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AMERICA'S PREMIER CHRISTIAN FINANCIAL NEWSLETTER

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Long-Term Care Insurance: To Buy or Not to Buy

Much has been written about long-term care insurance, and yet much confusion remains. Those who recommend the coverage are quick to rattle off scary statistics and stories of financial ruin among people who chose to go without the insurance. Others who say

long-term care insurance isn't necessary claim the risks are too small to warrant the expense. Whom should you believe? And

more importantly, what should you do? We hope

this primer will help you understand the issues and make a wise decision.

by Matt Bell

Of all the enjoyable ways you could spend your time, thinking through the various health-related scenarios you may experience toward the end of your life is probably pretty far down the list. The unpleasantness of the task helps explain why only 35 percent of adults have taken the time to have a will drafted, according to a survey by Lawyers.com. Faithful stewardship, however, requires that you consider *all* seasons of life, and the last season is one of the most important. It is a time of life when you'll want the peace of mind of knowing your loved ones will be provided for if you die or experience a debilitating illness. It's also a time when some of your most sizeable Kingdom investments could be made.

One of the greatest financial threats you will face toward the end of life is that of medical costs devouring much of your life savings. To manage that risk, a small but growing number of people are protecting themselves with long-term care insurance (LTCI). Should you join them? If so, with premiums rising quickly, can you afford it? Those are questions we hope to help you answer with this article.

What's at stake

Among people entering a nursing home in 2010, about 14 percent were covered by long-term care insurance, according to research from the Employee Benefit Research Institute (EBRI). That's up from six percent in 2000.

At first glance, it's easy to understand why carrying long-term care insurance is becoming more common. A study by the U.S. Department of Health and Human Services concluded that people who reach age 65 have a 40 percent chance of entering a nursing home. While no one thinks of nursing homes as luxurious, they still aren't cheap. According to the Genworth Financial 2012 Cost of Care Survey, the median cost for a private room in a nursing home is \$222 per day, or more than \$81,000 per year.

EBRI research shows just how quickly those costs can devastate household wealth. It found that median household wealth (including home equity) for those who spend a short amount of time in a nursing home (between one and 30 days) is about \$108,000, but those who stay for six months tend to get wiped out financially, with median wealth dropping all the way to about \$5,500.

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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

"A Game of Recovery"

In the movie *Bobby Jones, Stroke of Genius*, there's a scene in which the U. S. Open champion Walter Hagan plays the younger Bobby Jones. Although he has an erratic swing and seems error prone, Hagan runs away with the match. Afterwards, he confides in Jones: "I don't always hit the ball straight, but you know what I've learned? Three bad shots and one good one still make par. Golf is a game of recovery."

Most of us have seen unlikely turnarounds in sports. During

the recent Olympics, for example, the U.S. women's soccer team rallied from being a point down against Canada on three separate occasions before finally prevailing on a dramatic last minute goal. The victory propelled them into the final match where they defeated Japan to win the gold medal.

Turning to basketball, fans are annually treated to "March Madness" and a lineup of games that invariably include several seemingly impossible comebacks. Because of the many stunning recoveries, sportswriters often call the three-week event the most exciting in sports.

Or how about one of my all-time favorite "recovery" stories, the playoff victories of the 2004 Boston Red Sox? After losing the first three games of their league championship series with the N.Y. Yankees, they were trailing in game four with only three outs standing between them and the end of their season. But, improbably, they recovered. They came back to win that game, and, shockingly, the next three as well. In stunning the Yankees, they became the first team in baseball history to recover from an 0-3 deficit in a league championship and win four straight to claim the title (and eventually the World Series, their first in 86 years).

Sports fans can talk for hours about amazing comebacks. But the principle seems applicable across a broad range of life's experiences. Since this is a financial newsletter, let's move the conversation in that direction. Of course, stewardship (and the investing duties that come with it) is not a game. It's quite serious. When we handle this responsibility well, we help further God's kingdom – and also earn "Well done!" praise and eternal rewards from our Savior. But, like athletes, we don't always carry out our duties with perfection. We can fall behind where we know we need to be. Few of us, this writer included, can look

back at a lifetime of spending, investing, and giving decisions and be totally pleased with our performance.

It should be obvious I've been leading up to this: Being a good steward is—if I may use the term for purposes of illustration—a game of recovery. SMI exists to help you in this process. I certainly made my share of mistakes in earlier years, and am glad to share what I've learned so that you don't repeat them. I got up and kept going; so can you. You might even want to take a few tips from the athletes who have learned how to recover from setbacks. If you listen to their interviews, there's a common thread that goes through their description of how they overcame their poor starts.

1. **Let go of the past.** They have a long-practiced and rather remarkable ability to put their failures behind them—block them out—and concentrate on the task immediately at hand.

2. **Play the next play.** The most important thing is to focus on what they can do *now*. They know they can't make up for their past mistakes all at once, but they can begin to regain ground bit by bit—with a birdie on this hole, a basket on this trip down the floor, a single into center to keep the rally alive.

3. **Follow their training.** Athletes have received training over the years as to how to execute the task at hand, and they know it is essential to stay faithful to that training. When the pressure is on is no time for untested strategies or spontaneous innovations. Instead, it's essential to concentrate on doing simple things well, performing as taught.

4. **Persevere.** Essentially, this means repeating the first three steps over and over. It's not easy. It requires "a long obedience in the same direction." It's called being faithful.

If we invite the Holy Spirit to help us follow this pattern, we'll have a lot in common with the apostle Paul (who knew a thing or two about recovering from a bad start): "I am still not all I should be, but I am focusing all my energies on this one thing: Forgetting the past and looking forward to what lies ahead, I strain to reach the end of the race and receive the prize for which God, through Christ Jesus, is calling us up to heaven" (Philippians 3:13-14 NLT).



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Long-Term Care Insurance: To Buy or Not to Buy

(continued from front page)

To help add a real-world perspective to this issue, several SMI members agreed to share their perspectives on how they came to their decisions about long-term care insurance. Take 26-year old Robert, for example. Despite the potential financial risk, and the ready availability of LTCI through his employer, he's nevertheless decided to take a pass. He said he just doesn't believe in nursing homes. "I would never put a family member in one; I will never go into one. Obviously, I am young enough that most will feel I just am not in tune with the risks. Only time will tell."

None of us knows for sure whether we will need long-term care. The best we can do is use available information to assess our risk, staying mindful of the biblical mandate to provide for our families ("He who does not provide for his relatives, and especially for his immediate family, has denied the faith and is worse than an unbeliever" —1 Timothy 5:8). The two main risk factors to weigh are health and finances.

Assessing your health risk

A natural starting point in assessing your probability of needing nursing home care is a review of national statistics. Sure, statistics are less than perfect. After all, if each of us re-

flected the averages, such as the average household size (2.59 people, according to the U.S. Census Bureau), someone in our family would be less than whole! And, as Gregg Easterbrook, author of *The Progress Paradox*, pointed out, those who pay for and analyze statistical studies often crunch their numbers with considerable bias: "Torture statistics long enough," he wrote, "and they will confess to anything."

Still, several credible organizations have devoted themselves to the task of calculating the odds that you will need long-term care one day, each with its own way of framing the discussion. Let's look at some of the most widely used numbers.

According to the National Clearinghouse for Long-Term Care Information (www.longtermcare.gov), a site developed by the U.S. Department of Health and Human Services, about 70 percent of people now age 65 and older will need "some type of long-term care services during their lifetime." As we peel back the statistics onion, it's important to understand what is meant by "long-term care," how such care is typically provided, and how long it is usually needed.

According to the Clearinghouse site, "long-term care" is a catchall term that encompasses "a range of services and supports you may need to meet your health or personal needs over a long period of time. Most long-term care is not medical care, but rather assistance with the basic personal tasks of everyday life, sometimes called 'Activities of Daily Living,' such as: bathing, dressing, using the toilet, transferring (to or from bed or chair), caring for incontinence, and eating."

It's important to keep in mind that long-term care is not necessarily synonymous with nursing home care. In fact, Medi-

care reports that the majority (70 percent) of people needing long-term care are cared for in their own homes by family or friends.

In terms of length of care, the Clearinghouse site reports that, on average, someone who is 65 years old today will need some type of long-term care services and supports for three years. The site also notes that while about one-third of today's 65-year-olds may never need long-term care, 20 percent will need care for longer than five years.

As for how many of those people will require *nursing home care*, that's where the statistics get murkier. The previously mentioned figure—that people who live to age 65 have a 40 percent chance of entering a nursing home—does not mean that's how many will actually need nursing home care. Nor does the need for nursing home care mean such care will necessarily need to be provided for the rest of one's life.

According to Prescott Cole, Senior Staff Attorney at California Advocates for Nursing Home Reform, 67 to 70 percent of seniors who go into a nursing home are discharged within 90 days, and after two years less than six percent of those admitted will still be there. According to the Census Bureau, out of approximately 40 million Americans age 65 or older today, less than four percent currently live in nursing homes.

Of course, these are statistics for the population at large. To better understand your own risk of needing long-term care, take an honest look at your family history. How long did your parents and grandparents live? Is there a family history of serious illnesses? In particular, is there any history of Alzheimer's disease? According to the Alzheimer's Association, the risk of

getting the disease goes up significantly if you have a primary family member who has had it.

Assessing your financial risk

Even if your risk of needing nursing home care seems low, an inadequate financial base may leave you feeling vulnerable. Carrying a 10 percent health risk while sitting on a multi-million dollar nest egg is one thing; carrying that same health risk without much money in savings is quite another.

Clyde, another SMI member, described his decision to buy an LTCI policy “a slam dunk.” He retired in 1999 with pensions from two previous employers—the larger of the two without a survivor benefit—and not much money in personal savings. Making sure his wife would be provided for was his primary motivation. “I was looking at it, and I thought, ‘What happens if I have to go into a long-term care facility?’ She could end up with nothing.”

Jerry also decided to buy a policy, but said, “It was not a clear-cut decision.” In part, he was motivated to buy a policy after hearing financial teacher Dave Ramsey weigh in with his typically emphatic advice that *everyone* age 60 or older should buy a policy. But Jerry and his wife also know a couple where the woman suffers from Alzheimer’s disease. The man told Jerry they would have been financially devastated without an LTCI policy.

Won’t the government help?

This is an area of much confusion, with many people

wrongly assuming that Medicare will pay for a nursing home stay. Medicare, the federal government's health insurance program for people age 65 and older, typically does *not* pay for extended nursing home stays. It covers "medically necessary"



bills. That means it would cover nursing home care if you were there for rehabilitation purposes or post-acute care. In those cases, Medicare usually pays for the first 20 days and part of the next 80 days. The same is true for most private insurance. Medicare may also provide short-term home health care if you are recovering from an illness or injury, as well as hospice care if you are in the last stage of a terminal illness.

Medicaid, on the other hand, is a state and federal government program that pays for certain health *and* nursing home services for people with low incomes and few assets. In most states, it also pays for long-term care services at home. Eligibility and what services are covered vary by state. The quality of care may vary as well, as only certain nursing homes are Medicaid-approved.

Residents of 40 states have access to long-term care "partnership programs," which allow them to utilize Medicaid for long-term care without having to first use up all their assets paying for care. If you live in one of those states, purchase a

qualifying LTCI policy, and continue to need care after your policy's benefits are used up, then you can keep assets valued at the Medicaid limit plus the value of the benefits you received and still qualify for Medicaid.

Understanding the cost of long-term care insurance

Key factors that affect the price of long-term care insurance are your age, health, and the level of benefits you select.

- **Age.** The younger you are, the more likely you are to qualify for an LTCI policy and the less expensive your monthly premiums will be. Of course, younger people are likely to pay for their insurance over a longer period of time, raising the total cost of coverage. (If you're buying a policy at a younger age than you would otherwise simply to lock in a lower rate, don't. Rather than pay the premiums for a policy, you're likely to come out ahead if you invest that money instead.)

The risk in waiting to buy a policy is that you may develop a medical condition that disqualifies you from coverage. According to the American Association for Long-Term Care Insurance (AALTCI), the percentage of people applying for LTCI who are *accepted* declines with age. Underwriting standards are also gradually becoming stricter. The AALTCI reports that 11 percent of applicants under age 50 were denied in 2010, up from seven percent in 2007; 17 percent of applicants in their 50s were denied, up from 14 percent; and 24 percent of those in their 60s were denied, up from 23 percent.

- **Health.** Evidence of chronic conditions often prevents applicants from obtaining coverage. People with diagnosed memory loss or arthritis are almost always denied, and insurers

are getting tougher on osteoporosis and diabetes, experts say. By the same token, survivors of some conditions have been able to purchase policies if they can show that their condition is under control. These conditions include cancer, bypass surgery, Crohn's disease, congestive heart failure and forms of hepatitis.

Besides your age and health, the level of benefits you choose will impact how much you pay, including:

- **Elimination period (similar to a deductible).** This is the number of days that you need to be in a nursing home in order for coverage to begin. Options range from zero to 180 days. The longer the elimination period, the more of the initial costs you pay and the less expensive your policy.

- **Daily benefit.** This is how much the policy will pay per day. Options usually range from \$50 to \$250.

- **Maximum benefit period.** This is how long the coverage will last once you start using it. Options range from one year to the rest of your life, although unlimited lifetime coverage is becoming harder to find, and even if you *can* find it, the premiums may be cost-prohibitive.

- **Inflation protection.** The least expensive policies are those with little or no inflation protection. However, at the rate that healthcare costs are climbing, choosing a lower level of inflation protection is, in essence, choosing to increasingly shoulder the cost of long-term care out of personal savings.

If you decide to buy a policy, make sure you receive an "outline of coverage" that clearly states the policy's benefits, terms, and limitations. Look for at least one year of nursing home or home healthcare coverage, the right to cancel the policy for any reason within 30 days of purchase with a full

refund of premium, and a guarantee that the policy cannot be cancelled or terminated because of your age or health (physical and mental). Also consider a "shared care" rider that gives you and your spouse access to each other's benefits if you use up your own.

It is a good idea to make sure your policy also includes an "alternate care benefit," which recognizes that new trends in long-term care are emerging, and coverage could be provided in the future for options not specifically spelled out now.

Choose your insurer wisely

Over the past year alone, LTCI premiums have risen between six and 17 percent, according to the AALTCI. Insurers have simply underestimated the costs of providing benefits. Additionally, low interest rates have limited what insurers earn on the premiums they collect. As a result, some of the biggest players, such as Prudential and MetLife, have exited the market. According to LIMRA, an industry group, half of the top 20 individual long-term care insurance providers are no longer writing policies. To protect yourself, look for insurers that are highly rated by Moody's Investors Service, Standard & Poor's, and A.M. Best Company, and who conduct significant business in your state.

Keep in mind, however, that even strong insurers may raise your rates. While they can't single out individual policyholders, they can seek approval from state regulators to raise rates on *groups* of policyholders, such as those who opted for a certain level of inflation protection or those with lifetime benefits.

If you buy a policy and get hit with a hefty rate hike, most insurers will allow you to temper the increase in exchange for a decrease in benefits.

Alternatives to long-term care insurance

Of course, there are ways to pay for long-term care without carrying long-term care insurance.

- **Personal savings.** The late Larry Burkett used to say that the cheapest insurance is self-insurance. The key here, of course, is making sure that isn't just a good idea but a strategy

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FEATURE



ARTICLE

you act on through disciplined saving and investing. According to the Society of Actuaries, \$2 million is generally the amount of savings needed in order to be adequately self-insured. By the same token, the organization says people with savings of less than \$250,000 may be better off without a long-term care insurance policy. The assumption here is that those people will have such modest retirement income they they will not be able to afford LTCI premiums. Plus, if they need long-term nursing home care—at an average annual cost of over \$80,000—their savings will be used up quickly, leaving them eligible for Medicaid.

It's also very helpful to plan for a lower cost of living by making sure your mortgage is paid off by age 65 and choosing to live in a state with relatively low property taxes. Make sure you have a living will and healthcare power of attorney, and tell your family and doctor your wishes as well.

- **Family support.** People often worry about being a "burden" to their kids. However, there was a time when multi-generational families were the norm and people more readily assumed they would help care for their parents or grandparents. Perhaps more families would benefit from some open conversations about taking care of one another across generations.

The combination of family care and bringing in some outside help costs far less than a nursing home stay, and would likely provide a better quality of life for those needing care in their later years. According to Genworth, it currently costs about \$19 per hour for a home healthcare aide, and less for someone to help only with meal prep or housekeeping.

If you're the one in need of care, it may be difficult to ask an adult child for assistance, but if you're the adult child of a parent or grandparent whose health is in decline, consider what you might do to help. Perhaps you will create a new and very positive example for others in your family to follow.

- **Reverse mortgages.** As you consider ways to pay for long-term care, it may ease your mind to better understand how much money you could receive each month and for how long if you were tap your home equity through a reverse mortgage.

Not an either/or decision

So, should you purchase a long-term care insurance policy?"

As you can see, there is no one-size-fits-all answer to that question. To a great degree, it depends on how you weigh your health and financial risks and your wherewithal to pay the premiums. According to the AALTCI, the annual premium for a 55-year-old in good health, with a 90-day elimination period, a \$150 daily benefit for up to three years, and with five percent inflation protection, would be about \$2,300.

For mid-wealth individuals—those with a later life nest egg totaling between \$250,000 and \$2 million—the answer may be especially unclear. Perhaps the best idea is to recognize that this is not a purely yes or no question. Many articles about LTCI give the impression that there are only two alternatives: buy a policy that provides enough coverage to pay for most of the cost of an extended nursing home stay or self insure through personal savings. But the issue is more nuanced than that. It doesn't have to be an "all or nothing" decision.

After considering the many factors detailed in this article, you may still find yourself undecided. If you lack the confidence to tailor an LTCI strategy geared to your specific financial goals and lifestyle expectations, consider a fallback position: initially purchase an affordable policy that will provide at least a degree of protection.

Mike Cave, an insurance consultant who has written about insurance for SMI in the past (and who does not sell long-term care insurance), suggests taking out a relatively small long-term care policy that would "take the sting out of a costly nursing home stay without requiring an equally stinging monthly premium payment."

Thinking about this issue isn't the most pleasant of tasks, but

it's an essential part of whole-life stewardship. Far better to think about it now than to wait until you find yourself needing long-term care (which can happen at any age). A good starting point is to thoughtfully and prayerfully consider this bit of biblical wisdom: *"The prudent see danger and take refuge, but the simple keep going and pay the penalty"* — Proverbs 22:3. ♦

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All of SMI's core material is presented here to teach the average family the best ways to save and invest. Our main investing strategies, Fund Upgrading and Just-the-Basics, are the focus of the print newsletter, along with teaching investing basics in an extremely easy-to-understand manner. The print newsletter is designed to making investing understandable for beginners. Everything required to follow our core strategies is provided, so readers are never compelled to add any additional SMI products if their needs are being met.

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LEVEL **1** ONE

Getting Debt-Free

We begin our journey toward financial peace of mind by making it a priority to establish a budget, control spending, and pay off those credit cards, car

loans, and other short-term debts. While you're working on this, however, don't neglect reading the other Four Levels columns. Level Two will help you

create and invest in an emergency fund. Levels Three and Four will give you the basics you need to invest your IRA/401(k) accounts intelligently.

"The rich rules over the poor, and the borrower becomes the lender's slave." Proverbs 22:7

Mission Statement: The intent of this column is to provide motivation for you to make the sacrifices necessary to get debt-free, to educate you concerning mortgage and consumer debt, and to provide strategies which help you reduce your living expenses.

FINANCIAL DECEPTIONS (PART 1 OF 2 PARTS)

by Ron Blue

*Excerpted from Taming The Money Monster
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Often I am asked, "How do we get out of debt and stay out?" My advice is simple but not simplistic.

More deception (most of it unintended) is perpetrated by accountants, bankers, business schools, and businessmen regarding the use of debt than

most of us realize. We tend to respect these professional people. Yet they only pass on what they've been taught, and in many cases they've been taught half-truths. Being a CPA, former banker, alumnus of a graduate business school, and businessman myself, I remember what I was taught and have in turn taught others in time past. And there are four major financial deceptions conveyed implicitly or explicitly by my peer group. They are as follows:

- Borrowed money is always paid back with cheaper dollars in the future.
- The tax deductibility of interest makes using debt a wise thing to do.
- Inflation is inevitable; therefore, it is always wise to buy now at a lower

cost than in the future at a higher cost.

- Leverage (debt) is magic.

Perhaps I'm too critical in calling these deceptions, because they may or may not be true depending on certain assumptions. But the assumptions underlying the four statements are not adequately explained. So to better understand the whole issue of using debt wisely (if, in fact, you should use it at all), you must recognize these deceptions and evaluate them relative to your own circumstances.

Deception 1: Paying Back With Cheaper Dollars. In the 1970s and early 1980s, inflation was at double-digit levels and was projected by almost everyone to be ever increasing. The "wisdom" then was that you would

always be able to pay back borrowed money with dollars that were worth less in the future, because inflation eats away at the purchasing power of money. This wisdom was true as long as two basic assumptions were met. The first was that you were able to borrow at a fixed interest rate so your rate did not increase with inflation. The second was that inflation would continue.

The example used most frequently to sell this deception was the purchase of a home using a fixed-rate, long-term mortgage. This does in fact make sense in a time of inflation, because the dollars used to pay back the principal amount borrowed are worth less and less. In addition, when the interest rate is fixed

for the life of the loan, you can't be hurt by the increasing interest rates that go hand in hand with inflation. That approach continues to make sense if the two assumptions continue to be valid.

History proves, however, that there are economic cycles. They may not be geographically universal, but they do occur. For example, if you bought a home in the Southwest in the early 1980s, you would have paid a premium price. But when oil prices fell and the economy turned south in the Southwest, the assumption of continuing inflation proved to be wrong.

Other illustrations abound. Midwest farms in the early 1980s were selling as fast as they came on the market at

prices that eventually reached \$4,000 per acre. By the late 1980s, however, that same premium farmland could be purchased for \$1,200 to \$1,500 per acre. The point is that even if inflation were a valid assumption overall, it may not be valid for the region in which you live. When industries leave an area, inflation changes. There aren't as many people demanding the same goods and services, so prices tend to fall. Thus, what is true today regarding inflation may not be true tomorrow.

The idea of gaining an economic advantage by borrowing at fixed interest rates so your rate doesn't go up with inflation assumes that lenders are basically stupid and will continue to lend

money at low, fixed rates for long terms even during times of inflation. That's not the case. In periods of inflation, interest rates rise, and lenders promote adjustable-rate mortgages. They also know that the average home loan will mature (be paid off) within eight years as borrowers sell or refinance. Then the money from the payoff of that mortgage can be reloaned on the same house at a higher interest rate. Additionally, every time they make loans, lenders can charge points and fees that increase their income. Thus, they don't make bad decisions even when they're willing to make fixed-rate loans. They push as much of the risk to the borrower as they possibly can. And in times of infla-

tion, they charge premium rates.

Whenever you borrow money at a premium interest rate, the fact of paying back with cheaper dollars in the future is mitigated by the high rate. In my 20 years of professional experience, interest rates on credit card and installment debt have never been lower than the inflation rate except for very short periods. So while you may repay the loan with cheaper dollars in the future, the premium interest rates charged more than offset the benefit.

Coming next month: A discussion of the other three financial deceptions. ♦

Saving For Future Needs

Even if you've not fully paid off your consumer debt, it's still a good idea to set aside some of your monthly surplus for building a savings reserve. Your first savings priority is to set aside three to six months of living expenses for emergencies. We suggest \$10,000 as a starting point, but it's your call. After that, you will want to begin accumulating the funds needed for a major purchase you may be planning (such as a car).

"There is precious treasure and oil in the dwelling of the wise, but a foolish man swallows it up." Proverbs 21:20

Mission Statement: The intent of this column is to educate you concerning the various kinds of fixed-income investments useful to savers, inform you about the trends in interest rates, and update you on where you can currently get attractive yields at low risk.

WHAT IF THE BANK BREAKS? HOW TO BE SURE YOUR SAVINGS ARE SAFE

In almost any good-sized city, many of the largest buildings are likely to be *bank* buildings. Being housed in an

impressive edifice sends a not-too-subtle message: "Our bank is solid and successful. We're here to last." After all, bankers know that gaining and retaining depositor confidence is essential. If customers lose faith in a bank, then that institution is in serious trouble. Wary depositors will act quickly to take their money elsewhere.

If you've seen *Mary Poppins* or *It's a Wonderful Life* you have some idea what a "bank run" is like. Concerned customers rush to retrieve their cash before an expected collapse. Fortunately, bank runs occur infrequently in the U.S., thanks largely to the advent of federal deposit-insurance in the 1930s. But bankers still know that customer confi-

dence is a fragile thing.

In 2008, many depositors grew anxious when noted economist Nouriel Roubini of New York University warned of a “systemic banking crisis” resulting from rising mortgage defaults and unrecoverable consumer debt. He predicted that “hundreds of banks [would go] belly up.” In response to growing public concern, one of America’s largest banks sent a mass mailing to its depositors, stressing that the bank was “solid,” “strong,” and “resilient.” The American Bankers Association—the banking industry’s trade group—issued a list of “talking points” to member banks, urging them to emphasize that banks are “well-positioned to handle economic downturns” and that

“customers’ deposits are protected.”

The banking blowout Roubini predicted may have been mitigated by Federal Reserve action that pumped billions into the banking system, but even so more than 450 U.S. banks have failed since the beginning of 2008, according to the Federal Deposit Insurance Corporation (FDIC). Only about 40 of those failures have occurred this year, most involving relatively small banks with less than \$200 million in assets. But larger banks can fail too. In January, Tennessee Commerce Bank, a billion-dollar bank near Nashville, went under.

When a bank fails

Typically, a failed bank re-opens

quickly — with new owners and under the close supervision of banking regulators. It is not uncommon for a failed bank to be closed by the FDIC or state banking officials late on a Friday afternoon — with no prior public notice — and be re-opened the following Monday under new ownership and a new name. In most cases, the transition is a relatively smooth process. And the FDIC makes sure there is ample cash on hand when the “new” bank opens, just in case more than a few cautious customers decide to take their business elsewhere.

The good news is that losing money in a bank failure is unlikely. Under legislation passed during the 2008 financial crisis — and since extended — the

FDIC covers each depositor up to \$250,000.¹ Important: The federal coverage is \$250,000 per *depositor* at an insured bank, not per account. In other words, if you have multiple accounts at the same bank, each is not insured separately. But the “per depositor” rule works another way too: joint accounts—which legally have multiple owners—are covered up to \$250,000 per *owner*. So a husband/wife joint account, for example, would have \$500,000 in coverage, assuming the couple (continued on page 142)

MONEY RATES

BANK SAVINGS ACCOUNTS

SAVINGS INSTITUTION	MONEY MARKET	MINIMUM INVEST	6 MO CD	1 YR CD	MINIMUM INVEST	PHONE NUMBER
BARCLAY'S	1.00%	\$0	0.60%	0.90%	\$0	888-710-8756

ABLE BANK	0.90%	\$1,000	0.80%	1.00%	\$1,000	888-426-2253
ALLY BANK	0.89%	\$0	0.79%	1.01%	\$0	877-247-2559
DISCOVER BANK	0.80%	\$500	0.75%	0.90%	\$2,500	800-347-7000

[Source: www.bankrate.com on 8/20/2012]

WORTH INVESTIGATING FOR YOUR ACCUMULATION FUND

FUND NAME	TICKER SYMBOL	AVG PAST 3 YEARS	MINIMUM INVEST	SUGGESTED TIME FRAME	PHONE NUMBER	SEE SMI ARTICLES
VANGUARD S-T TREASURY	VFISX	2.01%	\$3,000	2-3 YEARS	800-662-7447	08/10, P119
VANGUARD S-T FEDERAL	VSGBX	2.71%	\$3,000	2-3 YEARS	800-662-7447	08/10, P119
VANGUARD S-T INVEST GRADE	VFSTX	4.63%	\$3,000	2-3 YEARS	800-662-7447	08/10, P119
VANGUARD GNMA BOND	VFIIIX	6.22%	\$3,000	3-5 YEARS	800-662-7447	09/10, P135

[Note: Values fluctuate daily. Losses are possible over the short-term. For more, see the articles listed above.]

MONEY MARKET FUNDS

DATA COLLECTED ON 8/20/2012

MONEY FUND	EFFECTIVE YIELD	MIN INVEST	PHONE NUMBER
FLEX FUNDS MMF	0.10%	\$2,500	800-325-3539
DELAWARE CASH RESERVE	0.10%	\$1,000	800-362-7500
FIDELITY SELECT MMF	0.09%	\$1,000	800-343-3548
SCHWAB CASH RESERVE	0.07%	\$1	800-435-4000
PIMCO MMF	0.05%	\$1,000	800-426-0107

U.S. GOVERNMENT-ONLY MONEY FUNDS

DATA COLLECTED ON 8/20/2012

MONEY	EFFECTIVE	MIN	PHONE
FUND	YIELD	INVEST	NUMBER
WEITZ GOVT MMF	0.04%	\$5,000	800-304-9745
PIMCO GOVT MMF	0.02%	\$1,000	800-426-0107
FIRST AMERICAN GOVT	0.02%	\$2,500	800-677-3863
PAYDEN CASH RESERVES	0.02%	\$5,000	800-572-9336
VANGUARD FEDERAL MMF	0.01%	\$3,000	800-662-7447

TAX-FREE MONEY FUNDS

DATA COLLECTED ON 8/20/2012

MONEY	EFFECT	IN 25%	MINIMUM	PHONE
FUND	YIELD	BRACKET	INVEST	NUMBER
INVESCO T-E CASH	0.09%	0.12%	\$1,000	800-659-1005
ALPINE MUNI MMF	0.05%	0.07%	\$2,500	888-785-5578
VANGUARD TAX-EXEMPT	0.01%	0.01%	\$3,000	800-662-7447
BMO TAX-FREE CL Y	0.01%	0.01%	\$1,000	800-236-3863
AMERICAN CENTURY	0.01%	0.01%	\$2,500	800-345-2021

¹Some financial products offered through certain banks are not

LEVEL **3** THREE

Investing For Retirement

When you invest in the markets, you take the risk of losing part of your money. That's why you should use your monthly surplus to invest for retirement *only after* you've paid all your consumer debts (excluding your mortgage, if any) and *only after* building your Level Two contingency fund.

Of course, you may already have money set aside in an IRA or other retirement plan; the topics discussed here can help you invest that more wisely.

"Well done, good and faithful servant. You were faithful with a few things, I will put you in charge of many things."

Matthew 25:21

Mission Statement: The intent of this column is to teach the basics about the stock-market, mutual funds, SMI strategies, and how to control risk. We want to help you develop a long-term perspective and personalized plan to guide your investment decision-making.

DO YOU NEED FOREIGN STOCKS IN

YOUR PORTFOLIO?

The investing world is filled with “conventional wisdom.” But every now and then, it’s good to reexamine these beliefs/assumptions. We recently did that as it pertains to investing in foreign stocks, and were surprised at what we found.

For decades, the conventional wisdom regarding foreign stocks revolved around the following two points:

1. Foreign stocks offer great diversification benefits. The theory being that foreign markets often zig when the U.S. market zags, so this tends to balance things out and make your overall portfolio less volatile.
2. Foreign markets offer exciting

growth opportunities. Why exclude half (or more) of the world's stocks from your portfolio?

A changing world?

Globalization has been one of the buzzwords of the past decade. While there are many definitions of this term, in its financial context it usually refers to the idea that the world's individual nations are becoming more interconnected. National economies used to be more isolated, and were affected primarily by local and regional factors. Today, the increasing ties of our global economy mean that what impacts one country or region tends to be felt rather quickly by many other countries and regions.

What we've seen in recent years is that when U.S. stocks have done well, so have foreign stocks, and vice versa. This is clearly reflected in the table on the right, which shows the results of investing in SMI's two primary investing strategies over the past 10 years. For each strategy, we've provided the year-by-year results of including the foreign component as recommended, as well as what the results would have been had an investor chosen to *not* include foreign (in which case the money was distributed evenly among the U.S. categories).

The table shows vividly that there hasn't been much difference between including or excluding the foreign com-

ponent from these portfolios over the past decade. In fact, last year's relatively small difference in results (2.5% for Just-the-Basics, 3.1% for Upgrading) was the largest of any year in the past decade.

With any study of this sort, the specific years examined can make a big difference. So we're leery of drawing too many conclusions from this relatively short period. We did go back six more years to the beginning of SMI's good data on these strategies, and with the exception of one big year (2001) when excluding foreign really helped Upgrading, the extra years just reinforced the same conclusion: including foreign stocks hasn't made much of a difference. (Full disclosure: using the 16-year period did swing the annual-

ized returns for both strategies slightly in favor of excluding foreign, the opposite of the 10-year period results below.)

	JustBasics no Foreign	JustBasics w/Foreign	Upgrading no Foreign	Upgrading w/Foreign
2002	-20.1%	-19.6%	-14.2%	-14.1%
2003	36.0%	35.7%	46.6%	46.7%
2004	14.7%	15.6%	16.3%	17.3%
2005	7.5%	9.0%	9.2%	12.0%
2006	15.0%	17.2%	14.7%	17.4%
2007	4.9%	7.1%	13.1%	14.3%
2008	-37.9%	-39.3%	-37.4%	-38.8%
2009	32.0%	33.9%	31.8%	33.6%
2010	21.1%	20.0%	18.5%	17.8%
2011	-0.9%	-3.4%	-2.2%	-5.3%
10 Years	4.7%	5.0%	7.0%	7.3%

But we still believe!

While the diversification argument for owning foreign stocks seems to have weakened, we tend to view that

issue somewhat differently. In our view, unless adding foreign stocks is *hurting* our performance (or greatly complicating our investing, which it is not), we're inclined to keep it. The diversification benefit may be small, but we still believe it is a benefit worth having. (Plus, it's always possible this benefit will grow in the future, though we're not counting on that outcome.)

The main reason we continue to favor including foreign stocks is the growth argument. As more of the world's economic growth happens outside the U.S., it seems unwise to exclude this growing proportion of international businesses from our portfolios. If anything, the increasing

number of growth-oriented economies internationally makes us think our proportion of foreign stocks may well *increase* over the years rather than decrease, though likely with significant year-to-year fluctuations.

Conclusion

While SMI isn't inclined to make any significant changes based on this analysis, it may have applications for some readers. Newer investors struggling to meet the minimum investment amounts for multiple funds may breathe easier skipping a foreign component initially. Other investors who either want to simplify their investing,

or who are uncomfortable with the idea of foreign investing, can also take comfort in these numbers. At least in recent years, including or excluding foreign stocks hasn't changed our overall performance much. ♦

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LEVEL 4 FOUR

Diversifying For Safety

This column goes beyond the basics taught in Level 3, going a little deeper into the “whys and hows” of our diversified investing strategies.

By adding holdings that “march to different drummers,” we create a more efficient, less volatile portfolio. We also use the investing personali-

ties and seasons-of-life guidelines to more closely align your allocation between stocks and bonds in accordance with your personal situation.

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

Ecclesiastes 11:2

Mission Statement: The intent of this column is to teach about the wider range of investment markets and strategies appropriate for a diversified portfolio. The "Recommended Funds" page and data in the quarterly Fund Performance Rankings are integral to this process.

INVESTING FOR INCOME

It's easy to invest for *growth*—just set up your portfolio with the largest stock allocation you can stomach and fasten your seatbelt. But what about investing for *regular income*, either for the intermediate- or long-term? Perhaps you're saving up for a big purchase, such as the down payment on a house, five years down the road. Or maybe you're in retirement and want a steady stream of income to live on. You want your investments to be secure, but would like to get a higher return than you can expect from ultra-safe investments such as bank

CDs and money market accounts. Bond funds have traditionally been the answer to this dilemma.

Typically, bond fund investors are seeking regular income. This leads most bond funds to distribute income to their shareholders on a monthly basis (or you may choose to have your monthly dividend reinvested in more fund shares). The amount of your monthly check, combined with any gains (or losses) in the value of the bonds owned in the funds, comprises your *total return*.

The table below provides some food for thought. It shows the total returns from investing in various combinations of Vanguard bond funds over the past 25 years. As you move to the right

across the page, the portfolios are increasingly diversified to include slightly higher-risk funds. Thus, the most volatile portfolio is on the far right.

Let's walk through an example. Assume you have money you can invest for the next five years. At the end of that time, you'll be cashing out to use the money toward purchasing a home. Historically, if you had put all the money in the safest fund shown (portfolio A), the *average* return during a typical five-year period would have been 6.0% (circled). However, it's the "result 2/3 of the time" line which is more indicative of what you're likely to experience. In this instance, it suggests that it's reasonable to expect annual returns somewhere be-

tween 4.2% and 7.8%.

We've accounted for two-thirds of the historical results, but what about the other one-third? They fell outside this range—half of the time doing even better and half the time doing worse. If you want to be optimistic, look at the 10.3% per year “best-case” scenario. You can assume that one-sixth of the historical results (one-half of the remaining one-third) were at least 7.9% annually (a number just above the upper limit of the 2/3 range) but no higher than 10.3% per year (the “best-case” scenario). On the other hand, with interest rates currently at generational lows, it's probably more appropriate for bond investors to be investing with one eye

clearly fixed on the “worst-case” scenarios. For the portfolio we’ve been looking at, that would be 1.9% per year. By the same token, you can also deduce that the final one-sixth of the historical results ranged from 4.1% *(continued on page 142)*

INCOME-ORIENTED PORTFOLIOS FROM VANGUARD

INVESTMENT RETURNS OF VARIOUS BOND FUND COMBINATIONS • JANUARY 1987 - JUNE 2012

Portfolio:	(A)	(B)				
(C)	(D)	(E)	(F)			
VFSTX Vanguard Short-Term Corp (#39)	100%	50%	33.3%	25%	20%	None
VBWFX Vanguard Total Bond Market (#84)	None	50%	33.3%	25%	20%	25%
VFIIX Vanguard GNMA Fund (#36)	None	None	33.3%	25%	20%	25%
VWEHX Vanguard High Yield Bond (#29)	None	None	None	25%	20%	25%
VCV SX Vanguard Convertible Sec (#82)	None					
None	None	20%		25%		None
Average of 295 1-Year Periods	6.1%	6.6%	6.9%	7.1%	7.6%	8.0%
Best 1-Year Period				15.7%		15.5%
16.0%	20.7%	25.0%		27.4%		
Worst 1-Year Period	-5.8%	-2.1%	-1.6%	-6.4%	-12.1%	-13.6%
Result two-thirds of the time	9.7% to 2.5%	10.3% to 2.9%	10.5% to 3.2%	11.5% to 2.8%	13.2% to 2.0%	14.3% to 1.6%
Average of 271 3-Year Periods	6.1%	6.6%	6.8%	7.0%	7.6%	7.9%
Best 3-Year Annualized Return				11.2%		11.9%
12.5%	13.6%	16.1%		17.7%		
Worst 3-Year Annualized Return	1.7%	2.0%	2.1%	1.6%	0.5%	0.2%
Result two-thirds of the time	8.3% to 4.0%	8.8% to 4.4%	9.1% to 4.6%	9.4% to 4.7%	10.1% to 5.0%	10.8% to 5.1%

Average of 247 5-Year Periods	<6.0%	6.5%	6.7%	6.9%	7.5%	7.8%
Best 5-Year Annualized Return				10.3%		10.9%
11.5%	11.3%		11.9%		12.8%	
Worst 5-Year Annualized Return	1.9%	2.7%	3.2%	2.5%	2.0%	2.1%
Result two-thirds of the time	7.8% to 4.2%	8.3% to 4.7%	8.5% to 4.9%	8.8% to 5.0%	9.5% to 5.5%	10.0% to 5.7%

Note: The periods shown are “rolling” periods throughout the year rather than calendar year periods only. Portfolios were rebalanced to their original allocations every 12 months.

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SOUND MIND



PORTFOLIOS

Recommended Funds

The fund recommendations shown for Upgrading accountholders are based primarily on their “momentum” scores, but consistency of performance and the portfolio manager’s philosophy and number of years at the helm are also important. Four recommendations are made in each risk category so that you can select the one(s) most in accord with your preferences and account size.

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

JUST-THE-BASICS STRATEGY — RECOMMENDED FUNDS

Portfolio				----- Performance -----						3Yr
Data through 7/31/2012				Rel	Expense	-----	Stock/Bond Mix -----			Ticker
1Mo	3Mo	6Mo	12Mo		Invested In		MOM	YTD		
40/60	Symbol			Avg	Risk	Ratio	100/0	80/20	60/40	
Total International Stock				Foreign stocks				-22.0		3.6%
0.3%	-5.2%	-3.5%	-13.3%	new	new	0.18%	20%	16%	12%	
8%	VXUS									
Extended Market Index				Small company stocks				-4.2		8.1%
-0.7%	-4.8%	0.5%	0.1%	15.3%	1.29	0.14%	40%	32%	24%	1
6%	VXF									
S&P 500 Index				Large company stocks				14.1		10.8%
1.2%	-0.9%	6.0%	8.9%	new	new	0.05%	40%	32%	24%	
16%	VOO									
Total Bond Mkt Index				Medium-term bonds				12.4		3.5%
1.2%	2.2%	2.9%	7.3%	6.6%	0.96	0.10%	None	20%	40%	
60%	BND									

VANGUARD JUST-THE-BASICS FOOTNOTES: Just-the-Basics is an indexing strategy that requires just minutes a year to assure that your returns are in line with those of the

overall market. You won't "beat the market" using this simple strategy, but neither will you fall badly behind. Your JtB portfolio should be allocated among as many as four

Vanguard funds (as shown above) depending on your stock/bond mix. For more on Just-the-Basics, see the [New Reader Guide](#) and June2012:p89.

UPGRADING STRATEGY — RECOMMENDED FUNDS

Date	Scottrade	Fidelity	Schwab	----- Performance -----				
	3Yr Relative Exp				Number	Redemp	Ticker	
Risk	Data through 7/31/2012 ¹				Added	Avail ²	Avail ²	Avail ²
MOM ³	YTD	1Mo	3Mo	6Mo	1 2Mo	Avg	Risk ⁴	Ratio
Fee ⁵	Symbol				Holdings			
	1. Tweedy, Brown Global Value				11/11	Yes	Yes	Yes
13.1	9.9%		2.4%	1.4%	8.0%	3.7%	11.9%	0.76

category Foreign	1.40%	110	2%	60days	TBGVX													
	2. Artisan International Inv																	
	3. Wasatch International Gro																	
	07/12	NTF	NTF	NTF	0.3	12.4%												
03/12	NTF	NTF	NTF	-1.8	15.2%													
1.8%	-2.5%	5.7%	-2.9%	7.7%	1.34	1.22%	84	2%	90days	ARTIX								
1.5%	-3.5%	6.5%	-4.8%	16.7%	1.26	1.57%	88	2%	60days	WAIGX								
C	4. Fidelity Intl Small Cap Opp																	
	-8.8	8.4%	0.9%	-5.3%	1.2%	-4.7%	12.9%	1.19	1.08%	151	2%							
	90days	FSCOX																
Category 4 Small Growth	1. Artisan Small Cap Investor		09/11	NTF	NTF	NTF	2.7	11.1%	-0.5%	-3.1%	0.0%	5.7%	18.8%	1.18	1.66%	66	None	ARTSX
	2. Akre Focus Retail		11/11	NTF	NTF	NTF	26.7	10.6%	0.3%	-2.2%	8.2%	20.6%	new	new	1.45%	29	18 30days	AKREX
	3. Wasatch Core Growth		09/11	NTF	NTF	NTF	8.2	8.6%	-0.3%	-1.9%	3.2%	6.8%	17.5%	1.05	1.31%	57	28 60days	WGRGX
	4. FBR Focus		07/12	NTF	NTF	NTF	6.8	4.7%	-0.6%	-5.0%	2.3%	9.5%	13.3%	1.11	1.44%	24	18 90days	FBRVX
Category 3 Small Value	1. Hennessy Focus 30		06/12	NTF	NTF	NTF	14.7	10.4%	4.2%	1.6%	9.5%	3.6%	17.6%	1.04	1.36%	32	None	HFTFX
	2. Fidelity Small Cap Discovery		04/12	Yes	NTF	Yes	4.0	8.3%	-0.1%	-3.0%	2.1%	5.0%	17.8%	1.33	1.07%	72	1.5% 90days	FSCRX
	3. iShares S&P 500 Val		02/12	ETF	ETF	ETF	-0.7	6.8%	-0.7%	-3.6%	-1.1%	4.0%	13.8%	1.34	0.29%	454	None	IJS
	4. Invesco VK Amer Val Y		06/12	No	Yes	No	6.3	9.3%	-0.2%	-3.7%	3.9%	6.1%	16.6%	1.14	1.02%	44	28 30days	NSAIX
Category 2 Large Growth	1. PowerShares QQQ		03/12	ETF	ETF	ETF	17.5	16.5%	1.0%	-2.7%	7.5%	12.7%	18.9%	1.15	0.20%	100	None	QQQ
	2. Guggenheim Russell Top 50		09/12	ETF	ETF	ETF	24.5	13.6%	2.1%	1.1%	9.3%	14.2%	13.0%	0.94	0.20%	52	None	XLG
	3. BBH Core Select Retail		09/12	NTF	NTF	NTF	24.6	13.0%	2.7%	2.2%	9.3%	13.1%	15.8%	0.81	1.25%	31	28 30days	BSTRX
	4. Touchstone Large Cap Gro		07/12	Yes	Yes	No	12.6	8.5%	-1.2%	-2.7%	6.8%	8.5%	15.7%	0.96	0.99%	42	None	TIQIX
Category 1 Large Value	1. Fidelity Mega Cap Stock		04/12	Yes	NTF	Yes	16.7	11.9%	1.7%	-1.6%	6.9%	11.4%	14.1%	1.08	0.79%	107	None	FGRTX
	2. Mairs & Power Growth		03/12	Yes	Yes	Yes	18.1	12.4%	0.7%	-1.2%	5.5%	13.8%	14.3%	1.00	0.72%	48	None	MPGFX
	3. Consumer Staples Select		07/12	ETF	ETF	ETF	36.4	11.0%	2.5%	5.0%	12.6%	18.9%	16.5%	0.62	0.18%	42	None	XLP
	4. iShares Dow Jones Divd Idx		07/12	ETF	ETF	ETF	26.5	8.6%	2.0%	2.1%	8.6%	15.8%	18.2%	0.77	0.40%	101	None	DVY
Bond Risk Conserv	Vanguard L-T Bond Index		07/12	ETF	ETF	ETF	42.9	9.7%	4.3%	9.0%	8.7%	25.2%	14.8%	3.16	0.11%	14.2 ⁶	None	BLV
	Vanguard Inflation-Protected		01/10	Yes	Yes	Yes	16.2	5.9%	1.9%	3.0%	3.6%	9.6%	10.1%	1.69	0.20%	8.4 ⁶	None	VIPSX ⁷
	Vanguard I-T Bond Index		07/12	ETF	ETF	ETF	17.8	5.7%	1.8%	3.4%	4.1%	10.3%	9.5%	1.59	0.11%	6.4 ⁶	None	BIV
	Vanguard S-T Bond Index		07/12	ETF	ETF	ETF	4.0	1.6%	0.5%	0.7%	1.0%	2.3%	3.3%	0.54	0.11%	2.7 ⁶	None	BSV

Upgrading Footnotes: [1] The funds in each risk category are selected (and ranked 1 through 4) primarily based on their momentum scores in mid-August, not those shown on this report. The fund ranked fourth is the one which appears most likely to be replaced

in the near future if performance doesn't improve. 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 Scottrade (800-619-7283), 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 November2008:p168. [4] A 1.0 reading indicates the fund has had the same volatility as the market in general over the past three years. For example, a fund with a relative risk score of 1.4 would mean the fund was 1.4 times (40%) more volatile than the market. See July2011:p104. [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 12 months 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] For bond funds, this column shows the "duration" in years. Typically, the longer the duration, the greater the risk/reward. See Jun2012:p88. [7] TIP and SCHP are acceptable ETF alternatives; see July2012:p105. [8] An alternative ticker, BBTEX, is available with a lower expense ratio but carries a transaction fee. See page 141.

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☎ Changes in our stock fund recommendations are explained in the MoneyTalk column.

SOUND MIND  PORTFOLIOS

Upgrading:

Easy as 1-2-3

SMI routinely presents a variety of investing choices, but don't be confused – our core investing strategy is Fund Upgrading. We encourage most

readers to use it as the foundation of their investing plan. Upgrading has proven itself in both bull and bear markets, producing market-beating

returns over time, and it is easy to implement. The page below 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. 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 considerably. While

Upgrading is relatively low-maintenance, it does require you to check your fund holdings each month and replace funds occasionally. A professionally-managed version of Upgrading is also available (see Dec2010:p185, or visit www.soundmindinvesting.com/smifx.htm).

SMI also offers an investing strategy based on index funds called Just-the-Basics (JtB). JtB requires attention only once per year, then goes unchanged the rest of the year. The returns expected from JtB are lower than what we expect (and have received) from Upgrading. JtB columns, split the difference.) Multiply each percentage by the value of your total portfolio amount to calculate the dollar amount to invest in each SMI risk category. The total to be invested and the frequency of Upgrades you are willing to make determine whether you should invest in just one recommended fund per risk category (see “Buying Only Our 5 Top-Ranked

1 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 1 in the text for information on our investment temperament quiz. You may want to fine-tune the above percent-

Funds Still Trounces the Market" in the April 2010 issue), or if holding 2-4 funds per category is appropriate.

3 Buying your funds is easy. Look at the recommended funds on the opposite page. In each category, start with the top listed

recommendation; if it's available at your brokerage, buy it. (If your preference is to buy more than one fund in a category, continue down the list to the next available fund.) Then contact your broker—online or via phone—to buy the funds 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 if buying one fund per category. First, he or she selects the proper stock/bond mix for their situation (let's assume 80/20). Then, from Table 2, finds the percentages for each risk category. Multiplying \$50,000 by each percentage yields the dollar amount for each category as shown in Table 3.¹ Looking at the Fidelity column on

makes the most sense for those in 401(k) plans ages to suit your
personal approach to risk-taking. the Recommended Funds page,
the highest-
that lack a sufficient number of quality
fund options to make successful Up-
grading within the plan possible.

2 FIND YOUR PORTFOLIO MIX

rated Cat. 5 fund available at Fidelity is Tweedy Brown Global Value, the highest-rated Cat. 4 fund available is **WHERE TO OPEN YOUR ACCOUNT**

Opening an account with a discount

Portion of Portfolio Allocated to Stocks:	100%	80%	60%	40%
---	------	-----	-----	-----

Portion of Portfolio Allocated to Bonds:	None	20%	40%	60%
--	------	-----	-----	-----

Artisan Small Cap Investor, and so on.

After doing this for each category, the

orders are placed and the Upgrading

broker that offers a large selection of no-

Invest by Owning: Cat. 5 – Foreign	16%	12%	8%	8%
------------------------------------	-----	-----	----	----

portfolio is complete! load funds greatly simplifies the Upgrad-

Invest by Owning: Cat. 4 – Small/Growth	21%	17%	13%	8%
---	-----	-----	-----	----

From then on, it's just a matter ing process.

This allows you to quickly and

Invest by Owning: Cat. 3 – Small/Value	21%	17%	13%	8%
--	-----	-----	-----	----

of checking the Recommended Funds easily buy/sell no-load mutual

Invest by Owning: Cat. 2 – Large/Growth	21%	17%
---	-----	-----

13% 8% Report each month. When an owned without having to

open separate accounts Invest by Owning: Cat. 1 – Large/Value

21% 17% 13% 8% fund is removed from the recom-

at all the various fund organizations. There are several good brokerage choices available. We recommend reading our latest Broker Review (February 2012; Cover article, also available online) for details

Invest by Lending – Long-Term Bonds	None	None	None	None
Invest by Lending – Inflation-Protected Bonds	None	None	5%	10%
Invest by Lending – Medium-Term Bonds	None	15%	20%	30%
Invest by Lending – Short-Term Bonds	None	5%	15%	20%

mended list (but not before), the Upgrader immediately sells that fund and invests the proceeds in the highest-ranked fund that: (1) is available and (2) is not already

regarding the pros and cons of each bro-

ker, as your specific investing needs will

largely dictate which broker is best suited

③ BUY YOUR FUNDS

owned (3) in the same category.

401(K) INVESTORS

to your situation.

HOW TO BEGIN UPGRADING

① First determine your stock/bond

Example uses an 80/20 mix
between stocks and bonds

Compute
Dollars

Invest In
Funds

Stock Cat. 5 – Foreign	12%	\$6,000	Tweedy Brown Global Value
------------------------	-----	---------	---------------------------

Stock Cat. 4 – Small/Growth	17%	\$8,500	Artisan Small Cap Investor
-----------------------------	-----	---------	----------------------------

If you have a “brokerage link”

option in your 401(k), you can use it
to follow the standard Upgrading
process and fund recommendations.

target allocation by working through the

Stock Cat. 3 – Small/Value	17%	\$8,500	Hennessy Focus 30
----------------------------	-----	---------	-------------------

If not, you can still benefit from investment temperament quiz
available

Stock Cat. 2 – Large/Growth	17%	\$8,500
-----------------------------	-----	---------

PowerShares QQQ

Upgrading, but it requires a little in the

“New Reader Guide” (or online in

Stock Cat. 1 – Large/Value	17%
----------------------------	-----

\$8,500 Fidelity Mega Cap Stock
extra effort. For a detailed
explanation the “Getting Started” section). For ex-

Long-Term Bonds	None	0	None
-----------------	------	---	------

nation of how to Upgrade within ample, Table 1 provides guidelines

Inflation-Protected Bonds	None	0
---------------------------	------	---

Vanguard TIPS Fund your 401(k) plan, see Mar2010:p40.
those with an "Explorer" temperament.

② Find the column that matches
your stock/bond allocation in Table 2.
(If your target falls between two listed

Medium-Term Bonds	15%	\$7,500	Vanguard I.T. Bond Index
Short-Term Bonds	5%	\$2,500	Vanguard S.T. Bond Index
Total	100%	\$50,000	

That article also contains ideas on
Upgrading in any type of account
where your available fund choices
are limited. ♦

¹Rounding off to the nearest hundred is fine. As time goes by, your portfolio will
gradually move WWW.SOUNDMINDINVESTING.COM ♦

SEPTEMBER 2012 **139** 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 Jan2009:p12
)

SOUND MIND



PORTFOLIOS

Optional Inflation

Hedges

Your use of this page is optional. These funds fall outside the criteria for our core portfolio holdings, but they have special characteristics that could make them desirable depending upon your individual goals, risk tolerance, and tax bracket. These investments typically carry a higher degree of risk than the fully-diversified stock funds shown on the "Recommended Funds" page.

"If any of you lacks wisdom, he should ask God who gives generously to all . . . and it will be given to him." James 1:5

WHAT ARE THESE RECOMMENDATIONS FOR?

Federal budget deficits projected for the coming decade are likely to be inflationary. We expect Upgrading to do a reasonably good job in an inflationary environment. The investments on this page are offered merely as options for those who wish to add *additional* inflation-fighting holdings to their core Upgrading portfolio.

- **Risk warning:** As a result of having a specialized focus, each asset class shown is likely to generate volatile returns. The best/worst results in recent years (shown below for three- and 12-month periods) illustrate that the short-term moves can be breathtaking. ♦

HOLDING MONEY IN THE FORM OF FOREIGN CURRENCIES

Another way to hedge against inflation and its consequent

devaluing of the U.S. dollar is to exchange dollars for another currency. Such holdings could substitute for a portion of your bond allocation. We track 20 currency ETFs (exchange traded funds), and make selections using a form of Upgrading. This recommendation typically changes every 6-9 months. Our current recommendation is:

- **Japanese Yen (symbol: FXJ).** This ETF lost 1.9% for the 12-months ending 7/31/2012. The fund can be purchased through your broker. There is no minimum purchase. ♦

Data as of 7/31/2012

--- From Upgrading In This Group 1996-2010 ---

(See footnotes on the

Date

Performance	-----	3Yr	Rel.	Redemp	Ticker	Avg	Best	Worst
Avg	Best	Worst						
	Recommended	Funds	page)	Added	MOM ³	YTD	1Mo	3Mos
6Mos	12Mos	Avg	Risk ⁴	Fee ⁵	Symbol	3Mos	3Mos	1
2Mos	12Mos	12Mos						

Gabelli Gold AAA 11/11 -52.6 -12.2% -1.9% -7.1% -21.8% -23.8% 5.3% 1.81 2%7days GOLDX +4.4% +54.5% -53.7% +16.3% +109.9% -56.8%

PRECIOUS METALS Most precious metals portfolios focus on gold-mining stocks, though some do own small amounts of gold bullion. Some have significant exposure to silver-, platinum-, and base-metal-mining stocks as well. Typically, precious-metals companies are based in North America, Australia, or South Africa. **PROS:** If sustained inflation produces a long-term bull market in gold, the leverage involved in owning mining stocks should prove more profitable than holding physical gold. Over time, gold stocks have tended to move twice as much--both up and down--as the price of gold itself. **CONS:** You'll get much higher volatility than owning physical gold. Gold has already tripled in price

over the past five years. Also, mining stocks are tethered to the stock market to some degree, which can hurt performance in the event that gold does well but stocks fall.

AmerCentury Real Estate					10/11	27.9	16.7%	2.0%	2.6%	10.
3%	14.9%	30.6%	1.31	None	REACX	+3.2%	+41.9%	-45.9%	+13.5%	
+112.0%		-58.0%								

REAL ESTATE Real estate portfolios invest primarily in real-estate investment trusts (REITs) of various types. REITs are companies that develop and manage real-estate properties. There are several different types of REITs, including apartment, factory-outlet, health-care, hotel, industrial, mortgage, office, and shopping center REITs. **PROS:** Inflation tends to boost both underlying property values, as well as the rents that can be charged. Many real estate funds offer healthy yields for those seeking current income. Funds offer excellent diversification among many REITs holding different properties. **CONS:** Property values have been plummeting at the same time occupancy rates and rents have been

falling sharply due to the recession. This may not be a typically positive inflationary cycle for the real estate market with the commercial sector being particularly hard hit.

ND ES	PowerShares Energy				05/10	-11.8	3.8%	4.6%	-2.2%
	-0.5%	-9.1%	19.3%	1.61	None	PXI	+3.8%	+35.5%	-39.9%
	+14.2%	+67.7%	-54.0%						

Energy and natural resources portfolios focus on commodity-based industries such as oil, gas, chemicals, minerals, and forest products in the U.S. or outside of the U.S. Some portfolios invest across this spectrum to offer broad natural resources exposure. Others concentrate heavily (or even exclusively) in specific industries, including energy or forest products. **PROS:** Global economic growth in the emerging countries is significantly raising the demand for energy. The sector stands to benefit both from normal inflationary impact on commodity prices, as well as concerns regarding total global supply of oil. **CONS:** Energy is subject to speculative boom and bust cycles (2007-2008) as well as recessionary downturns. There is also some concern regarding the regulatory oversight of the methods used by these funds to gain exposure to commodity price movements.

PearlTree Dynamic Emerging 4/12 -24.3 7.7% 1.8% -6.0% -3.7% -14.6% 7.9% 1.42 None QFFOX +3.7% +56.6% +46.6% +15.6% +98.3% -58.3%

Diversified emerging-markets portfolios tend to divide their assets among 20 or more nations, and usually focus on the emerging markets of Asia and Latin America rather than on those of the Middle East, Africa, or Europe. These portfolios invest at least 70% of total assets in equities and invest at least 50% of stock assets in emerging markets. **PROS:** These markets include many of the most dynamic and fastest growing countries in the world. Weakness in the U.S. economy and currency could signal an end to American dominance among world economies, making this a good diversification move. **CONS:** Just as these markets tend to profit more during good times, they also tend to fall faster

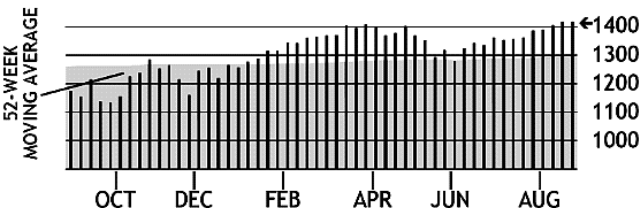
and harder during bad times. Readers with significant foreign allocations in their Upgrading portfolio likely have significant emerging markets exposure already.

STOCK MARKET TRENDS

U.S. LARGE COMPANIES → UP S&P 500 COMPOSITE STOCK INDEX

WEEKLY DATA: POSTED THROUGH AUGUST 20

S&P 500 Index	52 Week Moving Average	Index Above Trend By	39 Week Moving Average	Index Above Trend By
1418.13	1308.37	8.4%	1344.31	5.5%

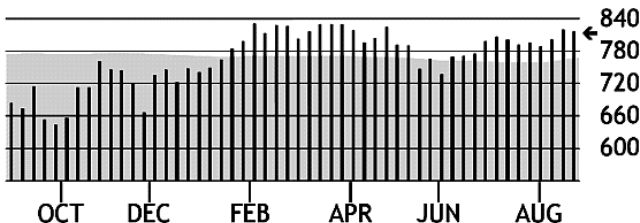


U.S. SMALL COMPANIES → UP

RUSSELL 2000 STOCK INDEX

WEEKLY DATA: POSTED THROUGH AUGUST 20

Russell 2000 Index	52 Week Moving Average	Index Above Trend By	39 Week Moving Average	Index Above Trend By
816.51	767.29	6.4%	790.05	3.3%



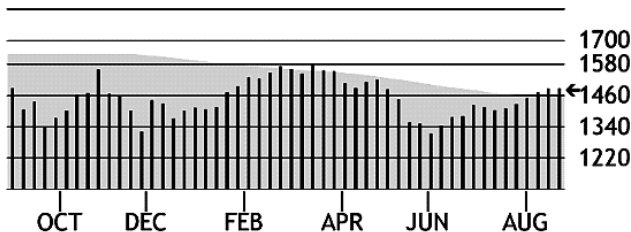
FOREIGN COMPANIES → UP

EUROPE, AUSTRALASIA, FAR EAST INDEX

WEEKLY DATA: POSTED THROUGH AUGUST 20

MSCI	52 Week	Index	39 Week	Index
------	---------	-------	---------	-------

EAFE Index	Moving Average	Above Trend By	Moving Average	Above Trend By
1485.61	1450.89	2.4%	1457.98	19%



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MONEY TALK

NEW FUND RECOMMENDATIONS FOR UPGRADING STRATEGY

[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. Those seeking the simplest method for picking new funds can simply refer to our 1-4

rankings on the "Recommended Funds" page, selecting the highest ranked fund(s) available through your brokerage. • Funds are selected with the hope they will be held for at least 12 months in order to qualify for long-term capital gains tax treatment. Nevertheless, changes are suggested when a recommended fund's performance violates certain mechanical guidelines. Our guidelines provide objective criteria for making the decision as to when to "upgrade" to a better performing fund. When these guidelines are violated, the fund is recommended for sale even if the twelve-month holding period has not yet 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 few months to achieve a tax benefit or save on transaction or redemption fees. Be aware, however, that from 2006-2010, the performance "cost" of retaining such funds has been roughly 0.5% per month. For more details, see Oct2011:p153.]

Two funds that were hovering near the quartile at the end of July have moved in opposite directions through the first half of August. In our small/value group, The iShares S&P 600 Value ETF (IJS) has bounced back up the rankings and is being retained, while in our large/growth group Sequoia (SEQUX) has fallen further and is being replaced. Both of the funds we're selling this month have been closed to new investors for some time, so it will be nice to once again have all of our recommended funds available for purchase.

◆ **In the Large/Growth group, Delaware Select Growth (VAGGX, 9/2011) and Sequoia (SEQUX, 1/2012) are being replaced.** Delaware Select Growth has been held a full year, which is good news for anyone who opted to purchase the C-share (DVECX) last September. If you own this C-share class, please check your buy/sell dates very carefully so as to avoid the 1% back-end load on shares held less than one year. Overall, Delaware Select Growth was a decent performer, given the circumstances of its purchase. The fund gained 8.9% during the first 11 months it was recom-

mended. This is slightly less than the average large/growth fund tracked by Morningstar. But remember that it was recommended on the heels of 2011's awful summer swoon before the market rebounded in the fourth quarter of the year. The fact it was recommended as a conservative fund, yet nearly kept pace while the market proceeded to rally is respectable. That said, it's clearly time to move on to a fund with a little more horsepower.

Sequoia's story is similar. When it was recommended at the beginning of 2012, we wrote, "If the market falls in 2012, we would expect this fund to hold up better than most. And if the market pleasantly surprises us with a rally, it's comforting to note that when a strong rally whipsawed this selection in late 2010, Sequoia was still able to hang in pretty well." Consider us pleasantly surprised, as the average fund in our large/growth group returned a solid 9.5% through the end of July. Sequoia's performance wasn't as strong, returning just 6.3%. Not horrible given its conservative bent, but again, time to upgrade.

- **Guggenheim Russell Top 50 (XLG) is being added.**¹ In last month's mid-year review,² we explained that big was beautiful through the first half of 2012. That is, the stocks of the largest companies have performed much better than the rest of the market. We showed how diversified portfolios, like those Upgrading creates, have lagged the popular indexes such as the Wilshire 5000 and S&P 500, which are dominated by the performance of the largest companies. By adding this Top 50 ETF, we can put this dynamic to work *for* us, rather than against us. This ETF seeks to replicate the performance of the U.S. market's 50 largest stocks. It is cap-weighted, meaning the largest stock in terms of market value — Apple — is the biggest holding, at 9.1% of the fund. Exxon Mobil is 6.5%, AT&T, Microsoft, and General Electric each com-

prise 3.5%, and so on down the list of very recognizable names. As long as big continues to be beautiful, this fund should shine. Remember, this is an ETF, so you'll need to buy it like a stock — see last month's "How to Buy or Sell an Exchange-Traded Fund" (page 125 of the August 2012 issue) for details.

- **BBH Core Select Retail (BBTRX/BBTEX) is being added.¹**

One difficult concept for many new investors is that of *relative value*. That is, how a company can be a fantastic business yet a terrible stock to own due to being overpriced. This phenomenon is common among growth stocks, where great businesses that are growing rapidly often get bid up to exorbitant prices. This was true across the board in the late 1990s, but still happens today (see Facebook, which has lost half its value since it went public in May). When stock price gets ahead of company value, having a great underlying business may not be enough to avoid losses.

This focus on relative value is an important ingredient for many successful funds, such as BBH Core Select, that ply their trade between the value and growth categories. Some of the more successful of these "blend" funds excel at recognizing when a formerly hot growth stock's price has declined enough to make it a compelling value. The managers of this BBH fund admit they wouldn't have owned many of their current holdings a decade ago. Now, the prices of these former high-flyers have come down quite a bit while their businesses have continued to grow.

Morningstar reports that since October 2005 when two of the fund's three current co-managers took over, BBH Core Select has more than doubled the S&P 500's return. Morningstar goes on to note the fund has suffered less than 70% of the S&P 500's declines in recent years. So the fund has outperformed the market,

yet done so with significantly less volatility. That sounds like a winning combination!

However, there is one noteworthy quirk to be aware of when buying this fund. Two share classes are available, with the Core Select N class (BBTEX) having net expenses 0.25% *less* than the retail class (BBTRX). So if you can buy either class at your broker without transaction fees or minimums being an issue, buy BBTEX. However, at Scottrade, Schwab, and Fidelity BBTEX appears to be a transaction-fee fund, while BBTRX is no-transaction-fee. BBTEX also has a higher minimum investment (\$10,000) at some brokers, including Fidelity. Generally speaking, then, investors buying less than \$25,000 of the fund will likely want to buy BBTRX and avoid the transaction fee. Above that amount, it becomes less clear-cut, as the wisdom of paying an up-front fee to get lower ongoing expenses hinges on how long the fund is ultimately held. The greater the amount being invested and the lower the transaction-fee, the more compelling BBTEX becomes. ♦

¹For more on this fund, visit www.morningstar.com. ²Aug2012:p121

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MONEY TALK

LEVEL 2 / CONTINUED FROM PAGE 135:

WHAT IF THE BANK BREAKS?

HOW TO BE SURE YOUR SAVINGS ARE SAFE

had no other accounts that applied against the insurance limit.¹

While \$250,000 (or \$500,000) in deposit insurance is plenty for most savers, wealthier savers should be careful to spread their risk. This simply involves dividing one's savings among *multiple* insured banks, making sure that the total in any one bank stays below the FDIC limit. In this way, all accounts will be insured separately.

Of course, many wealthy people (as well as businesses and nonprofit groups) have money saved in certificates of deposit. Multi-million dollar protection is available for CDs via the Certificate of Deposit Account Registry Service (CDARS).² Rather than having to deal directly with multiple banks to gain extra insurance coverage, a client makes a deposit with a single CDARS-member bank. The bank handles the chore of splitting the deposit into smaller chunks and spreading those chunks among other FDIC-insured banks in the CDARS network. The amount assigned to any given bank is kept below the federal \$250,000 limit, thus effectively providing insurance protection for the entire CD investment, even if the total amount far exceeds the FDIC cap. ♦

LEVEL 4 / CONTINUED FROM PAGE 137:

INVESTING FOR INCOME

(a result that's just below the lower limit of the 2/3 range) down to the 1.9% "worst-case" result.

Even assuming relatively poor results, then, this portfolio offers better returns than you'd get at your local bank. But you can likely improve your returns further by stepping up the risk ladder. High-yield bonds and convertible securities (included in portfolios D, E, and F) tend to track the stock market more than they do the bond market. Thus, as you begin adding those two funds into your mix, you increase both upside potential and downside risk.

Readers can take some degree of comfort from the fact that 15 of the 18 “worst” figures in the table have occurred in the four years since 2008’s financial crisis. It’s always possible an even worse scenario could come along, but knowing these worst-case results were inspired by the most dramatic financial crisis in 80 years does boost our confidence that they likely represent true lows.

Income tools for SMI web members

It’s worth noting that there’s nothing particularly magical about the five specific funds we’ve used in this analysis. Our goal with these Vanguard bond portfolios over the years has simply been to demonstrate reasonable steps across the risk spectrum from extremely conservative to extremely aggressive.

To allow for a greater degree of customization with these bond portfolios, SMI web members have access to our Vanguard Income Portfolio Tools. These tools can be accessed from the sidebar link in the Tools section of SMI’s Bond Market page. The tools provide the same Average/Best/Worst return data for combinations of up to 15 different Vanguard bond funds (as opposed to just five in this article).

The Income Portfolio Tools list the various bond funds from most risky at the top of the list to least risky at the bottom. So for most people, the best way to use the tools will be to experiment with various fund combinations to arrive at a portfolio that satisfactorily balances risk (worst case you’re willing to accept) and reward (average annual return). You might begin with a few funds from the bottom half of the table, emphasizing short- to intermediate-term average maturities. Print the results, then tweak that portfolio by adding a fund or two from the top, higher-risk grouping, and

print again. Doing this several times will result in multiple one-page printouts which you can then compare and analyze. As you might expect, we strongly recommend focusing on the worst-case scenarios as you review various potential combinations.

The data in the online tools cover only the years 1996-2010 (as opposed to the table in this article, which runs 1987-6/30/12), so you may notice some discrepancies if you compare the specific portfolios listed in this article. We'll update the online tools at the end of 2012 with the data from the past two years (the starting date will remain 1996, as several of the funds didn't exist before then). But you can still get a good idea of what types of returns various fund combinations are likely to produce and tailor your risk/reward expectations accordingly.³ ♦

LOOKING AHEAD / CONTINUED FROM PAGE 144:

BIBLICAL GUIDELINES FOR INVESTING

on any investment, consider all the costs.

4. The Lord's timing. The timing for the acquisition and sale of investments is especially important in this economic climate. Ecclesiastes 3:1 tells us: *"There is an appointed time for everything. And there is a time for every event under heaven."* The right investment at the wrong time is the wrong investment.

The decision to purchase or sell an investment is best made prayerfully. Despite what so-called financial experts and pundits so confidently express about what will happen to investments in the future, no one knows except the Lord. *No one.* Period!

God wants to be involved in every area of your finances, including investing. So humbly ask Him for wisdom as you consider an investment. Isaiah 48:17 says, *"I am the LORD your God,*

who teaches you what is best for you, who directs you in the way you should go." In Luke 8:18, Jesus warns us, "So take care how you listen." You could paraphrase those words like this: *Be careful what you listen to.* And be especially careful of receiving investment advice from those who do not have a biblical view of money.

5. Be a steady plodder. The fundamental principle for becoming a successful investor is to spend less than you earn, and regularly invest the surplus. In other words, be a steady plodder. The Bible says, "*Steady plodding brings prosperity, hasty speculation brings poverty*" (Proverbs 21:5, TLB). The original words for "steady plodding" picture a person filling a large barrel one handful at a time. Little by little the barrel is filled.

Nothing replaces consistent, month-after-month investing. Just do it—regardless of the investment climate—because when you do, your investments will grow through compounding.

Einstein once said, "Compounding is the greatest mathematical discovery of all time, not $E=mc^2$." Compounding occurs when the

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¹www.cdars.com ²The FDIC offers a Deposit Insurance Estimator online at www.fdic.gov/EDIE

³Past performance is no guarantee of future results. There is no assurance that future returns will be substantially similar to those generated in the recent past



MONEY TALK

earning your investments produce are added to the principal, allowing *both* the earning and the principal to grow exponentially.

God's instructions to successful investors

God realizes that when our assets increase, they can become a potential barrier to a close relationship with Him. If you have a lot of resources, the Lord isn't disappointed or surprised; rather, He entrusted it to you for a purpose. In 1 Timothy 6:17-19, the Lord gives instructions to help those with resources to remain undistracted from loving and serving Him.

1. Don't be conceited. *"Instruct those who are rich [successful investors] in this present world not to be conceited"* (1 Timothy 6:17). Wealth tends to produce pride. For several years I (Howard) drove two vehicles. The first was an old pickup truck that cost \$100—and looked it! When I drove that truck to the bank drive-in window to cash a check, I was humble. I knew the cashier was going to carefully check my account to confirm that the driver of that beat-up truck had sufficient funds in his account. And when I received the money, I drove away with a song in my heart and praises on my lips.

Our other vehicle was a well-preserved, second-hand car that was expensive when it was new. When I drove that car to the bank, I appeared to be a different person. I was a person who deserved a certain amount of respect. I wasn't quite as patient or grateful. Wealth often leads to pride.

2. Put no confidence in your assets. *"Instruct those who are rich [successful investors] in this present world not...to fix their hope on the uncertainty of riches, but on God, who richly supplies us with all things to enjoy"* (1 Timothy 6:17). The ability to accumulate

assets without placing our confidence in them is a massive struggle. Someone once observed, "For every ninety-nine who can be poor and remain close to Christ, only one can become affluent and maintain close fellowship with Him." It must be human nature to cling to the Lord when it's obvious that He must provide our needs. Once people reach financial freedom, however, they often take the Lord for granted because they no longer think they have as much need of Him.

When you have resources, the tendency is to first look to your money to solve problems, instead of first praying and seeking the Lord. We tend to trust in what we can see with our eyes, rather than in the invisible living God. King Solomon said it this way, *"The wealth of the rich is their fortified city; they imagine it an unscalable wall"* (Proverbs 18:11). We need to remind ourselves that wealth—like health—is completely uncertain, and can be lost in a heartbeat. The Lord alone can be fully trusted. ♦

THE SOUND MIND INVESTING NEWSLETTER MODEL PORTFOLIOS

CURRENT RETURNS AS OF JULY 31, 2012

	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	10 Year Annual
U.S. Market ¹	10.37%	1.05%	-1.42%	7.38%	14.19%	1.34%	7.05%
Just-the-Basics ²	8.25%	0.25%	-3.43%	-3.27%	12.77%	0.74%	7.87%
Fund Upgrading ³	6.32%	0.70%	-3.35%	-2.84%	10.58%	0.44%	9.55%

Notes: The newsletter model portfolios are hypothetical portfolio models based on SMI investing principles. The model portfolios are not securities and cannot be invested in directly. Further, the model portfolios do not incur expenses or trading costs. • ¹Based on the float-adjusted Wilshire 5000 Total Return index, the broadest measure of the U.S. stock market. • ²Calculated assuming account rebalancing at the beginning of each year with 40% of the stock allocation invested in the S&P 500 (VFIND), 40% in Extended Market (VEXMX), and 20% in International Growth (VWIGX). • ³Assumes the portfolio allocation for each risk category was divided evenly among all the recommended funds. Transaction costs and redemption fees—which vary by broker and fund—are not included.

THE SOUND MIND INVESTING MUTUAL FUND (SMIFX)

Current Returns as of 7/31/2012	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	Annual since Inception
SMIFX	3.95%	0.18%	-4.49%	-5.71%	9.29%	-0.24%	3.15% ¹
Wilshire 5000	10.37%	1.05%	-1.42%	7.38%	14.19%	1.34%	3.66%
S&P 500	11.00%	1.39%	-0.78%	9.11%	14.12%	1.13%	3.46%

Quarterly Returns as of 6/30/2012	Year to Date	1 Month	3 Months	12 Months	3 Year Annual	5 Year Annual	Annual since Inception
SMIFX	3.76%	2.89%	-5.80%	-7.77%	12.31%	-0.60%	3.16% ¹
Wilshire 5000	9.23%	3.95%	-3.13%	3.96%	16.65%	0.43%	3.54%
S&P 500	9.48%	4.12%	-2.75%	5.43%	16.38%	0.22%	3.29%

¹Annualized return since SMIFX inception date of December 2, 2005.

Total/Gross expense ratio: 2.16% as of 2/29/2012 (includes expenses of underlying funds)

Notes: The performance data quoted represents 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 NASD).

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PERIODICALS POSTAGE

PAID AT LOUISVILLE, KENTUCKY

Dated Investment Material
Please Do Not Delay!



LOOKING AHEAD

Compass' *Navigating Your Finances God's Way* small-group study is helping people across the world understand and embrace

God's financial principles. The study by Howard Dayton is highly practical. Those who have participated in the study have

confirmed that it has helped them make great strides toward getting out of debt. Couples have confirmed that their marriages

have been strengthened. Graduates of the study also are becoming consistent savers, generous givers, and prudent consumers.

Most importantly, people are entering into a closer relationship with Jesus Christ. For details, visit www.compass1.org.

Throughout 2012, this column is presenting core biblical concepts from the *Navigating Your Finances God's Way* small group study. Space necessitates editing each topic, so we encourage you to investigate the full course using the contact information above.

BIBLICAL GUIDELINES FOR INVESTING

[The *Navigating Your Finances God's Way* small group study by Howard Dayton of *Compass—finances God's way* is designed to “equip people to faithfully apply God's financial principles so they may know Christ more intimately, be free to serve Him, and help fund the Great Commission.”

I can attest to its power to transform lives, as I've led the study in my own home. Many participants tell me that it made a great difference in expanding their understanding of finances and true biblical stewardship. SMI believes in this study—so much so that we asked Compass' permis-

sion to run a series excerpting some of the study's core concepts for the benefit of SMI's readers.

If you have a heart to see others experience the blessing of financial freedom through handling money God's way, I encourage you to investigate leading a Compass small group study. It requires no special financial expertise, and you'll get to watch God's Word come alive in the hearts of your students. You'll be glad you did! — Mark Biller]

The Bible contains practical saving and investing advice. Let's begin with two important principles.

Finding the balance

First, we need to balance our saving and investing with generosity. Jesus told a parable of a farmer who harvested a bumper crop and said to himself, *"I have no place to store my crops....I will tear down my barns and build bigger ones, and there I will store all my grain and goods...."* But God said to him, *'You fool!...This is how it will be with*

anyone who stores up things for himself but is not rich toward God....For where your treasure is, there your heart will be also" (Luke 12:16-21, 34, emphasis added).

The key word in this parable is the word *"all."* Jesus called the farmer foolish because he saved everything, and didn't *balance* saving with giving. If we only pile up our investments, they will pull on our hearts like gravity. Our affection will be drawn away from God toward them because *"where your treasure is, there your heart will be also"* (Luke 12:34). However, if we give generously to God, we can invest *and* still love Him with all of our heart.

Let's face it—most people want to get rich. But the Bible strongly cautions against it: *"People who want to get rich fall into temptation and a trap and into many foolish*

and harmful desires that plunge men into ruin and destruction” (1 Timothy 6:9, emphasis added). This verse declares that those who want to get rich give in to temptations and desires that ultimately lead to ruin. So the second principle is that wanting to get rich is incredibly dangerous – but why?

The next verse answers that question: *“For the love of money is a root of all kinds of evil. Some people, eager for money, have wandered away from the faith, and pierced themselves with many griefs”* (1 Timothy 6:10). When we want to get rich, we actually *love* money.

Our heavenly Father does not usually allow His children to prosper when they are motivated to get rich. Wanting to get rich – loving money – closely parallels greed. And *“greed...amounts to idolatry”* (Colossians 3:5). It is for our sake that the

Father protects us from loving anything that would draw us away from Him.

Basic Investing Guidelines

1. Avoid risky investments. God warns us to avoid risky investments, yet each year thousands of people lose money in highly speculative investments and scams.

Ecclesiastes 5:13-15 says, *"There is another serious problem I have seen everywhere – savings are put into risky investments that turn sour, and soon there is nothing left to pass on to one's son. The man who speculates is soon back to where he began – with nothing"* (TLB).

How many times have you heard of people losing their life's savings on some can't-miss-get-rich-quick scheme? Sadly, it seems that Christians are particularly vulnerable to scams, because they trust others who appear to live by their same

values. If you are offered an investment opportunity that seems too good to be true...it's probably too good to be true! The strategy for avoiding scams or risky investments is to pray, seek wise counsel, and do your homework.

2. Diversify. Money can be lost on any investment. Stocks, bonds, real estate, gold—you name it—can perform well or poorly. Each investment has its own advantages and disadvantages. Since the perfect investment doesn't exist, we need to diversify and not put all our eggs in one basket. *"Divide your portion to seven, or even to eight, for you do not know what misfortune may occur on the earth"* (Ecclesiastes 11:2).

3. Count the cost. Every investment has costs: financial, time, effort, and sometimes even emotional stress. For example, a rental house will require time and effort to rent and maintain. If the tenant is irresponsible, you may have to try to collect rent from someone who

doesn't want to pay – talk about emotions! Before you decide *(continued on page 142)*
