealth-accumulation vehicle, a better case can be made for converting a portion of one’s nest egg into a reliable income stream during retirement. At this stage of life, a single-premium immediate fixed annuity is usually going to be the best type to use.

As we discussed, an immediate annuity provides an income stream right away. But it may be beneficial to wait at least a year or two after retiring before buying an immediate annuity. By waiting, you’ll be able to get a better feel for your true cost of living in retirement and see how your health is holding up. Any event or condition that poses a threat to a long life in retirement would make buying an annuity less attractive.

Also, by waiting, the monthly income from an annuity will be greater. The older a person gets, the more the cost of the annuity is driven by mortality tables instead of by interest rates.

How much and for how long?

A person buying an annuity has numerous options that will affect the amount of income received, how long those income payments will continue, and to whom they will be paid.

- **Single Life.** This is the option that will generate the highest possible monthly (or whatever interval is chosen) payment. However, payments will stop upon death and the balance in the annuity will be forfeited (unless you opt for a costly refund rider).

- **Joint Life and Survivor.** Under this scenario, you will receive less monthly income, but after your death that income will continue to your spouse for as long as he or she lives. You could choose for your spouse to receive 100% of the payments you received in your lifetime or a lesser percentage. Of course, the 100% option will reduce the amount of monthly income received while you’re alive by more than a non-100% option will.

- **Period Certain.** This option guarantees income for a specific period of time, such as 10 or 20 years. If you die before the period is up, your beneficiary receives the remaining payments. Again, the monthly amount will be lower than with a single-life annuity. However, if you die relatively soon after annuitization, the total payments likely will be larger than if you had not chosen this option.

- **Life Plus Return-of-Premium.** You or your heirs will receive payments as long as you live or until the payments total the sum of your investment, whichever is longer.

The table in the next column shows how much monthly income could be generated from a $100,000 immediate fixed annuity. The payout amounts vary by age (the older you are when you start, the higher the payment), whether payments would end at your death or continue to be paid to a survivor (the first column shows the age of each spouse in a married couple household), the level of benefit chosen for a surviving spouse, and whether payments will be adjusted for inflation.

<table>
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<th>Married couple</th>
<th>Monthly income, 100% to survivor</th>
<th>Monthly income, 100% to survivor</th>
<th>Monthly income, annual increase*</th>
<th>Monthly income, annual increase*</th>
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<td>$407</td>
<td>$381</td>
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<tr>
<td>M60/F55</td>
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<td>$406</td>
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<td>$641</td>
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Source: blueprintincome.com

In today’s low-rate environment, the benefit of putting a lump sum into a fixed annuity vs. managing that sum yourself is not as great as it likely would be in a higher-rate environment. For example, to duplicate the $448 monthly payment shown for the youngest ages in the table ($5,376 annually), an investor would need an annual earnings rate of only +5.38%. Importantly, by earning that in a self-managed portfolio, the investor would also retain principal.

An SMI reader who felt confident in his or her ability to achieve that return in an IRA would gain the potential for even greater returns, while also being able to leave principal as an inheritance (or use it as a backup source to pay future expenses). Of course, this option comes with less certainty and requires the time and potential stress related to ongoing investment management.

If opting for an annuity, the decision of whether to annuitize based on one life or two is influenced primarily by the health of both parties, along with a practical evaluation of other sources of income available to a surviving spouse. Numerous other variables must be considered as well, such as:

- What if the annuitant or the spouse has long-term care needs and could use the higher monthly payment of a single-life annuity to meet those needs?

- What if inflation significantly erodes the purchasing power of the monthly check and the purchasers wish they had forgone the survivorship benefits for a higher income?

- What if the spouse predeceases the annuitant?

Because annuity riders tend to be expensive, it’s generally better to lean toward the higher monthly payout. As the table above demonstrates, inflation protection is especially expensive. And yet, such protection is important. After all, longevity risk isn’t just about the possibility of outliving your money, it’s also about living so long that your buying power—and hence, your lifestyle—is reduced.

One way to gain inflation protection without buying a pricey rider is to stagger your purchase of annuities. For example, instead of putting $300,000 into an immediate annuity with an inflation rider, you could put $60,000 into a series of annuities without such a rider, buying one this year and then another every three or four years until you own five of them. The older you get, the more each new annuity would pay per month, even if interest rates don’t go up.

That’s because, as noted earlier, the older you get the more the mortality tables work in favor of the insurance company.
If interest rates do rise, the monthly payments would be even higher.

How to purchase an annuity

If, after considering the pros and cons, you decide an annuity is right for you, here’s how to make a wise purchase:

• **Choose a strong company.** The guarantees made by the issuing company are only as good as that company’s ability to pay, so investigate financial soundness and get quotes from multiple strong carriers. You can check an insurer’s strength via Comdex, a composite of all the rankings an insurance company has received. A Comdex report may be available for free from companies that provide you with quotes.

• **Shop around.** Compare quotes from companies such as Fidelity, TIAA-CREF, Schwab, and Ameritas Life, as well as online brokers blueprintincome.com and immediateannuities.com.

• **Choose your riders carefully.** Some variable annuities offer a guaranteed-income or minimum-withdrawal benefit (you can take a certain amount each year from your initial investment for the rest of your life no matter how the investments perform). Such riders can cost up to 1% of your investment per year in addition to other fees you are already paying. There are also different types of inflation riders. Some increase the annuity payment by a fixed percentage each year, whereas a consumer-price-index rider means any increase in payouts will be governed by an objective measure of actual inflation.

• **Demand full fee-disclosure.** Insist on a list of all fees up front and in writing. Such fees include annual mortality and administrative fees, underlying investment fees, surrender charges, rider charges, and commissions. Remember that the cost of some riders comes in the form of lower income payments to you. Also find out what it would cost to get out of the contract—what’s the maximum surrender charge and how many years does it take for the surrender charge to disappear?

Other types of annuities and options

• **Equity-indexed (or fixed-index) annuities.** These heavily promoted annuities, known as EIAs, have characteristics of both fixed and variable annuities, promising the potential for greater returns than a fixed annuity but with less market risk than a variable annuity. Usually these annuities are sold under the premise that they will never lose money, but in exchange the annuity is “capped” at a relatively low rate. So if the stock market is down 5% one year and up 10% the next, this annuity wouldn’t lose money the first year, but would only earn the cap amount (for example, 4%) the next year.

This compelling-sounding product (“all upside and no downside!”) may be tied to an index that is difficult to understand, making comparisons to competing products difficult. In fact, the Financial Industry Regulatory Authority (FINRA) issued an Investor Alert about EIAs, cautioning that the method of calculating the gain in the index to which the annuity is linked can be confusing. Buyer beware.

• **Deferred-income annuities.** This is a type of fixed annuity designed to protect against the financial risk of an especially long life, which is why it’s also known as a longevity annuity. You pay a lump sum just as you would with an immediate annuity, but instead of the income payments beginning right away, they are deferred, perhaps until age 85.

Whereas $100,000 invested in an immediate annuity by a 65-year-old man with a 67% survivor benefit for his 60-year-old wife would provide $486 of monthly income right now, $100,000 invested in a deferred annuity would provide $2,234 of monthly income beginning at age 85.

Some retirees may appreciate how a longevity annuity could simplify their portfolio management. Instead of trying to manage a portfolio in a way that provides a specific amount of inflation-adjusted income over an uncertain time frame, they could use a portion of their portfolio to buy the same amount of income that begins in 20 years, while using the remainder to cover their needs over a more clearly defined time frame (i.e., until the longevity annuity starts paying). That would also provide more liquidity than annuitizing a larger portion of their portfolio with an immediate annuity.

A longevity annuity may be purchased with money in an IRA or 401(K) plan account, subject to certain limits. This is known as a qualifying longevity annuity contract or QLAC.

• **Annuity-like mutual funds.** These funds, usually described as retirement-income, income replacement, or managed-payout funds, act like annuities in that they provide steady (although not guaranteed) income, while maintaining the liquidity and lower fee benefits of mutual funds. An investor typically invests a lump sum in such a fund in or near retirement, choosing among several pre-set portfolios. The fund provides an income stream that varies based on the performance of the fund’s underlying investments. With some of these funds, the monthly income is determined once a year and remains the same throughout that year.

Some managed payout funds, including Fidelity’s, aim to pay out their entire balance by a certain date. Others, such as those offered by Vanguard and Schwab, aim to pay out only their earnings. Vanguard’s Managed Payout Fund “targets” a 4% annual distribution rate. Some advisors recommend pairing a managed-payout fund with a deferred annuity.

Summary

An annuity isn’t right for everyone. In fact, in today’s low-rate environment, an annuity may be right for very few. For many people, giving up a portion of retirement savings in exchange for modest returns seems like an unwise trade. This has always been SMI’s default stance on annuities, and continues to be. However, the promise of guaranteed income is understandably appealing. Retirees can ill afford a sharp market downturn, and they live with the nagging fear that their money could run out before they die. If you are attracted to the idea of purchasing an annuity, the types that make the most sense for most people are a single-premium immediate annuity or a longevity annuity, purchased near—or when already in—retirement. Advisors often recommend using no more than 40% of your nest egg to fund an annuity.

Just as people in the accumulation phase of life allocate their portfolio across multiple asset classes, think of your sources of retirement income as a diversified portfolio. If you utilize an annuity, make sure it is only one part of the mix.
An allowance presents a great opportunity to teach kids about generosity, saving, and spending, so be proactive about teaching them what to do with the money they receive. By practicing giving and saving portions of every dollar they receive right from the beginning, it’s likely those habits will stick as they get older and earn more. As John D. Rockefeller once said, “I never would have been able to tithe the first million dollars I ever made if I had not tithed my first salary, which was $1.50 per week.”

So, from day one, establish guidelines around giving and saving. Use separate piggy banks or jars where at least 10% of every dollar is given toward Christ’s work in the world and a certain percentage is set aside for saving or investing.

Some people advocate teaching kids a 10-10-80 approach: Give 10%, save 10%, and feel free to spend the rest. However, at this stage of life when they have few, if any, fixed expenses, consider teaching them to save or invest a higher percentage, such as 40%.

As your kids get older, consider giving your kids more financial responsibility. Mary Hunt’s book Raising Financially Confident Kids presents an idea we have found very helpful. At around age 10, start giving your kids the money you have budgeted for some of their expenses, such as clothing, and have them manage it. That will teach them more about making trade-offs (one pair of designer jeans?) comparison shopping, waiting for sales, and more.

When to start, how much to give, and how often

Kids can understand certain aspects of money at a surprisingly young age. As early as age two, for example, researchers have found that kids can begin to see that money is a means of exchange. It’s an idea they can start to grasp the more they go to the store with you and watch as you hand money to the cashier and then receive groceries or clothing or whatever else in exchange.

So, with an allowance, err on the early side—perhaps as young as three or four, but certainly at least by the time they enter kindergarten.

Common ways to determine how much to give is to base the amount on the child’s age or grade. In the Bell household, we used the second method, basing the amount on their grade plus one. When they were in first grade, for example, we gave each child $2 per week. Of course, using their age would mean giving more. A seven-year-old child would get $7 per week.

As for how often to give an allowance, in the beginning, a weekly allowance will provide frequent opportunities to establish the habits of giving and saving. As they get older, changing “payday” to once a month can help kids learn to plan their spending so the money lasts until next month.

Just start

There’s a lot of conflicting and confusing advice about allowances “out there.” Don’t overthink this. Far better to get started and make some adjustments as you go than to wait until you have the perfect system figured out. And if you’re feeling late to the game, the same advice applies to you. Just start. The earlier your kids begin gaining some experience managing money, the better.
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

TRACING YOUR PORTFOLIO

Many investors have their investments spread across multiple accounts—a 401(k) with Firm A, an IRA with Firm B, and maybe a taxable account with Firm C. That can make tracking the value of your overall portfolio somewhat complicated.¹

You could go to multiple websites to gather performance information and then try to combine all the data into a sensible whole. Or, more simply, you could use an online tracking platform that gathers the data and displays it in an easy-to-understand format.

Such one-stop tracking platforms include “client portals” (available to clients of investment-management firms) and no-cost tracking websites offered by companies hoping to win a user’s investment business. Die-hard do-it-yourselfers, and those who have security concerns about linking their financial data to a third-party site, have the option of using a semi-automated spreadsheet that can auto-retrieve stock and fund performance data.

The SMI Private Client portal

A client portal of particular interest to SMI subscribers is offered by SMI Private Client, the investment-management business that is part of SMI Advisory Services, a company that is affiliated with but separate from the Sound Mind Investing newsletter. The portal is available only to Private Client members.

The portal’s “dashboard” can offer an at-a-glance summary of a user’s portfolio allocations, grouped by SMI strategy, across all of the accounts that are managed by Private Client. The dashboard provides performance data by date range and asset category, and it can display cost-basis data as well as unrealized gain/loss details. An “Activity” section summarizes transfers, contributions, distributions, and changes in market value.²

³For users signed up at Private Client’s “Select” or “Premier” levels, the dashboard can auto-update balance details

Free tracking platforms

The two major players in free all-in-one portfolio tracking are “fintech” firms Personal Capital³ and SigFig⁴ (short for Significant Figures). Although these companies offer account tracking at no cost, their marketing strategies are aimed at converting people who register for the tracking services into fee-paying investment-advisory clients. Users should expect regular “upsell” appeals.

With both Personal Capital and SigFig, a user must supply username-and-password data for each account to be tracked. (To track one’s Fidelity holdings, for example, the user must provide his or her log-in information for Fidelity’s website.) All such information is encrypted and both Personal Capital and SigFig stress that robust security protocols protect a user’s particulars.

Of the two free tracking platforms, Personal Capital is the more flexible, allowing users to include investment accounts, bank accounts, credit cards, household bills, etc. SigFig, in contrast, tracks only investment accounts.

The Personal Capital dashboard provides summaries of a user’s overall portfolio balance, net worth, and monthly cash flow. Each dashboard item can be clicked to reveal additional detail, such as one’s investment holdings, asset allocation, and sector exposure.

With SigFig, a user can adjust display preferences to highlight performance indicators of most interest, such as current value, total gain, dividends, and cost basis. At times, SigFig will suggest portfolio changes (e.g., “Your portfolio has excessive cash holdings”). These suggestions are aimed at nudging users toward signing up for SigFig’s robo-advisor service.

A semi-automated spreadsheet

For those uncomfortable with providing their account sign-in details to a third-party
Broadening Your Portfolio

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

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

2ND QUARTER REPORT: JUNE SURGE ENDS BEST FIRST HALF SINCE 1997

At the rate the financial markets respond to new narrative themes these days, it’s no surprise the three-month span of the second quarter was plenty of time to take investor emotions from optimism to despair to gleeful.

The quarter began with “Goldilocks” expectations: an economy neither too hot nor too cold, and interest-rate expectations to match. The economy was widely thought to have cooled just enough to halt the Fed’s multi-year rate hiking campaign, but not so much as to threaten the economy with recession. This combination led to strong April stock returns, while bonds were largely flat.

The May pivot to recessionary expectations, based largely on the breakdown of trade talks between the U.S. and China, was rapid and the impact on financial asset prices was immediate: stocks tanked and bonds soared. But following the modern script that investors have become familiar with (and reliant on?), the Fed quickly responded to the market’s cry for help. Fear not, they reassured, rate cuts would be quickly forthcoming if the economy were to slow further. There’s nothing modern financial markets like better than Fed intervention and rate cuts, so that was just the ticket to turn May tears into June laughter.

The first half of 2019 was the strongest start to a year for stocks since 1997, and most other asset classes also experienced strong returns. Bonds, real estate, gold—it was a great first half for investors of nearly all stripes. SMI investors certainly benefited from these strong returns as well.

While the results of the first half were great, it’s a bit sobering to compare how much the economic backdrop shifted in just those six short months. In the last quarter of 2018, expectations for economic growth were strong and interest rates were rising as a result. Stocks ran into trouble when those growth expectations began to slow and the Fed didn’t immediately announce a pause in their rate hike plans.

By mid-year, the stock market had completely erased the 2018 correction with gains of nearly +20%. Yet recent measures of economic growth and future expectations have both shifted lower, and the market’s June surge required not only the prospect of holding interest rates steady, but the prospect of future rate cuts.

SECOND QUARTER PERFORMANCE OF STOCK FUNDS BY RISK CATEGORY

<table>
<thead>
<tr>
<th>Risk Category</th>
<th>SMI Funds</th>
<th>Average Fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cat 5: Foreign Stock Funds</td>
<td>2.4%</td>
<td>2.7%</td>
</tr>
<tr>
<td>Cat 4: Small Company/Growth</td>
<td>6.2%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Cat 3: Small Company/Value</td>
<td>1.7%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Cat 2: Large Company/Growth</td>
<td>6.3%</td>
<td>4.6%</td>
</tr>
<tr>
<td>Cat 1: Large Company/Value</td>
<td>3.6%</td>
<td>3.0%</td>
</tr>
</tbody>
</table>

FOOTNOTES: [1] Average of the three recommended funds for each risk category (page 122), assuming any suggested changes were made on the last trading day of each month. [2] An average of all the mutual funds in the SMI risk category shown, including both load and no-load funds.

It’s hard to make an argument that the economy is in better shape than it was at the beginning of the year, despite the strong returns of financial assets. Eventually this connection matters—the long-term direction of the stock market is driven by the health of the economy, although the two can move in opposite directions temporarily, as they have this year. That said, there’s also no reason that financial asset prices face an imminent decline, given current conditions.

Thankfully, SMI’s strategies don’t have to predict these twists and turns in order to succeed. We can continue to stay invested and enjoy the gains of the rising markets while they last, while still having reason to be optimistic that we can avoid some of the downside of an eventual bear market.

Just-the-Basics (JtB) & Stock Upgrading

Both JtB and Stock Upgrading posted solid second-quarter gains. JtB gained +3.4%, slightly less than the U.S. market (+4.0%), due to lower returns from its smaller and foreign stock components.

In contrast, strong returns from both growth risk categories helped Upgrading beat the overall market during the second quarter with a +4.1% gain. As the table shows, the Upgrading process added value in four of the five risk categories during the quarter.

While the “insurance premiums” Upgrading paid in the first two months of 2019 via its defensive protocols cost it the chance of keeping up with the stock market’s magnificent first-half returns, it’s good to see that Upgrading was back on track in the second quarter. Given it held a substantial level of cash when the market rebounded so strongly in January, Stock Upgrading’s first-half return of +14.5% is impressive. Rather than being discouraged by trailing the market so far this year, hopefully SMI members will be encouraged by earning such strong absolute returns—without having to abandon the safety net provided by Upgrading 2.0’s defensive protocols.

Bond Upgrading

If the levitating stock market was the main story of 2019’s first half, plummeting bond yields were a close second. The benchmark 10-year Treasury yield fell all the way from 2.69% to 2.00% by mid-year. The first rule of bond investing is that prices rise as yields fall, which meant the first half of 2019 was outstanding for bond investors. Bond Upgrading earned +3.3% in the second quarter, bringing its total return for the first half of 2019 to +6.1%.

The second rule of bond investing is that the longer the duration of the bond, the more its price will move in response to interest-rate changes. This means that investors...
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

RETIREMENT PLANNING FOR SINGLES

Singleness has its advantages. For one thing, without a spouse to accommodate and care for, a single person is able to fully focus on “how to please the Lord” (1 Corinthians 7:32). There are downsides too, of course. Among them: “Woe to the one who falls when there is not another to lift him up” (Ecclesiastes 4:10).

These same two considerations — i.e., the clarity that comes with having fewer concerns and the obstacles that can arise from being by oneself — carry over into the financial area too, perhaps especially so with regard to retirement planning. A single person, for example, can concentrate on his or her own retirement needs without having to consider the long-term financial and healthcare needs of a spouse. At the same time, one who is single can’t rely on the greater financial sturdiness that comes from two people pooling their retirement-related savings and Social Security benefits.

 Needless to say, there are “varieties” of single people. Some have never been married, some are divorced, some are widowed. But even though the financial needs and situations of particular singles can be quite different, there are commonalities.

Building a firm foundation

As a single person (although this really holds true for anyone), the first order of business is to build an emergency savings fund. At SMI, we typically recommend having an emergency fund equal to three to six months worth of essential living expenses, but as a single person, you may want to save even more. If you’re still in the workforce, you have no one else’s income to rely on if you lose your job or can’t work for some reason.

Creating a surplus may require you to be especially proactive in managing your spending. If you don’t have children or if they are already grown, you have an advantage in this area: you can make spending/lifestyle decisions without regard to how such decisions will affect other family members. If you need to relocate to a cheaper place to live (or one that’s within walking distance to work), or perhaps sell a car and use public transportation for a while, you can make such changes more easily than a married couple or a family can.

Investing for the future

If your workplace offers a retirement plan, take full advantage of it — especially if your employer matches a portion of your contributions. Try to save an amount equal to at least 15% of your gross income. An employer-match will help you build retirement savings even more quickly.

If you don’t have access to a work-based retirement plan, open an Individual Retirement Account (IRA) and start socking money away. IRAs have an annual contribution limit (as of 2019) of $6,000, or $7,000 if you’re 50 or over. (Here is another advantage for singles: You probably don’t need to save as much for retirement as a married person.)

Whether to use a "traditional" account or a "Roth" account for your retirement savings depends on a number of factors. Traditional accounts provide an up-front tax benefit — i.e., you can deduct the amount of your contributions. Because singles typically have fewer tax breaks than married couples (as well as a lower standard deduction), contributing to a traditional 401(k) and/or an IRA is one of the few avenues available to single earners for reducing the income-tax bite. Just be aware that deferred taxes will be due as money is later withdrawn from retirement accounts.

Other considerations

• Social Security retirement benefits. Claiming strategies for married couples can be complicated, but for the never-married, the matter is relatively straightforward: Because you don’t need to be concerned about how your claiming decision might affect a spouse, you can simply act in your own best financial interest. You can claim as early as age 62, but your monthly benefit will be substantially higher if you wait until your Full Retirement Age (as defined by Social Security). Your benefit will be higher still if you wait until age 70.4

The situation may be different if you are divorced or widowed. Divorcees who have not remarried may be eligible for spousal benefits if the marriage lasted at least 10 years. Widows and widowers may be eligible for benefits based on a deceased spouse’s earnings record as early as age 60.5

• Life insurance. Whatever other uses it may have, life insurance is primarily a means of providing for a spouse/family in the event of a breadwinner’s early death. If you have dependent children, providing for them via life insurance is clearly important. But if there is no spouse or children to provide for, a single person’s need for life insurance is minimal — a relatively small “term” policy should suffice to cover death-related expenses and remaining debts.

• Disability insurance. As a single person, you don’t have a second earner whose income you could rely on if you were to become disabled and unable to work. Therefore, private disability insurance, which typically provides broader coverage than Social Security Disability, may be a wise purchase. Private coverage usually replaces about 60% of lost income (another good reason for maintaining a healthy emergency fund).

• Long-term care. Medicare doesn’t cover the kind of long-term “daily activities” care often needed by older adults (i.e., dressing, eating, bathing). As a single person, you won’t have an in-house caregiver

1Mar2015:p38 2The IRS allows contributions of up to $19,000 per year to a 401(k) or similar plan, or up to $25,000 per year for those age 50 or over (2019 limits). 3Apr2019:p57 4Sep2016:Cover 5See www.ssa.gov for details. 6Jun2016:p86
Basic Strategies

The fund recommendations shown for Upgrading account holders 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

<table>
<thead>
<tr>
<th>Category</th>
<th>Date Added</th>
<th>E-Trade</th>
<th>Fidelity</th>
<th>Schwab</th>
<th>MOM3</th>
<th>Performance</th>
<th>1YR</th>
<th>Rel Risk</th>
<th>Expense Ratio</th>
<th>Ticker Symbol</th>
</tr>
</thead>
<tbody>
<tr>
<td>Category 1</td>
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<td>ETF</td>
<td>ETF</td>
<td>47.6</td>
<td>23.4%</td>
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<td>5.8%</td>
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<tr>
<td>Category 2</td>
<td>05/19</td>
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<td>NTF</td>
<td>NTF</td>
<td>55.1</td>
<td>26.4%</td>
<td>4.1%</td>
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<td>26.4%</td>
<td>22.8%</td>
</tr>
<tr>
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<td>ETF</td>
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<td>19.3%</td>
<td>3.7%</td>
<td>5.1%</td>
<td>19.3%</td>
<td>18.6%</td>
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<tr>
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<td>ETF</td>
<td>ETF</td>
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<td>22.0%</td>
<td>5.3%</td>
<td>7.6%</td>
<td>22.0%</td>
<td>21.9%</td>
</tr>
<tr>
<td>Category 5</td>
<td>12/18</td>
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<td>ETF</td>
<td>ETF</td>
<td>31.6</td>
<td>16.5%</td>
<td>3.9%</td>
<td>3.8%</td>
<td>16.5%</td>
<td>11.3%</td>
</tr>
<tr>
<td>Category 6</td>
<td>05/19</td>
<td>NTF</td>
<td>NTF</td>
<td>NTF</td>
<td>52.8</td>
<td>31.6%</td>
<td>5.8%</td>
<td>3.0%</td>
<td>31.6%</td>
<td>18.3%</td>
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RECOMMENDED FUNDS FOR SMI’S UPGRAADING STRATEGY

<table>
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<th>Risk</th>
<th>Date Added</th>
<th>E-Trade</th>
<th>Fidelity</th>
<th>Schwab</th>
<th>MOM3</th>
<th>Performance</th>
<th>1YR</th>
<th>Rel Risk</th>
<th>Expense Ratio</th>
<th>Ticker Symbol</th>
</tr>
</thead>
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<tr>
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<td>ETF</td>
<td>ETF</td>
<td>ETF</td>
<td>21.6</td>
<td>7.7%</td>
<td>1.5%</td>
<td>3.8%</td>
<td>7.7%</td>
<td>10.0%</td>
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<td>07/19</td>
<td>ETF</td>
<td>ETF</td>
<td>ETF</td>
<td>39.6</td>
<td>18.6%</td>
<td>6.6%</td>
<td>5.5%</td>
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<td>15.5%</td>
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<td>Category 3</td>
<td>01/19</td>
<td>ETF</td>
<td>ETF</td>
<td>ETF</td>
<td>43.0</td>
<td>19.3%</td>
<td>3.7%</td>
<td>5.1%</td>
<td>19.3%</td>
<td>18.6%</td>
</tr>
<tr>
<td>Category 4</td>
<td>06/19</td>
<td>ETF</td>
<td>ETF</td>
<td>ETF</td>
<td>62.7</td>
<td>27.7%</td>
<td>6.7%</td>
<td>8.6%</td>
<td>27.7%</td>
<td>26.4%</td>
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<tr>
<td>Category 5</td>
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<td>ETF</td>
<td>ETF</td>
<td>ETF</td>
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<td>18.0%</td>
<td>5.3%</td>
<td>4.8%</td>
<td>18.0%</td>
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<tr>
<td>Category 6</td>
<td>11/18</td>
<td>ETF</td>
<td>ETF</td>
<td>ETF</td>
<td>45.4</td>
<td>21.2%</td>
<td>4.1%</td>
<td>6.3%</td>
<td>21.2%</td>
<td>17.9%</td>
</tr>
</tbody>
</table>

Upgrading Footnotes: [1] The funds in each risk category have been selected and ranked (1 through 3) based primarily on their momentum scores in late July, rather than on the end-of-June performance data shown on this report. There are no new recommendations this month (i.e., for August). The fund ranked third is the one that currently appears most likely to be replaced next. [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 (800-425-4000). Policies change frequently, so be sure to verify their accuracy. EFTs trade like stocks and are typically available at all brokers for a modest commission.

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Changes in our fund recommendations are explained in the MoneyTalk column.
Upgrading: Easy as 1-2-3

Fund Upgrading has long been SMI's most popular Basic Strategy. Whether used in isolation or in combination with SMI's Premium Strategies, Upgrading forms a solid foundation for an investing plan. Upgrading has proven itself over time with market-beating returns over the long haul, and it is easy to implement. This page explains exactly how to set up your own Upgrading portfolio.

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

WHY UPGRADING?

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/smfxf).

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 fund organizations. There are several separate accounts at all the various brokerage choices available. We recommend reading our latest Broker Review (March 2018:Cover article, also available online at bit.ly/smbroker) 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

1 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.

2 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.

3 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—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, the investor selects the stock/bond mix for his or her 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-ranked Cat. 5 fund is Sextant International, the highest-ranked Cat. 4 fund is Value Line Mid Cap Focus, and so on. 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.

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/smbondupgrading).
SIGHTING: VALUE STOCKS HAVEN’T TRADED THIS LOW SINCE THE DOT-COM BUBBLE

A total-return measure of value versus growth across developed markets just slumped to its lowest since 2000. That marks almost two decades since shares dubbed inexpensive traded at such depressed levels versus those with the best earnings growth....

When value stocks plunged to similar levels versus growth at the height of the dot-com bubble in 2000, they went on to surge more than 50% against their opposing cohort in the next 12 months, MSCI indexes show....

Structurally, there’s a growing suspicion the value factor may be broken. Technology is evolving so rapidly that it’s turned traditional sectors like financials and industrials into permanent laggards, the argument goes.... In a Bank of America survey from July, just 2% of fund managers who oversee a total of $489 billion expected value to outperform growth in the next 12 months, the least since 2010....

[But] value is backed by one of the longest histories and some of the most academically rigorous research among factors.... [From] 1926 through 2018, various metrics of value beat growth by at least 1 percentage point in annualized returns, O’Shaughnessy Asset Management research shows.

– From a 7/24/19 market-analysis piece published by Bloomberg. Read more at bloom.bg/2JUg8jq.

SIGHTING: WHAT INVESTORS NEED TO KNOW ABOUT “REGULATION BEST INTEREST”

(From a video interview produced by Morningstar.com.)

Host Christine Benz: [Describe] what Regulation Best Interest is about and what its major ramifications are.

Morningstar research analyst Aron Szapiro: In a nutshell, this is the SEC’s attempt to elevate the standards of conduct that broker/dealers have to follow when they’re giving advice to retail customers....

Benz: When you say broker/dealers, I think people outside of the industry might be confused about what you mean.

Szapiro: [There are two main types of financial advisors.] There are broker/dealers who are selling securities, usually on a commission-based or transaction-based model where they’re paid when they make a recommendation and usually paid on a commission-based or transaction-based model where they’re paid when they make a recommendation and usually paid on commission. That’s in contrast to the Registered Investment Advisor [model], which is generally based on a fee that is in turn based on the assets under management....

Benz: Say, I am a consumer, an individual who works with a financial advisor. What [changes] should I expect to see?

Szapiro: Starting in June of next year, your advisor—[if] you’re working with an advisor who is a representative from a broker/dealer—will say, “Hey, I’m following Regulation Best Interest and I’m acting in your best interest.”

But that doesn’t mean that they can’t have some conflicts of interest. They will have to disclose them to you as a consumer or as an investor—[however, in some instances] disclosure will not be enough.... There are certain bright-lines in the regulation, certain things they [will have to] try to mitigate. You also [will] get a new disclosure called the Customer Relationship Summary that will provide... information on services you’re going to get, fees, etc....

[So it’s] important for people to understand that part of this “best interest” obligation can be satisfied with [a simple] disclosure. And it’s going to be incumbent on you as an investor to look at those disclosures and [decide whether or not to] say, “Okay, I understand the business model [and] I’m comfortable with it.”

– Interview posted on 6/14/19. Watch it at bit.ly/2McnCBa (free registration required).

SIGHTING: THE INVESTOR’S HIGH

As Jason Zweig shared in Your Money and Your Brain, “The neural activity of someone whose investments are making money is indistinguishable from that of someone who is high on cocaine or morphine.”

The problem is that while confidence tends to grow commensurately with portfolio balances, our actual tolerance for risk does not respond in kind.

While markets rise, this is generally a non-issue. After all, what’s risky about investments that are growing? Volatility to the upside is not what most investors lose sleep over, so adding to what’s working and forsaking what isn’t seems safe and reasonable.

It’s only when markets fall that we realize we’ve taken on too much [risk]. Our perception of risk returns to reality, but at that point, it’s too late. Making adjustments after the fact is not a winning approach.

All of this sounds like it has a simple solution. As the saying goes, “Don’t confuse brains with a bull market.” But if it were that easy, investors wouldn’t panic sell. Our perception of risk may be fluid, but our portfolios should not be.

– From a 7/18/19 post by advisor Brendan Mullooly on his blog Your Brain on Stocks. Read more at bit.ly/2MboZ39.

SIGHTING: THE MARKET WENT ___ ON ___.

Here are [three recent] headlines....
• “The Dow Loses 33 Points Because the Market Is Getting Pulled in Different Directions”
• “Stock Market Gains After Fed Removes ‘Patient’ From Policy Statement.”
• “The Dow Is Falling Because the Jobs Report Might Have Been Too Good”

Surely, these writers can’t be serious.... The total market cap of the S&P 500 is somewhere around $24,000,000,000,000.... To say [on a daily basis] that the market did ______ because of ______ ...seems so far out in left field I can’t even begin to comprehend it.... There is no way to know why $24 trillion+ in capital fluctuates in value on any given day, week or even year.

– From a 7/08/19 post by financial advisor and blogger Ashby Daniels at Retirement Field Guide. Read more at bit.ly/2Z9wRpo.
company, or for people who simply prefer a more hands-on approach to keeping tabs on their money, a semi-automated spreadsheet may be the best approach. Google Sheets, for example, can be automatically populated with up-to-date performance information (from Google Finance), making the inputting of data significantly less tedious.¹

Tiller, a fintech company that specializes in financial spreadsheets, offers a free template for creating a Google Sheets investment-tracking sheet.² A similar template is available from the financial blog DoughRoller.³

A SEMI-AUTOMATED SPREADSHEET CREATED IN GOOGLE SHEETS

Although you must have a Google account to use Google Sheets, there is no need to provide sign-in or password data for your investment accounts. Inputting a formula⁴ for each fund you own will display the fund name and current price. Other details, such as purchase dates and number of shares (including shares purchased with dividend reinvestments), must be added manually.

Recap—and a word of warning

To summarize, SMI Private Client can provide an overview of SMI strategy performance (for accounts managed by Private Client) that other services can’t provide, whereas Personal Capital and SigFig excel at providing a “one portfolio” view of all your holdings, but they can’t provide analysis by SMI strategy. A spreadsheet system can help you see at a glance how your specific holdings are performing, but without additional coding such systems can’t offer the kind of data sorting and performance insights provided by more sophisticated account trackers.

Whichever method you may choose to track your portfolio, whether one of the options described above or another approach, keep in mind that it isn’t wise to check performance numbers too often. Tracking how your investments are doing day-to-day can be tough on the emotions! So we suggest you access tracking data sparingly, perhaps once a month or even once a quarter. An overabundance of tracking is unlikely to help you stay on track. ◆

1. Newer versions of Microsoft Excel can auto-update stock/fund prices too, as can Apple’s Numbers app.
2. bit.ly/2X0p8E7  bit.ly/2JiJBk  ³The formula is =GOOGLEFINANCE("ticker")

MONEY TALK

2ND QUARTER REPORT: JUNE SURGE ENDS BEST FIRST HALF SINCE 1997

in long-term bonds have earned the best returns as rates have fallen. (This includes DAA investors, who have gained +12.7% in long-term bonds so far in 2019.) In Bond Upgrading, we’re more concerned about our bond holdings providing safety and stability than we are shooting for the highest gains, so we’ve purposely avoided the higher risks present in long-term bonds. Despite that safety tilt, Bond Upgrading still outperformed the broad bond market +3.3% to +3.0% in the second quarter. Bond Upgrading provided higher returns with less risk this quarter, which is a great combination.

Dynamic Asset Allocation (DAA)

DAA was the strongest performer of SMI’s strategies during the second quarter, earning +4.4%. This beat the stock market’s second-quarter return, even as DAA was able to avoid the roller coaster ride stock investors were taken on. The stock market had a solid second quarter overall, but came in just third among DAA’s six asset classes, behind both long-term bonds and gold.

The fact that DAA often runs “out of synch” with the stock market is a feature, not a bug. Yes, this can be frustrating when the stock market is rising and DAA doesn’t keep up. But the portfolio diversification DAA consistently provides is valuable in its own right by smoothing the overall returns of blended portfolios that allocate money to it.

Sector Rotation (SR)

While SMI’s other strategies navigated the rapid up-down-up reversals of the second quarter pretty well, SR felt the impact of those directional changes acutely. Due for a fund replacement at the beginning of May, SR unfortunately jumped aboard a high-flying tech fund just as the May swoon was beginning. That fund lost -14.3% in May and was the primary driver of SR’s -12.8% overall loss for the quarter.

While that type of rapid loss is rare even for SR, it is a potent reminder of both this specific strategy’s volatility and the speed at which market losses can erode any strategy’s past gains. SR’s current 10-year annualized gain of +17.8% still dwarfs the market’s +14.7%, but that gap was twice as wide just six months ago (a gap of 6.2% then vs. 3.1% now).

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 diversi-
Ried portfolio we encourage most SMI readers to consider. As we saw again this quarter, the markets can shift suddenly between rewarding risk-taking and punishing it, so a blend of higher-risk and lower-risk strategies can help smooth your long-term path and promote the type of emotional stability that breeds sustained investing success.

A 50/40/10 portfolio would have gained +2.5% during the second quarter, a bit less than the broad market’s gain of +4.0%. While Stock Upgrading and DAA both outperformed the market, SR’s significant decline reduced the overall return of the portfolio. That’s disappointing, but it’s also unusual for SR to lag during a rising market, so hopefully this will be a rare exception. We continue to believe that over the full market cycle (bull and bear market), the performance of a 50-40-10 portfolio stands a good chance of beating the broad market—while protecting investors during bear markets when they are most prone to making costly mistakes. Whether you use this specific 50/40/10 strategy mix or a different combination, we think most SMI readers can benefit from blending these strategies in some fashion.

LEVEL 4 / CONTINUED FROM PAGE 121
RETIREMENT PLANNING FOR SINGLES
to turn to if you need such care. That makes long-term-care insurance worth looking into—but it’s not cheap. You’ll want to familiarize yourself with the pros and cons of other payment options too, such as a lower-cost hybrid life/long-term care policy, a Health Savings Account (HSA), and a reverse mortgage. As part of your research, visit nearby assisted-living facilities.

MARKET NOTES, QUOTES, AND ANECDOTES

crazy times
“We are in such bizarre times, all bets are off. It is certainly not the time for ‘buy and hold’ unless your goal is to lose everything. If not, then you need an active, flexible, defensive investment strategy now more than ever.” – John Mauldin, chairman of Mauldin Economics, writing on 7/19/19. He believes the Fed’s increased intervention in the markets has made this an especially challenging time to be an investor. Read more at bit.ly/2SyJms0.

The price of trend-following strategies
“Risk management means paying insurance premiums all the time, not just when you want to.” – A Wealth of Common Sense blogger Ben Carlson, writing on 6/27/19. He compared trend-following strategies to insurance, noting that, “…you pay premiums over time that cost you money (in the form of whipsaw trades where you sell out and buy back in at a higher level) to insure against catastrophe (missing a big chunk of a huge crash).” Read more at bit.ly/2y3ZbxN.

Investor, know thyself
“Some discretionary spending on entertainment and travel may be essential for our personal fulfillment, while at the same time only some ‘essential’ spending is truly essential.” – Financial advisor Michael Kitces, in an article for Financial Planning on 7/23/19, writing about one of the complexities of using a “bucket strategy” to manage retirement spending. When using different accounts for necessary vs. discretionary spending, he said, it can be surprisingly difficult to distinguish between needs and wants. Read more at bit.ly/2Z8AImF.

Beware the short memory
“Let’s not forget it was just seven months ago when volatility and fear were much higher, and the stock market was falling hard. And just like it may have been wrong to sell everything out of fear back then, is there really any reason to bet the farm now?” – “Blue Harbinger,” cautioning on A Dash of Insight on 7/11/19 that investors should not become complacent. Read more at bit.ly/2LDGAKg.

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. "Worst12" represents the worst investor experience over 181 rolling 12-month periods from 2001-2018.

### 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 asset 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.

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<td>21.0%</td>
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#### 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.

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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. “Worst12” represents the worst investor experience over 181 rolling 12-month periods from 2001-2018.
Transaction costs and redemption fees—which vary by broker and mutual fund—may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results.

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 recommended funds. 
4 Based on Bloomberg 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. Results prior to January 2013 are hypothetical, calculated from backtesting the strategy following a mechanical rules-based system.

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. 
1 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.smnfund.com. Read the prospectus carefully before investing. 
2 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. 
3 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. 
4 The Sound Mind Investing Funds are distributed by Unified Financial Securities (member FINRA).