FREEDOM TO SOAR

YOUR GUIDE TO A BETTER FINANCIAL OUTCOME

By Rick Keast

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Freedom to Soar

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FREEDOM TO SOAR

Rick Keast

This book is dedicated to my kids, Emily, Ryan, Kelsey, Connor, and Ellie. You are always in my thoughts.

"The hardest thing to do in baseball is to hit a round baseball with a round bat, squarely."
- *Ted Williams*

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FOREWORD

When I was asked to consider writing this foreword, I was delighted to accept the job before I'd even had the chance to read it. And now that I have, I'm even more excited to have the chance to be a small part of this labor of love about wealth enhancement.

That's not just because our Risk Number® technology has been woven into the heart of Redhawk's wealth management process. It's not just because many of the charts and graphs in this book are screen shots from our platform.

I′m excited because this book turns the standard operating practices of our industry on its head, and demonstrates an unheard of generosity to every day investors that many financial advisors should follow.

For far too long many financial advisors have considered their knowledge and insights to be the value that they bring to their client relationships. As such, advisors are reluctant to share any of that knowledge, or any of those insights, unless someone signs on the dotted line and becomes a client first.

In writing this book, Rick Keast has done a revolutionary thing: turning that standard operating procedure on its head and giving the average person a behind-the-scenes understanding of WHAT, WHY and HOW to make sure they have a secure retirement with dignity. That the average person can help their grand kids go to college, can change the world through non-profit giving, or can achieve any other life goals their finances and investing can support.

This book demonstrates a confidence in the value of great financial advice which comes not just from knowledge, but from wisdom — the ability to put that knowledge into practice on behalf of others.

In reading it, you will really get a solid understanding of how to hire a great financial advisor regardless from which firm they hail, how to ask the tough questions and how to discern whether that advisor's oversight, compensation, and process are designed to help you succeed versus just helping the firm grow its bottom line.

I hope you greatly enjoy this book, share it with your friends, and are empowered to invest fearlessly to achieve an abundant financial future.

Aaron Klein
Co-Founder and CEO, Riskalyze

INTRODUCTION

The Secret to a Better Financial Outcome? Spoiler Alert: It's No Longer Secret.

When you think about this question and how it pertains to both your investments and retirement, you and everyone you know may have different answers.

{ Is it being able to retire earlier, being able to travel, purchasing a vacation home, or something else? This book will outline sound and practical strategies to make all your aspirations possible. }

Reflecting on this question reminds me of the similarities it has to the healthcare industry and how we view our health and well-being. Clearly, while exercise and healthy eating are important, we sometimes face health challenges through no fault of our own. Yet personal responsibility can only take us so far.

Our finances and the way we approach them aren't terribly different from this concept. We are primarily responsible for securing our retirement outcome. Personal responsibility, which was once a lifestyle choice, is now a requirement for financial survival. We must fully accept responsibility for where we are and where we're going, primarily because pensions have disappeared, and government-based Social Security benefits aren't enough to fund a successful retirement. The only way we can survive is by accepting the challenge in front of us.

{ I believe creating a better financial outcome for your investments can be a simple process that includes three critical objectives. }

By focusing on these three objectives, you will improve your probability of obtaining a more financially secure retirement. The remainder of this book will break-down the steps you need to take to make a better financial outcome in retirement a reality.

Throughout my career, I either made or helped large institutions make decisions that have impacted the financial well-being for thousands of clients throughout the U.S. Preparing for a secure retirement is a journey with many curves and forks in the road. Like with any trip, you have a destination in mind, and you use your GPS to navigate along the way. Similarly, a retirement destination needs principles to follow which provide simple, steady and, most important, effective guidance along the way.

{ Few people would go on a road trip without a GPS (or at least a map) yet most probably spend more time planning for a road trip than planning for their secure retirement. }

By working with thousands of clients over the years, I've boiled down the key success criteria to three simple yet critical rules by which to live. When you are considering a retirement planning strategy, always try to accomplish the following three objectives.

Key Success Criteria for a Better Financial Outcome in Retirement

Source: Redhawk Wealth Advisors, Inc.

In working with clients at Redhawk, sometimes we can accomplish all three, however (to be totally transparent) there are times when we can only satisfy one or two out of the three. There are even instances when we can't accomplish any. That being said, getting the entire truth of your situation is paramount to understanding where you stand and what you can do to improve your financial outcome.

{ In my own personal experiences, some potential clients for whom we couldn't improve on various aspects of these better financial outcome principals became clients anyway. }

This is because Redhawk made it easy for them to understand the benefits of the process, our ongoing monitoring of their investments, and the frequent communications along their journey to a secure retirement.

Dear reader,

I would be remiss if I didn't mention the COVID-19 global pandemic that began in 2019 and its impact on the world economy and finances during the writing of this book. Please be sure to read the Epilogue following Chapter 9 for full context.

Thank you,

Rick Keast

CHAPTER 1

Financial Heights You Can Reach.

Let's begin with an analogy. All the best athletes have a coach that helps them become the best physical version of themselves in order to reach their highest potential. Hiring a financial advisor is no different in that it helps you achieve the best retirement outcome possible.

{ Making long-term decisions about your money can be difficult and even a little scary. }

There are many benefits to hiring a financial advisor. A smart financial advisor can help you figure out your savings strategies, retirement options, and overall retirement plan. To be sure, a professional opinion can be especially helpful at the beginning of the retirement planning process, when you're trying to set goals. Most importantly, a financial advisor will keep you focused and disciplined toward achieving your goals. There are many financial advisors that offer good advice. Make sure the one you select always has your best interests in mind.

{ Financial advisors usually have a broader, deeper knowledge of money management and taxes than a so-called "investment professional." }

Source: Redhawk Wealth Advisors, Inc.

"If debt is a measure of consumer confidence, we have become very confident indeed."

Another benefit of hiring a financial advisor is that they can save you time. Some financial advisors will manage your portfolio, removing a huge burden from your evolving list of decisions. While you will need to periodically meet with your financial advisor to talk about your goals and where your investments stand, you won't be responsible for things like periodically rebalancing your accounts, staying on top of market conditions, and assessing various investment options. That's what a savvy financial advisor can and should do.

With the wealth of information at your fingertips, you may think you understand the markets enough to invest for yourself or that getting a financial advisor to manage your assets is too expensive. However, investing is challenging, to say the least, and emotional responses in periods of volatility can undo years of past or potential future success.

{ The benefits of having a financial advisor to filter capital market news or temper your own emotions can create significant value when it is needed most. }

The services a financial advisor provides go well beyond simply selecting investment products for you. Financial advisors can assist you in a full 360° spectrum of cash management, wealth planning, investment management, retirement and estate planning, as well as guidance on taxation to help you work toward your goals.

It is well-known that human behavior leads to decisions primarily based on emotion; then the decisions are rationalized using science. Financial advisors can help you avoid common mistakes caused by human behavior by staying informed and remaining objective when making financial decisions on your behalf. People often let emotions and other tendencies get in the way of their financial goals. Ultimately, letting your emotions guide your investing decisions will cost you money. So how can emotions get in the way of achieving your goals? Studies have proven that inexperienced and unknowledgeable investors have a strong tendency to buy high and sell low (commonly referred to as emotional investing). Typically, when the market is going up the every-day investor wants to buy and when the market is going down, they want to sell. This happens because a positive perception of an investment or market can lead investors to feel they have a higher return at a lower risk than they do, while a negative feeling can lead to predictions of lower returns at a higher risk.

{ Put another way, people run away when scared and become overly confident when comfortable. }

Taking your investment cues based on the fears and goals of others, such as family, friends, co-workers, social media, or news, is called *Social Investing*. Engaging in this behavior can influence you to make decisions based on the emotions of others rather than your own goals. Additionally, allowing behavior patterns to influence your decisions, or *Ego Investing*, may also make you lose sight of your goals. Many investors fall victim to these behaviors and don't heed their own advice. That's where a financial advisor comes in handy, by discovering how much cash you will need to provide for your own lifestyle and dependents against potential market downturns. At the same time, a financial advisor can help you take advantage of investment opportunities with the rest of your wealth.

"YOU HAVE NOTHING TO BE PHOBIC ABOUT BUT YOUR PHOBIAS THEMSELVES."

{ Having professional advice allows you to maximize the potential return of your wealth rather than investing it with fear. }

The results of research done by Dalbar Inc.[1], a company that studies investor behavior and analyzes investor market returns, consistently show that the average investor earns below-average returns. In Dalbar's 2017 study, they found that investors' biggest behavioral problems are the herding effect and loss aversion. The study showed just how poorly investors perform relative to market benchmarks over time and the reasons for that under-performance.

The study also proves that a do-it-yourself ("DIY") investor can't beat an index over the long haul. Indexes do not account for the effect of taxes, trading costs, and fees over time. There are also internal dynamics of an index that affect long-term performance that do not apply to an actual portfolio, such as share buy-backs and market-cap valuation. However, even the problems listed above do not fully account for investors' under-performance over time. The key findings of the study show that:

- The average equity mutual fund investor under-performed the S&P 500 by a margin of 4.7%. While the broader market made gains of 11.96%, the average equity investor's return was only 7.26% (see the numbers circled on the following graph).
- The average fixed-income mutual fund investor under-performed the Bloomberg Barclays Aggregate Bond Index by a margin of 1.42%. The broader bond market realized a return of 2.65%, while the average fixed-income fund investor's return was 1.23% (see the numbers underlined on the following graph).
- The 20 year annualized S&P 500 return was 7.68%, and the average equity fund investor's return was only 4.79%, a gap of 2.89% (see the numbers double underlined on the following graph).

	Investor Returns[1]					
	Equity Funds	Asset Allocation Funds	Fixed Income Funds	Inflation	S&P 500	Bloomberg Barclays Aggregate Bond Index[2]
30 Year	3.98%	1.85%	0.57%	2.65%	10.16%	6.34%
20 Year	4.79%	2.29%	0.48%	2.13%	7.68%	5.29%
10 Year	3.64%	1.78%	0.40%	1.83%	6.95%	4.34%
5 Year	9.83%	4.85%	0.05%	1.40%	14.66%	2.23%
3 Year	3.42%	1.45%	-0.23%	1.25%	8.87%	3.03%
1 Year	7.26%	5.48%	1.23%	2.07%	11.96%	2.65%

Source: Dalbar, 2017.

[1] Returns are for the period ended December 30, 2016. Average equity investor, average bond Investor, and average asset allocation investor performance results are calculated using data supplied by the Investment Company Institute. Investor returns are represented by the change in total mutual fund assets after excluding sales, redemptions, and exchanges. This method of calculation captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses, and any other costs. After calculating investor returns in dollar terms, two percentages are calculated for the period examined: Total investor return rate and annualized investor return rate. Total return rate is determined by calculating the investor return dollars as a percentage of the net of the sales, redemptions, and exchanges for each period.

[2] Amended May, 1 2017.

According to the study, the under-performance in 2017 directly relates to the psychological behavior of individual investors. As noted by Dalbar: "The retention rate data for equity, fixed-income, and asset-allocation mutual funds strongly suggests that investors lack the patience and long-term vision to stay invested in any one fund for much more than four years. Jumping into and out of investments every few years is not a prudent strategy because investors are simply unable to correctly time when to make such moves."

According to the Dalbar study, there are three primary causes for the chronic shortfall for equity and fixed-income investors:

Source: realinvestmentadvice.com

Notice that while "fees" are important to overall returns, they are not a key issue. As stated in the study, the issue of "costs" is an important consideration when choosing between two specific investment options; however, the emotional mistakes made by investors over time are much more important.

{ The central under-performance problems of individual investors come down to a lack of capital to invest and irrational psychological barriers. }

While the inability to participate in the financial markets is certainly a major issue, the biggest reason for under-performance is psychology. Behavioral biases that lead to poor investment decision-making is the single largest contributor to under-performance over time. Dalbar defined nine of the irrational investment behavior biases:

"I was spreading some risk around, and apparently it all wound up in your portfolio."

1. **Loss aversion:** The fear of loss leads to a withdrawal of capital at the worst possible time, a behavior known as "panic selling."
2. **Narrow framing:** Making decisions about one part of the portfolio without considering the effects on the total.
3. **Anchoring:** The process of remaining focused on what happened previously and not adapting to a changing market.

4. **Mental accounting:** Separating performance of investments mentally to justify success and failure.
5. **Lack of diversification:** Believing a portfolio is diversified when in fact it is a highly correlated pool of assets.
6. **Herding:** Following what everyone else is doing which leads to "buy high/sell low."
7. **Regret:** Not performing a necessary action due to the regret of a previous failure.
8. **Media response:** The media have a bias toward optimism to sell products from advertisers and attract viewers or readers.
9. **Optimism:** Overly optimistic assumptions tend to lead to dramatic reversions when met with reality.

Dalbar concludes that the most significant of those problems for individuals are the herding effect and loss aversion. Those two behaviors tend to function together, compounding investor mistakes. As markets rise, individuals are led to believe that rising price trends will continue to last for an indefinite period. The longer the rising trend lasts, the more ingrained the belief becomes until the last of the holdouts buy in and the market evolves into a euphoric state. As markets decline, there is a slow realization that "this drop" is something more than a "buy the dip" opportunity. As losses mount, the anxiety of loss begins to mount until individuals seek to "avert further loss" by selling.

Study after study shows that when the stock market goes up, investors put more money in it. When the market goes down, they pull money out. Would you run to the mall every time the price of something goes up and then return the merchandise when it is on sale? This irrational behavior causes investor market returns to be substantially less than historical stock market returns.

The problem is that the human response to good news or bad news is to overreact. This emotional reaction causes illogical investment decisions. The tendency to overreact can become even greater during times of personal uncertainty, such as nearing retirement or when the economy is bad. There is an entire field of study which researches this tendency to make illogical financial decisions called *behavioral finance*. The study of behavioral finance documents labels our money-losing mind tricks with terms like "recency bias" and "overconfidence."

With overconfidence, you naturally think you are above average. For example, in one study, 81% of new business owners thought that they had a good chance of succeeding, but only 39% of their peers succeeded. In another study, 82% of young U.S. drivers considered themselves in the top 30% of their group in terms of safety.

When it comes to investing, overconfidence causes investors to exaggerate their ability to predict future events. They are quick to use past data and to think they have above average abilities that enable them to predict market movements into the future.

Popular books, like Carl Richards' "The Behavior Gap"[2], also do a great job of explaining the behavioral decisions that lead to the large gap between market returns and actual investor returns. Despite the research and education, the gap continues. So, what can you do to avoid the fate of the average investor?

One of the best things you can do to protect yourself from the natural tendency to make emotional decisions is to seek professional help by hiring a financial advisor. In doing so, use a disciplined screening process to find the right financial advisor for you. A financial advisor can serve as an intermediary between you and your emotions.

Fiduciary Intelligence. (Why it's so smart.)

Very few investors know the importance of selecting a financial advisor that serves as a pure fiduciary for their financial wellness. The term *financial advisor* is very broad. Financial advisors come in all shapes and sizes and can have many different titles. There are various types of investment professionals and the products and services they can, or cannot provide, will depend on the license(s) and training they have. Let's go over what a fiduciary does:

{ A fiduciary holds a legal or ethical relationship of trust with you. }

A fiduciary prudently takes care of your money or assets. They may be a financial advisor, a corporate trust company, or the trust department of a bank. (This book will only cover the fiduciary duties of a financial advisor.)

{ When a financial advisor has a fiduciary duty to you, they must act in a way that will financially benefit you. }

The financial advisor who has a fiduciary duty is called *the fiduciary*, and to whomever the duty is owed is called the principal or the beneficiary. If the fiduciary breaches their responsibilities to you, they would need to account for their ill-gotten profit and you are entitled to damages. Financial advisors who are fiduciaries hold a relationship of trust by which they must abide. Fiduciary duty is the ethical obligation to act solely in your best interest.

Fiduciary commitment eliminates conflict of interest concerns and makes their advice more trustworthy. Fiduciaries must:

- put your best interests before their own, seeking the best prices and terms.
- act in good faith and provide all relevant facts to you.
- avoid conflicts of interest and disclose any potential conflicts of interest to you.
- do their best to ensure the advice they provide you is accurate and thorough.
- avoid using your assets to benefit themselves, such as purchasing securities for their own account before buying them for you.

What is the difference between a broker and an investment advisor representative? You may be surprised.

The differences between these two professionals are considerable. Only certain licensed professionals can place security trades for customers or offer paid investment advice under U.S. securities law. While both brokers and investment advisors can place security trades for customers or offer paid investment advice under U.S. securities law, they tend to service different kinds of clients and focus on varying outcomes. It is not impossible for a professional to be both a broker and an investment advisor representative at the same time, or to fluctuate between one designation and the other. Sound confusing? Let's take a deeper dive.

Brokers and Broker-Dealers

While many people use the word ″broker″ generically to describe someone who handles stock transactions, the legal definition is different and worth knowing. A ″broker-dealer″ is a company that is in the business of buying and selling securities, including stocks, bonds, mutual funds, and other investment products, on behalf of its customers, for its own account. Some well-known firms that operate as broker-dealers include Merrill Lynch, Edward Jones, Raymond James, Wells Fargo, AXA, Ameriprise, and LPL. Individuals who work for broker-dealers are the sales personnel whom most people call brokers and are also known as registered representatives.

With few exceptions, broker-dealers must register with the Securities and Exchange Commission ("SEC") and be members of the Financial Industry Regulatory Authority ("FINRA"). FINRA is an independent organization that regulates financial firms doing business in the United States. They oversee all the securities and financial instruments, such as stocks or bonds, that can be traded freely on the open market. A broker must register with FINRA, pass a qualifying examination, and be licensed by your state securities regulator before they can do business with you. Broker-dealers hire brokers to sell their products and services.

Broker-dealers vary widely in the types of services they offer, falling generally into a full-service or discount brokerage firm. Full-service firms typically charge more for each transaction, but they tend to have large research operations that brokers can tap into when making recommendations, can handle nearly any kind of financial transaction you want to make, and may offer investment planning or other services. Discount broker-dealer firms are usually cheaper, but you may have to research potential investments on your own, though the broker-dealer websites may have a lot of information you can use.

Brokers are primarily securities salespeople and may also go by such generic titles as financial consultant, financial advisor, or investment consultant. The products they can sell you depend on the licenses they hold. For example, a broker who has passed the Series 6 exam can sell only mutual funds, variable annuities, and similar products, while the holder of a Series 7 license can sell a broader array of securities. When a broker suggests that you buy or sell a particular security, they must have reason to believe that the recommendation is suitable for you based on a host of factors, including your income, portfolio, overall financial situation, your tolerance for risk, and your stated investment objectives.

The SEC defines a broker as someone who acts as an agent for someone else, and a dealer as someone who acts as a principal for their own account.

Investment Advisor Representative

{ A registered investment advisor ("RIA") is "a person or firm that, for compensation, is engaged in the act of providing advice, making recommendations, issuing reports or furnishing analyses on securities, either directly or through publications" }

This description is according to The Investment Advisers Act of 1940. An RIA is a business entity that has been registered through the proper channels and been approved by the regulatory body that will oversee it. This is usually either the SEC or the state(s) in which the RIA operates.

An RIA firm is represented by investment advisor representatives ("IAR" or "IARs") who have met the licensing or examination requirements enforced by the regulatory body overseeing the RIA firm. The primary responsibility of an IAR is to provide investment related advice. According to regulations, IARs can only offer advice on topics in which they have passed the appropriate examinations. An IAR must register with an RIA firm and receive compensation by charging a fee.

In general, IARs register in the state in which they provide investment advice and they do not require SEC registration. In most states, IARs are required to pass the Series 65 exam. In addition to passing the appropriate exam, an IAR must be registered with the proper state authorities. To expand their knowledge of financial products and principles, many IARs hold either the Certified Financial Planner ("CFP") or Chartered Financial Analyst ("CFA") designations.

One of the things that makes an RIA different from a broker-dealer is that it is bound by a "fiduciary duty." It is the highest standard of care under the American legal system and requires that the IAR always put the interest of the client above its own. This is a much more stringent standard than the "suitability rule" to which brokers and broker-dealers are held.

{ At Redhawk, all financial advisors are Investment Advisor Representatives and serve in a fiduciary capacity. This is the highest standard of care and requires that they always put your interest above theirs. }

Redhawk developed key principles to guide financial advisors when acting as a fiduciary, calling these principles the FiduciaryShield Promise. Each financial advisor must successfully go through a series of educational modules in order to convey these promises to their clients. The following graphic is the FiduciaryShield principles which represents the four elements that the financial advisor promises to provide to you.

Fiduciary Duty versus the Suitability Rule. How they are different.

Some financial professionals such as brokers and insurance agents aren't bound by fiduciary duty. Instead, they are only required to fulfill a suitability obligation. While fiduciaries must put your best interests before their own, brokers or registered representatives who adhere to the suitability rule must only provide "suitable" recommendations to you.

So, what does that mean? To determine whether a recommendation is suitable, brokers must consider your financial situation, goals, and risk tolerance. Additionally, they must ensure that you won't incur excessive costs and that excessive trades won't be made.

{ Brokers may suggest suitable products that aren't necessarily in your best interest or that may benefit them more than you. }

"Do we have a place for our portfolio's ashes?"

CartoonCollections.com

Suitability Rule versus Fiduciary Duty

Suitability Standards	Fiduciary Standards
Recommendations must be suitable for you.	Recommendations must be in your best interest.
Less strict requirement regarding disclosing conflicts of interest to you.	Required to disclose all potential conflicts of interest to you.
May be loyal to their broker-dealer and not you.	Must be loyal to you and act in good faith.

At the time of this writing, the SEC just approved the new Regulation Best Interest Rule ("Reg BI"). As discussed earlier, IARs are held to a fiduciary standard and brokers or registered representatives are held to a suitability standard. Because of these two standards, consumers are confused and it's difficult to understand the differences. Reg BI was enacted to bring the two standards closer together.

The final rule's package of items basically contains four main parts:

1. Reg BI (**Regulation Best Interest**) – This is the centerpiece, requiring brokers to act in your "best interest" without placing the financial or other interest of the broker or broker-dealer ahead of your interest. Most of this will be done through disclosure of conflicts and a somewhat light requirement to mitigate conflicts. A broker would satisfy this duty by complying with four specific obligations:

- *Disclosure Obligation:* Broker-dealers must disclose material facts about your relationship and recommendations, including specific disclosures about the capacity in which the broker is acting, fees, the type and scope of services provided, conflicts, limitations on services and products, and whether the broker-dealer provides monitoring services.
- *Care Obligation:* A broker-dealer must exercise reasonable diligence, care, and skill when making a recommendation to you. The broker-dealer must understand potential risks, rewards, and costs associated with the recommendation. The broker-dealer must then consider these factors considering your investment profile and a recommendation that is in your best interest including the costs of the recommendation.
- *Conflict of Interest Obligation:* The broker-dealer must establish, maintain, and enforce written policies and procedures reasonably designed to identify and at a minimum disclose or eliminate conflicts of interest. This obligation specifically requires policies and procedures to:
  - Mitigate conflicts that create an incentive for the firm's financial professionals to place their interest or the interests of the firm ahead of your interest.
  - Prevent material limitations on offerings, such as a limited product menu or offering only proprietary products, from causing the firm or its financial professional to place his or her interest or the interests of the firm ahead of your interest.
  - Eliminate sales contests, sales quotas, bonuses, and non-cash compensation that are based on the sale of specific securities or specific types of securities within a limited period.

- *Compliance Obligation:* Broker-dealers must establish, maintain and enforce policies and procedures reasonably designed to achieve compliance with Reg BI.

Importantly, this "best interest" standard would apply under several conditions: when making a recommendation related to securities or an investment strategy involving securities; when a recommendation is regarding account types, roll-overs, or transfers of assets in a workplace retirement plan account to an IRA, and; when making a recommendation to take a plan distribution. It is also notable that the standard of conduct under Reg BI is an independent standard applicable only to broker-dealers that is not specifically the same as or tied to the conduct standard applicable to RIAs.

2. Form CRS (**Customer Relationship Summary**) – This piece lays out the relationship between you and the broker or IAR and distinguishes to some degree between the two groups of potential ways you can get investment advice. According to the SEC, this document would need to be delivered to you at the beginning of a relationship. This would lay out potential conflicts, their legal standard of conduct, fees, services, and other important information relating to your relationship.

Specifically, Form CRS is intended to inform you about: (i) the types of relationships and services the firm offers; (ii) the fees, costs, conflicts of interest, and required standard of conduct associated with those relationships and services; (iii) whether the firm and its financial professionals currently have reportable legal or disciplinary history; and (iv) how to obtain additional information about the firm. Form CRS will also reference Investor.gov/CRS, a page on the Commission's investor education website, Investor.gov, which offers educational information to you about registered investment advisors, broker-dealers, and individual financial professionals and other materials.

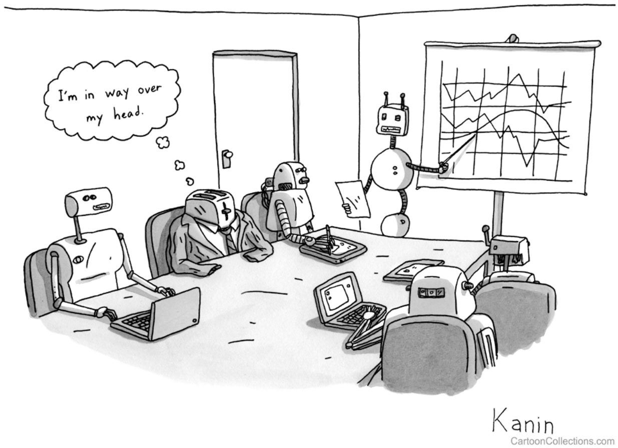
3. RIA Standard of Conduct – The rule also further interprets the standard of conduct surrounding RIA firms currently acting as fiduciaries.

Reg BI imposes a new standard of conduct specifically for broker-dealers that substantially enhances the broker-dealer standard of conduct beyond existing suitability obligations. The standard of conduct draws from key fiduciary principles and cannot be satisfied through disclosure alone. It provides specific requirements to address certain aspects of the relationships between broker-dealers and you, including certain conflicts related to compensation.

4. "Solely incidental" – Lastly, the SEC sought to further clarify and interpret the meaning of investment advice that is "solely incidental" to their business. In general, a financial advisor is someone who engages in the business of advising you about investments for compensation. The current regulations provide that certain types of professionals, such as accountants and teachers, can provide incidental investment advice in connection with their normal jobs without being required to register as an investment advisor representative. Broker-dealers are given a similar exception from investment advisor representative registration if they give investment advice that is "solely incidental" to their brokerage business. Even if a broker-dealer's services are consistent with this "solely incidental" interpretation, the broker-dealer must also receive no special compensation for the activity to be eligible for the broker-dealer exclusion.

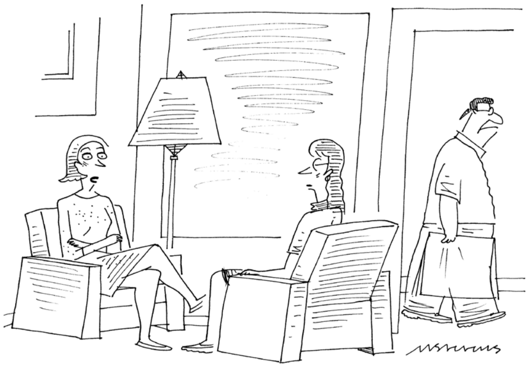
What's a "Robo-Advisor" and should I trust one?

I'd be remiss if I didn't talk about *robo-advisors*. If you did any investing over the past decade, you might have heard people talking about robo-advisors. Investopedia defines them as, ″digital platforms that perform automated, algorithm-driven financial planning with little to no human supervision. The first robo-advisor popped up after the financial crisis of 2008. Today, there are hundreds.



Part of what draws investors to prefer working with a financial advisor face-to-face is the process of planning. A human financial advisor can help you prioritize and track your goals and adapt as your life changes. This inherently builds a human relationship with you that extends beyond just the nuts and bolts of investing. Here are four advantages that financial advisors have over robo-advisors:

1. **Human emotions**
   Emotions may be the single most defining aspect of humanity, as a life without emotion carries no substance or meaning beyond its stark physical existence. This is by no means an attempt to go into a deep philosophical discussion, but it is meant to convey the power and influence our emotions have on our everyday decisions, especially our financial ones. The truth is, you probably have an inherently emotional relationship with your money. Have you ever been broke? Have you ever experienced a windfall of cash? Think back to the emotional response you had to these events and the decisions those emotions spurred you to make. Were they rational?



"His mood is pegged to the dollar."

{ This is where a financial advisor is superior to a robo-advisor. Robo-advisors only do one thing: use algorithms to manage your investment portfolio. }

They are not designed to manage the emotional component of investing and building wealth. For financial advisors, this is a daily role they fulfill. For example, when markets decline or you experience an important financial event, the financial advisor is there to help you make a rational decision void of strong emotions.

2. **Accountability**
   Without accountability, results are difficult to come by. Certainly, you can hold yourself accountable on your own but having someone else committed to helping you in the endeavor only increases your chances of success. In terms of achieving your financial goals, the financial advisor yet again wins the race. Computers are certainly capable of creating tasks and sending you reminders, but they have little to no flexibility in helping you devise an accountability system that truly works for you and is tailored towards your specific goals.

3. **Flexibility**
   Let's face it, over time your life can change drastically. You may

inherit money, lose a job, buy a house, or have kids. Each one of these life events creates an action that needs to occur in order to ensure a positive outcome. Over time, many discussions are required during this process, and having a human expert helps you adjust and adapt as needed and can make all the difference in the world in your success. Robo-advisors, on the other hand, operate solely on algorithms, making them inherently less flexible.

4. **One-size-fits-all vs. tailored service**
   Part of why robo-advisors are cheap, relative to financial advisors, is because they are a streamlined, automated service. As great as this can be, it also creates a lot of limitations. Rather than being built and catered specifically to you and your current financial situation, robo-advisors are designed to serve the masses. This means a somewhat cookie-cutter, one-size-fits-all approach in their offerings. Financial advisors, on the other hand, can tailor the services and investment management style they provide according to your unique financial situation.

Despite their appeal, only 5% of U.S. investors invest with robo-advisors, while 55% have not heard about them at all.[3] According to a study by FINRA, 56% of U.S. investors who hold financial assets outside of pension plans do consult with a financial advisor.[4] In the FINRA study, the most important reasons people give for using a financial advisor are to improve investment performance and to help avoid losses. Additionally, nearly two-thirds also feel it is important to learn about investment opportunities, and over half feel it is important to have access to investments in which they otherwise would not be able to invest. In a Gallup survey,[5] they found that over 70% of U.S. investors currently believe that human financial advisors are better than robo-advisors. That is, investors see human financial advisors as better serving their interests, making good investment recommendations, taking clients' entire financial picture into account, advising clients on risks they are taking, making people feel confident about their investments, and helping clients understand their investments.

In 2017, the SEC's Division of Investment Management released regulatory compliance guidance for robo-advisors. The guidance observed that the unique business model of the robo-advisor raises concerns and emphasized the obligation of robo-advisors to address these concerns. These concerns included the need for adequate disclosure about the robo-advisor and the services it provides, the need to ensure that the robo-advisor is providing suitable advice to its customers, and the need to adopt and implement appropriate compliance programs tailored to the automated nature of the robo-advisor's services.

As you can see, the robo-advisor falls short of being a fiduciary. Robo-advisors only offer you advice based on your investment goals, rather than your full financial situation over your lifetime.

Is a financial advisor always legally bound to act in your best interest? Absolutely.

As fiduciaries regulated under the Investment Advisers Act of 1940, RIAs are held by law to the highest standard of responsibility to you, therefore upholding them to always act in your best interest. This encourages a unique level of personalized service not always found in investor-financial advisor relationships.

Also called "fiduciary obligation", fiduciary duty is a legal obligation to act in your best interest. As we discussed earlier, many brokers call themselves "financial advisors" or "financial planners," but they may not have a fiduciary duty and in fact may not be required to put your interests first. They represent their broker-dealer. Rather than legally acting in your best interest, they instead must only provide you with "suitable" financial products and really act in their broker-dealer's best interest. This "suitability standard" is very broad and difficult to impose. Fiduciary duty is stricter than the suitability standard. It's not enough for them to just provide suitable recommendations, they must provide you with the best advice possible.

"I thought it was legal—I wrote it on a legal pad."

The fiduciary duty is a well-established legal principle, backed by decades of precedent. A financial advisor who acts as your fiduciary knows you can take them to court or, if you agree, arbitration.

{ A financial advisor that's a true fiduciary will have an agreement listing the services they will provide and the terms and conditions of your relationship. If they aren't willing to put it in writing, walk away. }

How is a financial advisor paid? Honest?

Always ask a financial advisor for a clear explanation of how they will be compensated before you hire them. Look for an honest, straight-forward answer and steer clear of financial advisors who try to avoid the question, tell you not to worry about it, or imply that their services are free. Financial advisors should readily disclose all compensation clearly and up front.

{ In general, the annual costs for a financial advisor have historically hovered around 1% of assets under management. }

Fees may vary based on the overall services the financial advisor is providing and how often they are meeting with you. Financial advisor fees vary and most will charge fees in the form of commissions, an hourly rate, or percentage of your account value. Listed below are the six most common ways a financial advisor gets paid:

1. **Percent of Assets under Management** (**"AUM"**)
   This is the most common way that IARs will charge for their services. This method is based on the percentage of assets that they oversee on your behalf, typically anywhere from 0.25% - 1% per year. In most cases, the more assets you have, the lower the fee.

   When you hire a financial advisor who is compensated this way, it is important to understand if investment management and financial planning services are provided or just investment management. Expect to pay more if they are providing full-service financial planning along with investment management. Many times, financial advisors will charge a flat dollar amount for financial planning that you pay directly.

   Using the AUM method, as your account value grows the financial advisor will make more money. If your account value goes down, they will make less money. Consequently, they have an incentive to grow your account and to minimize losses. Typically, the fees are debited right from your accounts, so you don't have to write a check and these fees won't impact your monthly cash flow. Additionally, fees debited from IRAs are being paid with pre-tax dollars which can be great if you are in retirement.

2. **Commissions**
   This is the most common way that brokers or registered representatives get paid. Commissions can take the form of a front-end sales load charged on a mutual fund, a commission for selling an annuity, or commissions may be paid directly to the financial advisor

from the investment company, as in the case of the sale of many non-publicly traded REITs. Ask for a clear explanation of how the financial advisor is paid, and exactly how much they will receive if you buy the investments or insurance products they recommend.

3. **Hourly Rate**
   This can be a great way to pay for financial advice if you are willing to implement the advice on your own. For example, you may pay a financial advisor an hourly rate to tell you how to allocate the investments in your 401(k) plan. Then you would be responsible for making the changes they suggested.

   Since an hourly rate is not tied to the value of investments, or generated by the purchase of any specific investment, you can feel confident you will receive objective advice. Just like attorneys or accountants, hourly rates will vary widely from financial advisor to financial advisor. Expect to pay a higher hourly rate for experienced financial advisors, or financial advisors who specialize in certain areas such as tax, law, or retirement plans. Lower hourly rates are generally charged by less experienced financial advisors.

4. **Flat Fee to Complete a Specific Project**
   When you need a project completed such as an initial retirement plan, it may make sense to pay a flat fee to have someone analyze the numbers and help you understand all the moving parts that go into creating an accurate retirement plan projection.

   Since a flat fee is not tied to the value of investments or generated by the purchase of any specific investment, you can feel confident you will receive objective advice. The fee should be quoted upfront, along with a clear description of what will be provided for that fee. Ask if follow-up meetings or questions are included.

5. **Retainer Fee**

   If you have a more complex situation, such as ongoing stock options to be exercised, a small business, rental properties, or a need for regular income from your investments, then you may benefit from paying for ongoing advice.

   Since a retainer fee is not tied to the value of investments or generated by the purchase of any specific investment, your chances of receiving objective advice are good. After learning about the complexity of your situation a financial advisor can tell you what your retainer fee would be, and what services are included in that fee. A written contract detailing the fee and services is usually provided.

Be sure to do a background check on your advisor. There should be no objection.

Before you make a major purchase such as a car, television, or refrigerator, you've most likely done some extensive research to ensure you are making the right decision. One of the most important decisions that investors make is choosing the right financial advisor to work with.

The most qualified financial advisors have earned advanced degrees in business or finance, have accredited credentials, and possess years of experience in the industry. Perform due diligence on a financial advisor with little or no experience as they may lack the overall expertise and education to analyze and select the solutions that are in your best interest.

It's amazing to me that with all the fraudulent and deceptive money-making schemes in the headlines that only 1/3 of all investors who decide to work with a financial advisor actually check the background of the person to whom they are about to hand over their life savings. It is critical to double check your prospective financial advisor's background. It may not be an absolute guarantee of success, but you can at least find out if the financial advisor has had any prior wrong doings or "disclosures" on their record.

"You know, I never properly vetted you."

CartoonCollections.com

Sources to check before you hire a financial advisor.

1. **Financial Industry Regulatory Authority ("FINRA"):**
   As we've discussed, a broker or registered representative is with a broker-dealer and is regulated by FINRA. To help investors keep tabs on brokers, they developed a service called FINRA BrokerCheck that is located at brokercheck.finra.org. All you need is the financial advisor's name and the following information is provided:

   - Previous firms where the broker was licensed.
   - Any disciplinary actions that have been filed against the broker.
   - States where the broker is licensed to transact business.
   - Industry exams that the broker has passed.
   - All previous employment history for the past 10 years.
   - Any outside affiliations or business interests. This will show if the broker is involved with any outside business activities.

2. **Securities and Exchange Commission ("SEC"):**
   As mentioned earlier, this is the governing body that regulates Registered Investment Advisors. RIAs that get paid to give advice

about investing in securities generally must register with either the SEC or the state securities agency where they have their principal place of business. RIAs who manage $100 million or more in client assets generally must register with the SEC.

RIAs who manage less than $100 million must register with the state securities agency in the state where they have their principal place of business. You can go to the SEC website located at adviserinfo.sec.gov/iapd to find out more about the RIA or IARs that are affiliated with the RIA.

3. **Certified Financial Planner Board** (**"CFP" Board**):
   Before choosing a financial advisor, one thing you might want to consider is if they are a Certified Financial Planner® professional. Only those who have fulfilled the certification and renewal requirements of the CFP Board can display the CFP® certification marks. CFP practitioners agree to abide by a strict code of professional conduct, known as CFP Board's Code of Ethics and Professional Responsibility, which sets forth their ethical responsibilities to the public, clients, and employers. You can check to see if the financial advisor has obtained the CFP designation on the CFP's web site located at www.cfp.net. On the site, you can use their search tool to find out if the financial advisor has had any disciplinary actions against them.

"IT'S JUST A TEMPORARY TITLE UNTIL THE STAFF GETS TO KNOW YOU."

How qualified is your financial advisor? Check their credentials.

What are all those acronyms after the name of a financial advisor? Many financial advisors have professional designations attesting to their qualifications. However, the lack or presence of a title is not by itself a reason to either reject or select a financial advisor. If possible, you should review their biography and expertise on their website.

The following designations and explanations will help you understand what each acronym or title means but should not be considered as evidence that the financial advisor is suited for your needs:

1. **AIF** (**Accredited Investment Fiduciary**)
   The purpose of the AIF designation is to assure that those responsible for managing or advising on investor assets have a fundamental understanding of the principles of fiduciary duty, the standards of conduct for acting as a fiduciary, and a process for carrying out fiduciary responsibility. This designation is a professional certification that demonstrates a financial advisor or other person serving as an investment fiduciary has met certain requirements to earn and maintain the credential. A client will benefit from using the expertise of a financial advisor with the AIF designation because the financial advisor will be held to a standard of excellence to which others may not adhere. With the importance placed upon fiduciary responsibility and suitability, the AIF was named one of the "Ten Most Wanted" designations in the investment industry by Financial Planning magazine.

2. **CFA** (**Chartered Financial Analyst**)
   Considered the most exclusive and most difficult title to achieve, the CFA designation requires multiple monitored exams, working as an investment professional for a minimum of four years, and committing to a code of ethics and standards of professional conduct. This title is bestowed by the CFA Institute, founded in 1959. However, it is unlikely that an individual investor would deal with a CFA. CFAs are

generally research analysts employed by investment banks, mutual fund companies, and securities firms. They typically specialize in an industry and the companies operating within that industry.

3. **CFP** (**Certified Financial Planner**)
   CFP, a designation conferred by the Certified Financial Planner Board of Standards, Inc., has become increasingly popular in recent years, particularly by those who provide fee-based advisory services to individuals or sell financial products which are frequently coordinated with other components of personal finance. Certification is rigorous and it involves a lengthy education requirement and follows the successful passage of multiple exams completed over a two-day period dealing with personal finance subjects, including investments, insurance, and estate planning. Candidates are required to possess a bachelor's degree and three years of relevant experience and must adhere to a code of ethics.

4. **CFS** (**Certified Fund Specialist**) **or**
   CFMC (**Chartered Mutual Fund Counselor**)
   Professionals who earn the CFS title have completed a portion of the CFP program and focus on assisting clients with setting up investment portfolios for retirement and estate planning. However, a bachelor's degree is not required. A CFS is sometimes referred to as a Chartered Mutual Fund Counselor ("CMFC").

5. **ChFC** (**Chartered Financial Consultant**)
   The ChFC is a financial planning designation primarily for the insurance industry, and is also awarded by the American College. It addresses a range of financial planning topics and requires the passage of multiple exams. Candidates must possess three years of business experience (two if they hold an undergraduate degree) and abide by a code of ethics.

6. **CIC** (**Chartered Investment Counselor**)
   In 1975, the Investment Advisor Association ("IAA") working with the Institute of Chartered Financial Analysts created the title of chartered investment counselor. This recognizes the special qualifications of

persons employed by IAA member firms whose primary duties are to manage investment portfolios or provide counseling to such managers. Candidates for the CIC designation must hold the CFA designation, have a minimum of five years' experience in performing investment counseling and portfolio management responsibilities, be employed by an IAA member firm, provide work and character references, endorse the IAA's standards of practice, and provide professional and ethical information.

7. **CLU** (**Chartered Life Underwriter**)
   The CLU is a designation for life insurance agents bestowed by the American College. It requires three years of business experience (two if the candidate holds an undergraduate degree), passage of specialized tests across a range of life insurance topics, and adherence to an industry code of ethics.

8. **CPA** (**Certified Public Accountant**)
   The CPA designation is granted by individual state boards of the American Institute of Certified Public Accountants and is considered to have the most rigorous requirements of any professional designation, which vary by state. CPAs assume personal liability for their work as accountants, auditors, and tax advisors.

9. **CRPC** (**Chartered Retirement Planning Counselor**)
   The CRPC is a graduate-level designation program for experienced financial advisors who wish to offer more comprehensive retirement advice to individual clients. The CRPC designation is recognized as the industry-benchmark for retirement planning credentials and is endorsed by the top financial firms.

   A Chartered Retirement Planning Counselor is someone with a professional financial planning designation awarded by the College for Financial Planning. Individuals may earn the CRPC designation by completing a study program and passing a final multiple-choice examination. Every two years, CRPC professionals must complete 16 hours of continuing education and pay a small fee to continue using the designation.

10. **CRPS** (**Chartered Retirement Plans Specialist**)
    The CRPS is a credential for those who create, implement and maintain retirement plans for businesses. Unlike most other professional financial planning and advisory professional designations, the CRPS focuses on wholesale and business clients. It is awarded by the College for Financial Planning to individuals who pass an exam demonstrating their expertise.

11. **CTFA** (**Certified Trust and Financial Advisor**)
    The American Bankers Association confers CTFA certifications to trust and wealth management professionals who offer fee-based services. To qualify for CTFA certification, individuals must meet specific levels of experience (depending on their level of education), pass a comprehensive exam, and agree to abide by a code of ethics.

12. **PFA** (**Personal Financial Advisor**)
    This is a new designation created by the National Association of Personal Financial Advisors, a competitor of the Certified Financial Board of Standards, Inc. which issues the CFP designation. The PFA is for fee-based planners who have at least five years' experience and have passed a series of exams to qualify for the title.

13. **PFS** (**Personal Financial Specialist**)
    A graduate of the American Institute of CPAs Personal Financial Planning program allows CPAs to demonstrate their knowledge and expertise in personal financial planning. Only certified public accountants can receive the PFS designation. However, the personal liability they assume as accountants does not extend to the recommendations they make regarding investments.

14. **REBC** (**Registered Employee Benefits Consultant**) **and RHU** (**Registered Health Underwriter**)
    These designations are also bestowed by the American College to insurance agents. Candidates must have three years of business experience (two if they hold an undergraduate degree), pass a series of exams, and adhere to an industry code of ethics.

That may all seem like alphabet soup, however many financial advisors will have one or more of these designations, depending upon their experience and the specific components of personal finance with which they work. Additionally, there are other designations that a financial advisor may have. You can go to finra.org/investors/professional-designations to find out more.

Will your financial advisor manage your investments? How about the rest of your money?

A genuine financial advisor that is acting in a fiduciary capacity will most likely select a professional money manager that will manage your investments in accordance with your financial objectives and appetite for risk. Additionally, they will place your holdings with a reputable custodian in a discretionary account, so they can make decisions on your account that are in your best interest.

{ You should look at a financial advisor like a general contractor. }

In the construction industry, a General Contractor understands your needs and hires sub-contractors who are highly qualified experts in their field so you get the best service and outcome for the building project. It is impossible for the G.C. to be the best plumber, welder, or HVAC professional. It's the same with financial advisors. Most fiduciaries will hire the best money managers for your portfolio, whether they manage it for growth or income. It's very difficult for a financial advisor to be the best planner, money manager, and trader.

What about conflicts of interest?

Ask the financial advisor for a copy of their Form ADV Part 2A firm brochure. Form ADV Part 2A is the uniform form used by investment managers to register with both the SEC and state securities authorities. The Form ADV Part 2A, or firm brochure as it's commonly called, is the primary disclosure document that financial advisors provide to their clients. It will disclose fees along with possible conflicts arising from securities trades and answers many other questions. Additionally, ask the financial advisor for their ADV Part 2B. The ADV Part 2B is the disclosure document for the financial advisor and it will disclose the services they provide, other business activities they may have, and any potential conflicts of interest.

As a fiduciary, a financial advisor owes you their undivided loyalty, and may not engage in activity that conflicts with your interest without your consent. The United States Supreme Court held that financial advisors have an affirmative obligation of utmost good faith and full and fair disclosure of all material facts to their clients, as well as a duty to avoid misleading them. A financial advisor must disclose all potential conflicts of interest between the financial advisor and their clients, even if the financial advisor believes that a conflict has not affected and will not affect the financial advisor's recommendations to their clients. This obligation to disclose conflicts of interest includes the commitment to disclose any benefits the financial advisor may receive from third parties as a result of its recommendations to clients.

Some examples of practices that may go undisclosed to you include the following:

- Acting as an issuer or affiliate of an issuer of securities.
- Recommending unregistered, non-exempt securities, or the use of unlicensed broker-dealers.
- Any activity that acts as a fraud or deceit to clients.
- Charging unreasonable fees.
- Failing to disclose the availability of fee discounts.
- Using contracts which seek to limit or avoid a financial advisor's liability under the law.
- Limiting the options regarding the pursuit of a civil case or arbitration.
- Borrowing money from or lending money to clients.
- Acting as a broker-dealer and/or securities agent.

- Receiving transaction-based compensation, including 12b-1 or other marketing fees, related to securities recommended to its clients.
- Receiving any type of compensation from any source for soliciting or referring clients to another financial advisor or a broker-dealer.
- Not disclosing hidden fees in the form of undisclosed service charges, wrap fees, or expenses reimbursed by other parties.

You'll want to meet with your financial advisor. How long and how often?

Most financial advisors are good communicators, but at the same time, they only have a limited number of hours. Most financial advisors segment their clients based on the complexity of the client. For very complex clients, they may meet with them monthly or quarterly. At a minimum, your financial advisor should meet with you once per year or when you have a significant life change such as marriage, death, new job, child, grandchild, etc. to review your portfolio and investment policy statement ("IPS"). The IPS identifies your investment objectives, tolerance for risk, when you want to retire, your return objectives, and income needs at retirement. If you don't have any life changes, an annual meeting is enough. However, market conditions can sometimes dictate a change in the IPS and initiate the need for more frequent meetings.

The duration of your meetings is also worth discussion. A brief update may be all that is required to put you at ease that your assets are being managed properly. This could also be important if it is a new relationship or if you are just becoming familiar with a financial advisor's style or the financial markets in general. You may appreciate in-person meetings at the financial advisor's office or a lunch or dinner meeting.

These days, there is also a growing list of acceptable contact methods. In-person meetings are likely the most valuable and impactful, especially when the relationship is new. In other circumstances, a simple call may be enough, especially if you don't live in the same state as the financial advisor. Quicker communications could include also email or video. Social media is generally meant for a wider audience, but individualized means of communicating may also be available.

{ Financial advising is a relationship business. But in our increasingly mobile and time-stressed society, it is harder than ever to maintain face-to-face relationships.}

Not just because it may be difficult to find a time to schedule an in-person meeting with you, but also because you may relocate and aren't even in the area for a face-to-face meeting.

With the rise of broadband internet access, it is now increasingly acceptable, and at times preferable, for financial advisors to use video to connect with you at a distance. Of course, your financial advisor will communicate with you via emails and phone calls, but video literally puts the "face-to-face" back into a long-distance relationship. You can see the financial advisor, they can see you, and all the non-verbal communication that is lost in a phone call or email comes back into the conversation.

When considering a financial advisor, it's important to understand how often will they communicate with you. At a minimum they should:

- Send you a weekly commentary on the market.
- Inform you when the investment manager is considering a change to the portfolio.
- Periodically let you know if you are ahead of or behind your retirement goals.
- Communicate any regulatory changes, federal or state income tax changes, geopolitical news, or any new laws or bills coming out of Congress that will impact your investments.

Hiring a financial advisor may be your best investment.

A relationship with a financial advisor who provides you with in-depth understanding of your financial and personal situation and ongoing guidance for life's major moments can be one of your best investments. Planning is one of the most important services a financial advisor can provide, and it requires a deep understanding of your entire personal and financial situation to ensure they get it as right as possible. Professional guidance to uncover and comprehend what's most important to you takes time and knowledge.

Russell Investments conducted a study in 2017 to find out how much value a financial advisor provides.[6]

{ The study found that the value of working with a financial advisor is worth just over 4%. }

A financial advisor can be important in helping you manage your money and can bring value to you by:

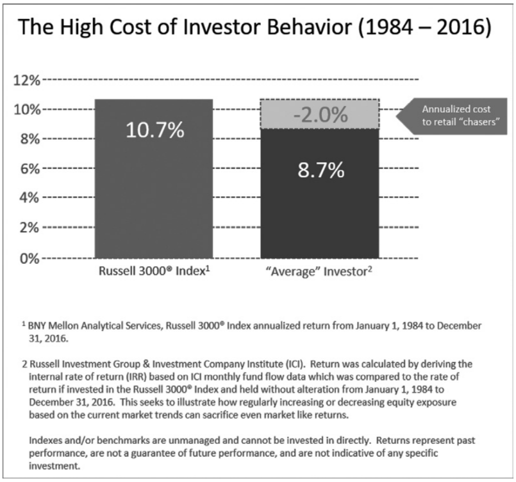
- Steering you away from making behavioral mistakes like chasing performance.
- Establishing an objective rebalancing strategy for your portfolio.
- Building a complete financial plan that saves you time and keeps you on course.
- Reducing your tax burden.

Let's look at these four values more closely.

Value #1: Steering you away from making behavioral mistakes like "chasing performance."

People tend to let emotions and other behavioral tendencies get in the way of their financial goals. Ultimately, investing with emotion will cost you money.

The most common behavior mistake is to buy high and sell low. Simply put, when the market is going up, you want to buy, and when the market is going down, you want to sell. Another common mistake is to make investment decisions based on family, friends, co-workers, social media, and the news. Having a financial advisor who is an unbiased professional allows you to maximize the potential return of your wealth rather than investing it with fear.



Additionally, in the study conducted by Russell Investments, the average stock fund investor's inclination to chase past performance cost them 2% annually in the 33-year period from 1984-2016 (see chart above). Therefore, a financial advisor's ability to help you stick to your long-term financial plan and skirt irrational, emotional decisions adds this value.

A financial advisor serving as your behavior coach can be one of the most important factors in increasing your retirement portfolio over time.

{ It's a proven fact that, if left to your own devices, you most likely will buy high and sell low. }

For example, from the beginning of 2009 through the end of 2012, investors withdrew more money from U.S. stock mutual funds than they put in. All the while, the Russell 3000® Index climbed 69.76%. For those that chose to stay in cash since the market bottom on March 9, 2009 to the end of 2016, they missed a cumulative return of 189%, based on the Russell 3000® Index.

Value #2: Establishing an objective rebalancing strategy for your portfolio.

Rebalancing is the periodic buying and selling of assets in your portfolio to maintain your originally desired asset allocation. For example, let's assume you have selected a balanced portfolio of 60% stocks and 40% bonds. Assuming a year of positive stock performance, your portfolio could now have 70% of your money in stocks and 30% in bonds. Rebalancing is a strategy most financial advisors employ to your portfolio near its target allocation. In this case, rebalancing would involve selling some stocks and buying some bonds, so you get back to the original target allocation of 60/40. This seems like a simple enough strategy that is available to investors, but common knowledge is not always common practice. The evidence strongly points to regular rebalancing not being implemented. In their study, Russell Investments showed that financial advisors who work with investors to establish a consistent rebalancing policy have the potential to add incremental returns to portfolios while reducing volatility (a measure of risk) of the return pattern.

{ Establishing a rebalancing policy can potentially add incremental return while managing risk. }

The rebalancing comparison on the next page, from the Russell Investments study, reflects a period from December 1979 to December 2016 and highlights the impact the corresponding rebalancing plan would have had on the portfolio. In each of these instances, you are looking for the annualized return to be higher than the "buy-and-hold" strategy. For annualized risk, you are looking for the percentage to be lower than the "buy and hold." When looking at the example below, you can see that rebalancing can be a valuable practice. The difference may seem small, but the simple act of rebalancing may help ensure that your gains are captured and that you never have all your eggs in one basket.

A Comparison of Rebalancing Strategies (Dec 1979 - Dec 2016)

Rebalancing Type	Buy and Hold	Systematic Rebalancing*
Annualized Return	9.9%	10.1%
Annualized Risk	10.4%	9.7%

Source: Russell Investments Canada Limited. Original Portfolio Asset Mix: 40% Fixed Income (FTSE TMX Canada Universe Bond Index), 20% Canadian Equity (S&P/TSX Composite Index), 20% US Equity (S&P 500 Index), 20% Foreign Equity (MSCI EAFE Index). Index performance is not indicative of the performance of any specific investments. Indexes are not managed and may not be invested in directly.

* Based on assumption that hypothetical portfolio was rebalanced whenever one of the indexes varied by more than 2.5% from the original asset mix.

Value #3: Building a complete financial plan that saves you time and keeps you on course.

Don't underestimate how much time disciplined investing may take. A financial plan is a key element in helping you reach your goals. A comprehensive financial plan may incorporate coordination of your multiple financial goals, considerations for investing at different stages in your life, and implementation with a variety of financial professionals dedicated to looking out for your financial health. For you, every stage of your life is a first. One value of a financial advisor is that they will have insights into what your life may be like in five or ten years because they likely have had clients who have gone through those same stages that you have not yet experienced.

What is required to develop a financial plan in terms of time, resources, and expertise? According to a recent analysis in personal finance website MoneySense[7], a financial plan costs about $5,000 for an investor with a $1 million portfolio.

{ Creating, updating, and managing your financial plan can take up to 100 hours each year. }

In addition, you may need to consider that a financial advisor might offer the following services as part of the relationship which are not included in the estimates above:

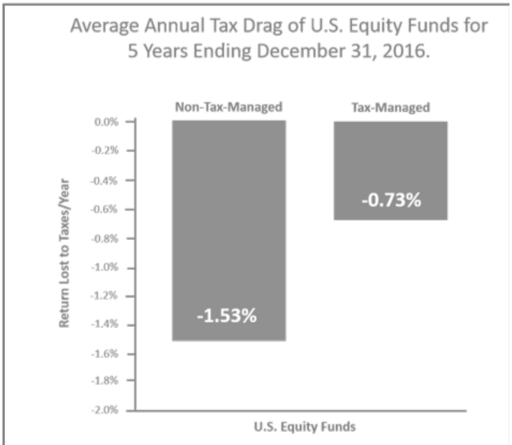
- Annual updates.
- Ongoing goal and risk-tolerance monitoring.
- Potentially coordinating annual tax preparation.
- Retirement planning and setting up distributions in retirement.

Additionally, the Russell Investments study found that financial advisors add value by building and regularly updating custom financial plans, conducting regular portfolio reviews, and offering ancillary services such as investment education, assistance with annual tax return preparation, Social Security and retirement income planning, and one-off custom requests. As we mentioned earlier, the average cost of planning, according to a Financial Planning Association ("FPA") study[8] is as follows:

- The cost of developing and building an initial financial plan averages $2,600.
- Financial advisors typically charge approximately $200 per hour for ongoing monitoring and updating.
- Based on this, the value of providing and maintaining a plan is worth 0.75% on a $500,000 account.

Value #4: Reducing your tax burdens.

One thing we can agree on is that taxes are painful. Studies have shown that an average family now spends more of its income on taxes than it does on necessities like food, shelter, and clothing combined. By simply investing in tax-efficient solutions and taking advantage of a tax-efficient structure, your financial advisor can add tremendous value to your overall portfolio.



Source: Russell Investments, 2017. Tax-managed funds identified by Morningstar to be tax-managed. Created table of all U.S. equity mutual funds identified as tax-managed. Calculated arithmetic average for the Tax Cost Ratio as calculated by Morningstar.

Providing a more tax-aware approach is an area where financial advisors can distinguish themselves and demonstrate fiduciary standards of expertise. According to the Russell Investments study, the average annual tax drags for the five years ended December 31, 2016 was material (see the chart above). Investors in non-tax managed U.S. equity products (active, passive, ETFs) lost on average 1.53% of their return to taxes. Those in tax-managed U.S. equity funds forfeited only 0.73%. With taxable investors holding $7.2 trillion of the $15.7 trillion invested in open-end mutual funds, this is a widespread concern.

The Bottom Line

Behavioral mistakes individual investors typically make.	**2.00%**
Annual rebalancing of investment portfolios.	**0.20%**
Cost of providing a financial plan and ongoing meetings.	**0.75%**
Tax-aware planning and investing.	**0.80%**
Cost of basic investment-only management.	**0.33%**
Total 2017 value of a financial advisor	**4.08%**

Source: Russell Investments, 2017.

So, what's the bottom line in hiring a financial advisor? According to the Russell Investments study, a financial advisor that delivers services and value above and beyond investment-only advice has an estimated contributory value of 4.08% to your retirement portfolio (see the previous chart).

Now let's look at another study conducted by Vanguard. Vanguard, one of the world's largest investment companies, has been studying the question around value for 15 years. Based on research, analysis, and testing, Vanguard has concluded that, yes, there is a quantifiable increase in return from working with a financial advisor. Vanguard calls this advantage the Advisor's Alpha[9]. When certain best practices are followed, the result can be an increase in performance of up to 3% per year. When a financial advisor does things in order to improve your financial health, that increase is called "alpha."

Vanguard has identified seven ways in which a financial advisor can add value to your investment efforts and create that 3% Alpha. They are listed below in increasing order of impact on your portfolio:

1. **Suitable Asset Allocation.**
   This might not generate any additional return, but it can mitigate a negative hit to your portfolio. While income investing works, an over-emphasis on meeting your annual income goal with dividends and interest alone might result in you taking on too much risk and getting too narrowly focused on your asset choices.

2. **Rebalancing.**
   This can potentially add 0.35% per year to your portfolio. The goal here is to minimize risk, not maximize return. If you never rebalance you end up with something called style drift. Let's say you start with a portfolio with 60% stocks and 40% bonds. If the stock market exceeds the bond market for a period you will end up with a far greater percentage of stocks, and more risk. From 1960 to 2000, for example, your 60% in stocks would end up being 90%, which is an entirely different diversification than when you started.

3. **Cost Effective Investments.**
   This practice can return 0.40% per year because it's about controlling your expenses. You can find large-cap mutual funds that charge 1% or 1.5%, and you can find ETFs that have the same performance and charge just 0.1%. A financial advisor can help identify assets that will meet your goals while pushing your costs lower.

4. **Tax Management.**
   This can earn you up to 0.75% per year. Taxes can be a huge drag on your portfolio growth and a financial advisor can help manage your tax bill in several ways. They can offer insight on whether to hold assets in a taxable or tax-deferred account, and how to manage year-end market losses and gains to minimize your taxes.

5. **Withdrawal Strategy.**
   This one could net you up to 1.1% per year. The order (and timing) in which you withdraw funds from your various retirement accounts can have a huge impact on how much tax you pay. Vanguard says this is one place where a financial advisor's knowledge and expertise makes a huge difference.

6. **Coaching.**
   This is the single most important benefit of working with a financial advisor because it can generate up to 1.5% per year of additional returns. Financial advisors will keep your fears and emotional impulses in check by providing steady, fact-based advice, and hand-holding when the markets get volatile.

{ Keep in mind that working with a financial advisor isn't just about maxing out your returns relative to the very best index. It's about maximizing your returns relative to your goals and comfort, with risk. }

The Vanguard study confirms and quantifies something millions of Americans already know from their own experience: An experienced, skilled financial advisor can be a powerful ally in your investment efforts.

CHAPTER 2

Time, Goals, Objectives, and Risk: Determining Your Exclusive Plan.

The most important research you can perform is to really think deeply about your retirement goals. After you have developed your goals, you will want to create a financial plan that will allow you to achieve them. At Redhawk, we call the investment plan an Investment Policy Statement ("IPS") and it's customized to fit your situation. So how do you start? In this chapter, we'll lay out a basic understanding of investment objectives and how you can use them. It's always prudent to revisit your goals and plan to see what, if anything, has changed and whether your plan needs an update. There are four main components of an IPS as described below:

- **Financial Goals:** These can include saving for retirement, children's college, purchasing a car, paying off debt, or buying a home.
- **Risk Tolerance:** This quantifies how much risk you are willing to take to reach your financial goal. For example, are you willing to invest in

something that could lose 20% of its value over the next six months? If so, then you have a high-risk tolerance.

- **Time Horizon:** This simply means the length of time it will take you to reach your goal. If you are saving for retirement, for example, and plan to stop working in 20 years, then that is your time horizon. If you are a couple, you both should realize that you may not have the exact same time frame in mind when it comes to retirement. Your plan needs to look at both of you.
- **Investment Objectives:** This simply means the investments that you will need in order to achieve your financial goals. Are they growth-orientated, income-driven, or a combination of both?

Think of your goals as targets on a time line.

Financial goals are targets, usually driven by specific future financial needs. Some financial goals you might set as an individual include saving for a comfortable retirement, saving to send your children to college, or managing your finances to purchase a home. A goal is the first step that sets you on a path and should be inspirational, based on your own values and interests. Ask what matters most to you? What are you willing to sacrifice in order to make it happen sooner? What can help you stay the course?

{ Categorizing your financial objectives by short-, medium-, and long-term provides focus to your plan. It also helps you match your goals with the appropriate investment resources. }

Short-term goals are those you hope to achieve within the next one to five years, like taking a special vacation or making a down payment on a new car. For short-term goals, you'll choose investments with short-term maturity dates or investment vehicles that protect you from losing value. Make sure you can access your funds any time without penalties.

Medium-term goals are five to fifteen years away. Examples of medium-term goals include a down payment on a new house or funds to renovate your home. With medium-term investments or savings, you should still make sure you have access to your funds when you need them and without a penalty.

Long-term goals are more than fifteen years away. Some of life's biggest goals, including retirement, fall into this category. For your long-term goals, you may want to consider more aggressive investments, which will potentially earn you more money. As your goal nears, increase the percentage of more conservative investments to reduce risk and ensure your financial stability.

Jeff Rose recently wrote an article entitled "The Top 10 Good Financial Goals That Everyone Should Have in 2019."[10] According to Jeff, you should consider these goals for your financial plan:

1. Have a well-stocked emergency fund.
2. Get completely out of debt.
3. Plan for early retirement.
4. Create multiple income streams.
5. Have enough insurance to cover contingencies.
6. Live on less than what you earn.
7. End any addiction to things you don't need.
8. Plan to do work that you love.
9. Share your good fortune.
10. Leave your finances in good order upon your death.

1. Have a well-stocked emergency fund.

Most people think of having an emergency fund as being a short-term financial goal. While that may be true, an emergency fund has important long-term benefits as well and may be the most important goal to achieve. Here are just some of the benefits that a well-stocked emergency fund can provide you with throughout your life:

- It can take away a lot of the money worries that you have since you know that you will always have a reserve should you get into a tight spot.
- It will be there to soften a crisis in the event of a sudden emergency, such as a job loss or a large medical expense.
- It's an important money management tool and if you can save money for an emergency fund, then you can save money for any financial goal.
- It provides you with an intermediate funding source, like a line of credit so you don't have to tap into your long-term investments.
- It will give you some peace of mind when the stock market becomes volatile knowing that your survival isn't at stake when the market falls.

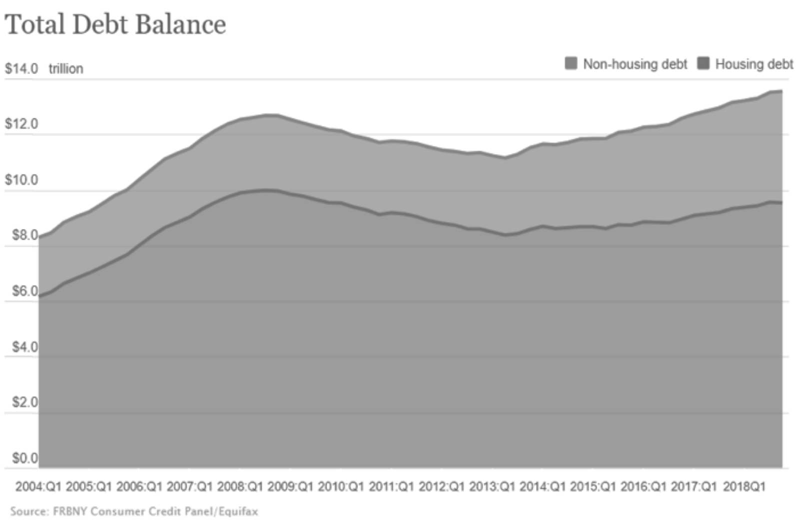
2. **Get completely out of debt.**

This sounds so simple on the surface, yet it's probably the most difficult to achieve, especially in our culture of easy credit and loans. All debt is bad debt no matter your income level. That being said, some types of debt are unavoidable, like taking out a mortgage to purchase a home. For the moment, let's ignore the good-debt-versus-bad-debt debate. Here are some of the excellent reasons to get out of debt mentioned in the article:

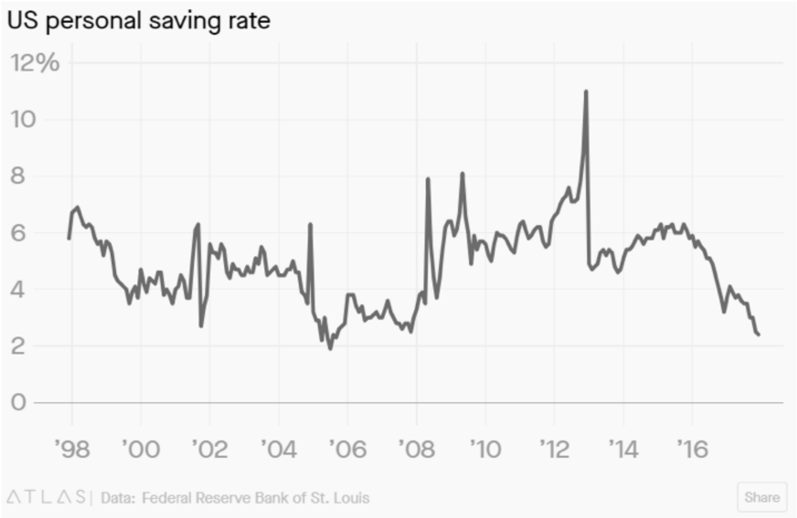
- You will have full control over your income.
- It will leave you with more money for savings and investing.
- It will make it easier to retire early.
- It will free your mind of the worry and stress that come with debt.

Many of us remember the 2008 financial crisis when fear gripped the U.S. Everyone was scared and the main topic of conversation was how much their 401(k) balance shrunk — if they even wanted to look at the statement. This crisis had immense economic and political consequences over the following decade leading to new regulations that transformed banking into a safer, albeit more boring industry. It wreaked havoc in tens of millions of American lives as foreclosures became an epidemic, college graduates were forced to move into their parents' homes, and aging workers saw their retirement plans evaporate.

Fast forward to today. It is remarkable how little the financial crisis changed behaviors regarding the relationship to debt and savings. We still borrow more and save far less than we should. U.S. household debt, which declined between 2008 and 2013, has rebounded sharply and by the first quarter of 2018, it was at an all-time high of $13.2 trillion. The nature of our debt has changed, and we've been better able to manage our obligations mostly to an extended period of low interest rates. American household debt continues to climb to record levels, reaching $13.54 trillion in the fourth quarter of 2018. According to the latest report from the Federal Reserve Bank of New York's Center for Micro-economic Data, household debt is now $869 billion higher than 2008's $13.2 trillion peak (see the following chart).



On the flip side, it didn't make us place more value on savings. Between 1960 and 1984, the U.S. personal savings rate, which is savings as a percentage of disposable personal income, never fell below 8%. Conversely, in December 2017, the personal savings rate dropped to 2.4%, which was the lowest level since 2007 (see following chart).



3. **Plan for early retirement.**

This is one of those goals that is easier said than done. Planning for early retirement is one of the top-rated financial goals, even if you absolutely love what you do for a living. A recent survey from Provision Living[11] suggests that 43% of Millennials (those born between 1981 and 1996) have $5,000 or less stowed away for retirement. The survey also revealed that most Millennials are concerned about their retirement and doubt they will have enough to live on.

By planning to retire early you will be front-loading your retirement investment portfolio. That will give you a larger portfolio early, which will mean that you won't have to work so hard saving for retirement later in life when doing so may be far more complicated or difficult.

4. **Create multiple income streams.**

Creating multiple income streams is a form of income insurance and should be on your list of good financial goals. One of those streams could be in the form of part-time job cash flow that enables you to retire early if you want to start your own business, but aren't ready to quit your full-time job. The extra cash flow from any additional income stream could be used to help fund your retirement savings or it could also be used to help you pay off your debts.

5. Have enough insurance to cover contingencies.

Most people don't have enough coverage while many others are paying too much for the coverage that they have. Having the right amount of insurance is another good financial goal. For example, make sure you don't have too much life insurance so that you'll be worth more dead than alive, or that you're not overpaying for the amount of coverage you do need. For auto insurance, carry the lowest level of coverage possible, particularly if you have a long history as a safe driver. For health insurance, use the highest deductible plan you can and make up the difference with an emergency fund that is large enough to cover the deductible.

6. Live on less than what you earn.

By learning to live on less than you earn, no matter what, you will always have plenty of income. That means that you'll have ample income for savings, investments, and for paying off debt. It's important to always be thinking of ways to increase your income. However, this strategy will only be effective if you can live on less than you earn so that you can put the difference to better use to improve your life.

7. End any addiction to stuff you don't need.

This may not be considered a formal financial goal, but it is a behavior that will stand in the way of all good financial goals.

{ An addiction to stuff can be like a financial parasite. }

A disproportionate amount of your income and financial reserves will go to pay for your need for stuff. Americans have a major problem with buying and keeping stuff. Americans pay to store their items to make space for more items. Why does everyone have, and keep, so much? The number of self-storage facilities supports this notion. If there's anything the self-storage industry shows is that Americans have a hard time parting ways with their belongings.

One reason is people develop an emotional connection with their items. When people revisit these items it triggers a memory that helps them recall their past. Then they have the thought, "What if I need this again in the future?"

"I'm doing some reorganizing–are there any of your possessions that you want to keep?"

There are many interesting facts about the storage industry's growth:[12]

- In the U.S., 65% of self-storage renters have a garage in their home, 47% have an attic, and 33% have a basement. This suggests that Americans have more things than their homes can contain.
- More than $3.5 billion in property taxes have been paid to local government authorities by self-storage companies.
- Self-storage facilities in the U.S. employ more than 170,000 people.
- In 2015, 90% of self-storage units nationwide were occupied, leaving only 10% vacant.
- 52% of the nation's self-storage facilities are in the suburbs while 32% are in cities, and only 16% are in rural areas. They don't need a storage facility if you have the land to house your stuff.

It's clear that stuff is a capital trap and it ties up your money, while at the same time generally provides no financial benefit. Any money that goes into stuff is money that is not going towards your retirement and productive investments.

8. Do work that you love.

Ultimately, the purpose of improving your finances should be to provide you with independence. A recent Gallup poll[13] suggests that engagement at work, defined as enthusiastic involvement and commitment at work, is at an all-time national high at 34%. While that number may be higher than in the past, it still only constitutes 1/3 of American workers. That means quite a large percentage of the population is indifferent, or in some cases, downright miserable, when it comes to their job.

{ Getting out of debt, preparing for early retirement, developing multiple income streams, and ending your addiction to stuff, should clear the way for you to do the kind of work you really love. }

9. Share your good fortune.

There are numerous reasons why giving to others is good for you:

- Letting go of money affirms your power over it because you know that it will come back.
- Giving to those in need makes you part of the solution in the world and not the problem.
- Hoarding money is all about security and letting go of it is celebrating its value.
- Giving to others just feels good, particularly the knowledge that you *can* do it.

10. Leave your finances in good order upon your death.

It should be a goal to make sure that your loved ones are left at least a little bit better off as a result of your life. That means not only making adequate provisions for those who are dependent upon your financial resources but also making sure that you don't leave them with a financial mess to clean up.

Make sure all your debts are paid, and if there are any large or unusual ones, buy a term life insurance policy to pay off that debt upon your death. Consider the impact of estate taxes, if your estate is large enough to be subject to them. Discuss the financial implications of your death with your loved ones, to make sure that everyone understands what you want to do, and so that you will consider any concerns or insecurities that they may have. Most importantly, put all of this in an estate plan.

What's your investor personality? It's unique.

So, I've spent a lot of time going over potential goals. These are important things to think about. Now I'm going to cover the amount of risk you are willing to take.

Let's face it, when it comes to investing, you simply can't have it all risk free. To get a reward, you must be willing to accept some risk. This is the fundamental trade-off of investing and risk is involved with almost any investment. Consequently, you must establish your *investor personality* to structure your investment strategy. There is no singular investment strategy that is perfect for every person. People have varying risk tolerances and different investment objectives. Many factors go into finding an *investor personality*.

Financial advisors usually explore things like age, size of investment portfolio, expected retirement date, future earnings, and financial obligations to gauge your investor personality. These quantifiable aspects can tell us a lot about your ability to take investment risk, but what about your willingness? A good place to start is to determine how much time you need to reach your financial goals.

What's your time horizon? It's a matter of years.

Your time horizon is instrumental in determining how you should manage risk. The more time you have, the easier it will be for your portfolio to absorb risk. To balance both the income and growth levels of a portfolio you will need to allocate your investment assets according to both your level of acceptable risk as well as the amount of time you have available to achieve your goals. To help determine the time frame you need for your investments, consider the following definitions:

- **Long-Term Investor** – if your time horizon is more than fifteen years, then you should consider yourself as a long-term investor.
- **Intermediate-Term Investor** – if your time horizon is a minimum of five years and a maximum of fifteen years, then you should consider yourself as an intermediate-term investor.
- **Short-Term Investor** – if your time horizon is a period of one to five years, then you are a short-term investor.

"Our short term solution is money. Our long term solution is more money."

As you can see, a time horizon is the length of time over which an investment is made or held before it is liquidated. Time horizons can range from seconds, in the case of a day trader, all the way up to decades for an individual who is investing in a retirement plan.

What's your risk tolerance? There's an "app" for that.

Your risk tolerance is the degree of variability in investment returns that you are willing to take. You should have a realistic understanding of your ability and willingness to stomach large swings in the value of your investments. For example, if you take on too much risk, you might panic and sell at the wrong time. If you can understand your level for risk, then you won't feel panicked at every bump or blip on your investment portfolio's radar screen. To help determine a risk profile, consider the following definitions:

- **Aggressive Risk Taker** – You can withstand and recover from a 15% or more loss in your portfolio within a given year.
- **Moderate Risk Taker** – You can withstand and recover from a 5% to 15% loss in your portfolio within a given year.
- **Conservative Risk Taker** – You can withstand and recover from losses up to a maximum of 5% of your portfolio within a given year.

The Old Way of Determining Risk Tolerance

Financial advisors have been using the same method to determine an investor's risk tolerance for decades. They use a questionnaire and based on how an investor answers each question, it will determine their risk tolerance. Answers to the questionnaire help financial advisors determine how much investors should allocate to stocks, bonds, and cash (commonly referred to as asset allocation).

Taking a risk tolerance questionnaire during one five-minute period on one day in your life isn't going to uncover your actual ability to handle a loss. Your risk tolerance isn't stable and most likely fluctuates based on how the market is behaving. For example, you might tend to be risk-seeking when the market is going up and risk-averse when there is a downturn in the market.

Risk tolerance questionnaires attempt to measure an investor's level of comfort with risk. Some of the questions are very direct in asking how much risk an investor is comfortable with or how they rank themselves along the spectrum of risk-takers. Other questions ask an investor how they would behave in certain scenarios. Most questionnaires only measure emotional ability and not financial capacity.

There are two components to your risk personality. One is your emotional ability to take risks, based on your attitude toward financial risk and the degree of emotional pain experienced when facing or contemplating financial loss. The other is your actual capacity to take on financial risk which depends on such things as income, wealth, and investment horizon.

{ Research suggests that investors aren't very good at assessing their own risk tolerance. }

Trying to get a sense of how an investor would behave in the face of various adversities produces unreliable results. It is very hard for you to gauge, with any accuracy, how you would react in the face of a 20% market decline until you experience one. Consequently, risk tolerance questionnaires measure risk tolerance based on hypothetical risk rather than actual risk. Saying you can tolerate a 20% loss, for instance, is quite different from losing 20% of your nest egg. The biggest problem with most risk tolerance questionnaires is that their results are highly correlated to your past experiences. Think about it, it doesn't make sense to look backward for a forward-looking purpose.

The New Way of Determining Risk Tolerance

There is a shift going on from measuring the emotional and subjective response to a quantitative and objective approach that understands when you prefer risk and when you prefer certainty, based on the dollar amounts relevant to your financial capacity.

{ At Redhawk, we use an application called Riskalyze[14] to help you see just how much risk you are taking or need to take. Riskalyze provides you with a clear picture of where you are in the risk spectrum and where you need to be. Simply put, it does a better job at capturing your appetite and capacity for risk. }

Managing risk in your portfolio, as well as managing your expectations about risk, can be very challenging. When markets are up, you probably want to know why you aren't doing better (which would require more risk than may be appropriate for your portfolio). Conversely, when markets are down, you may want to know why you are losing money (which would require less risk).

Our first step is for you to answer a Riskalyze 5 minute online questionnaire[15] that covers topics such as portfolio size, top financial goals, and what you are willing to risk for potential gains. Then Riskalyze will calculate your customized Risk Number between 1 and 99. This number pinpoints your exact comfort zone for downside risk and potential upside gain. The lower your score, the less risk you are willing to accept. The higher your score, the more risk you can handle. Once we know your Risk Number, we can then create an investment portfolio that aligns perfectly with your risk tolerance and goals.

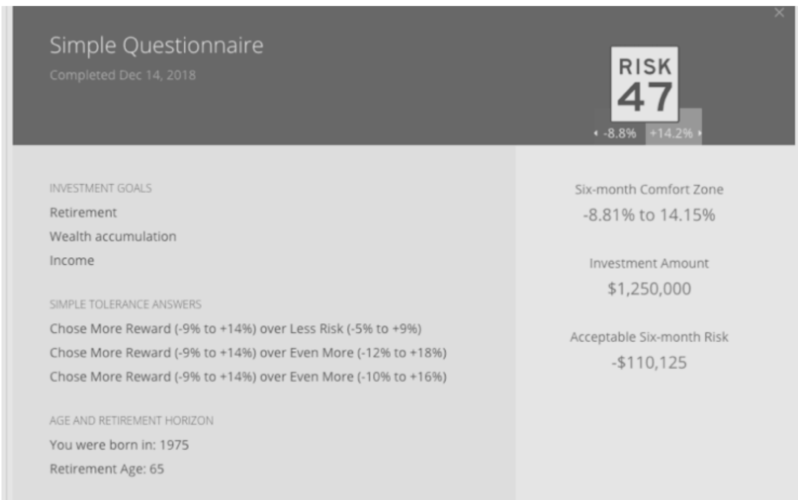
In addition, we also use Riskalyze to analyze the risk tolerance of your portfolio. Together, we can run stress tests to see how your investments would fare if there were an interest rate spike or an economic crisis. When it's all said and done, you will feel confident that your portfolio matches your personality and needs.

At Redhawk, we feel that it's important to quantify the amount of risk you are taking and compare it to what you are comfortable with over the next six months. For example, if you have $250,000 in your portfolio and you are retiring in two years, what would you be comfortable in losing over the next six months in order to have the opportunity to increase your portfolio by a dollar amount? A major mistake you could make is when markets pull back, you might sell in order to protect your portfolio — and lock in horrible losses.

Most likely you might sit out the recovery and wait until you feel comfortable to get back in the market, which is usually at the top.

The Riskalyze Risk Number and corresponding risk/reward range allow you to quantify your level of risk. Most risk tolerance questionnaires are very subjective and do a poor job of accurately pinpointing your appetite for risk. With Riskalyze you are empowered by transparent, objective, well-defined, actionable expectations and the probability of success is quantified and unemotional.

Riskalyze is a great tool to quantify your risk, but what does your Risk Number mean? As you can see in the graphic below, if you score a 47, you are comfortable with the risk of losing 8.81% and the prospect of gaining 14.15% over the next six months.

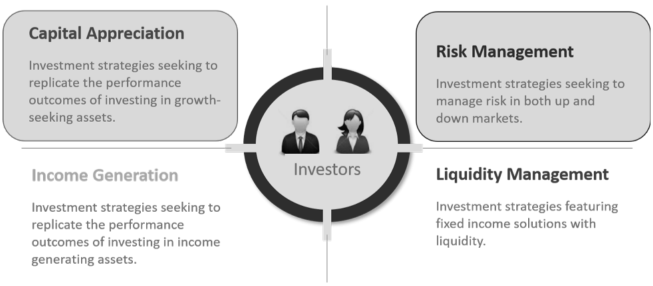


Source: Riskalyze

What are your investment objectives? Four power principles.

When you have defined your financial goals, tolerance for risk, and desired retirement age, your investment objectives will become clear. Simply defined, an investment objective is the type of strategy that you use to accomplish a financial goal.

{ At Redhawk, we use four basic types of investment objectives when managing portfolios: capital appreciation, income generation, risk management, and liquidity management. Taken together, they give you power. }



Source: Redhawk Wealth Advisors, Inc.

Capital Appreciation

Capital appreciation is another term for growth, and growth is appropriate for long-term and aggressive investors who can ride out the ups and downs of the stock market. Growth entails risking your principal because investments that produce large returns also can have large losses. This objective typically fits those who need to fulfill long-term goals, such as saving for retirement or paying for a child's college education. Growth investments include common stocks, mutual funds, exchange traded funds ("ETF"), and alternative investments. It generally means a higher appetite for risk as opposed to an income objective, which has a lower risk tolerance.

The formula for capital appreciation is: Sale Price - Purchase Price = Capital Appreciation.

Once the asset is sold, it's commonly called a capital gain or capital loss for tax purposes. Note that this formula assumes the sale price is higher than the purchase price. If you sell an asset for less than you paid, this is called a capital loss. Let's assume you purchase 100 shares of Company XYZ for $1 per share, and after three months the share price increases to $5. This means the value of the investment has increased from $100 to $500. Thus, the amount of capital appreciation is $400.

Tax payers report capital gains on IRS Schedule D, but these gains are subject to different tax rates depending on whether they are short term (held under one year) or long term (held over one year). You should realize that capital appreciation is taxable, but only when the asset is sold. Until that point, any gains are considered unrealized and are not taxable. The IRS considers nearly every asset owned by individuals or companies as capital assets and thus subject to capital gains taxes.

Risk Management

Investment risk management strategies are for those investors that want to participate in and protect first the upside performance while including an active management component whereby the investment manager will move to safety or a non-correlated asset class during down markets. The goal is to have a high upside capture ratio (the portfolio participates in an up market) and a low downside capture ratio (meaning that the portfolio will minimize its participation in a down market).

Investment risk comes in many forms, and each can affect how you pursue your financial goals. The key to dealing with investment risk is learning about the various elements of risk and how to manage it.

Step 1: Understand the various risks involved.

Investment risk is generally defined as the probability that an actual return on an investment will be lower than your expectations. Fear of losing some money is probably one reason why you may choose conservative investments, even for long-term savings. While investment risk does refer to the general risk of loss, it can be broken down into more specific classifications. Familiarizing yourself with the different kinds of risk is the first step in learning how to manage it within a portfolio.

- **Market Risk**
  Market risk, also known as systematic risk, is the likelihood that the value of a security will move in lock step with the overall market. For example, if the stock market is experiencing a decline, the stock investments in your portfolio may decline as well. Or if bond prices are rising, the value of your bonds could likely go up as well. These factors will have an impact on the overall performance of the financial markets and can only be reduced by diversification into assets that are not correlated with the market, such as certain alternative asset classes.

- **Interest Rate Risk**
  Interest rate risk is most often associated with fixed income investments, this is the risk that the price of a bond or the price of a bond fund will fall with rising interest rates. Say you bought a 10-year, $1,000 bond today at a coupon rate of 4%, and interest rates rise to 6%. If you need to sell your 4% bond prior to maturity you must compete with newer bonds carrying higher coupon rates. These higher coupon rate bonds decrease the appetite for older bonds that pay lower interest. This decreased demand depresses the price of older bonds in the secondary market, which would translate into you receiving a lower price for your bond if you need to sell it. In fact, you may have to sell your bond for less than what you paid.

  Rising interest rates also make new bonds more attractive because they earn a higher coupon rate. The longer the term of your bond, the greater the chance that a more attractive investment opportunity will become available, or that any number of other factors may occur that negatively impact your investment. In summary, bonds and interest rates have an inverse relationship:

- Bond prices will go up when interest rates go down.
- Bond prices will go down when interest rates go up.

Interest rates and bond prices have an inverse relationship

So, let's look at an example[16]. Suppose the ABC Company offers a new issue of bonds carrying a 7% coupon. This means it would pay you $70 a year in interest. After evaluating your investment alternatives, you decide this is a good deal, so you purchase a bond at its par value: $1,000. *

Now let's suppose that later that year, interest rates in general go up. If new bonds that cost $1,000 are paying an 8% coupon, or $80 a year in interest, buyers won't want to pay the $1,000 face value for your 7% ABC Company bond. In order to sell, you would have to offer your bond at a discount that would allow it to generate approximately 8% to the new owner. In this case, that would mean a price of about $875. *

Similarly, if rates dropped to below your original coupon rate of 7%, your bond would be worth more than $1,000. It would be priced at a premium, since it would be carrying a higher interest rate than what was currently available on the market. *

* This hypothetical illustration assumes a 7% coupon, $1,000 face value, and a 10 year maturity. The illustration is approximate and is not intended to represent the return of any bond or bond fund. Bond values fluctuate in response to the financial condition of individual issuers, changes in interest rates, and general market and economic conditions.

- **Inflation Risk**

  Inflation risk is the risk that the value of your portfolio will be eroded by a decline in the purchasing power of your savings, as a result of inflation. Inflation risk needs to be considered when evaluating conservative investments, such as bonds, bond funds, and money market funds as long-term investments. While your investment may post gains over time, it may be losing value if it does not at least keep pace with the rate of inflation.

  For example, an investment that returns 2% before inflation in an environment of 3% inflation will produce a negative return (–1%) when adjusted for inflation. If you don't protect your portfolio, inflation can be harmful to fixed income returns. You may buy fixed income securities because you want a stable income stream, which comes in the form of interest or coupon payments. However, because the rate of interest, or coupon, on most fixed income securities remains the same until maturity, the purchasing power of the interest payments declines as inflation rises.

- **Credit Risk**

  Credit risk comes into play with bonds and bond funds. It refers to a bond issuer's ability to repay its debt as promised when the bond matures. Bonds and bond funds are given credit ratings by such agencies as Moody's and Standard & Poor's. In general, the higher the rating, the lower the credit risk. Junk bonds, which generally have the lowest ratings, are among the riskiest in terms of credit. People who invest in junk bonds typically seek higher yields to compensate for their higher credit risk. In addition, international investments involve such risks as fluctuating currency values (currency risk) as well as the potential for social, political, and economic upheavals that may affect a country's markets.

Step 2: Manage the risks with diverse investments.

Diversification is the practice of spreading your investment dollars among many types of investments. The idea behind diversifying your investments is that it spreads your risk. For example, if one of your investments loses value, the others won't necessarily lose money at the same time, thus balancing out your risk to some extent. While having a diversified portfolio is usually a wise practice, any investment strategy comes with risk. However, the benefits of diversification generally outweigh the risks of diversification.

When you diversify, you reduce the risk in your portfolio. Each individual investment carries a chance that it could be a great success, a great failure, or something in between. Spreading your money out limits your exposure to great failures. If you invest all your money in a company that turns out to be a failure, you could lose all your money. If, however, only 20% of your money was in that company, you'd still have 80% of it working for you.

The other benefit of a diversified portfolio is that, if it is properly structured, you should have less volatility in the overall portfolio. One of the keys to diversification is to select assets that have very low correlations. For instance, if you invested all your money in different oil companies, that would not be very diverse, because if one company did especially poorly or well, the others would often follow that same trend. It would be more diverse to have some money in unrelated investments, such as foreign oil and domestic pharmaceuticals. Oil prices and drug prices are less closely correlated than the prices of two oil companies. Diversifying reduces your potential returns in good times, reduces your losses in bad and increases your peace of mind. This is the very definition of diversification.

With that in mind, the safety that diversification brings also carries a downside. It's a good idea to spread your risk between multiple investments in case one of the investments severely under performs. On the other hand, if you pick a great investment and spread your money out, you lose the opportunity to completely benefit from that investment. Consequently, diversifying carries the risk of diluting your gains as well as your losses. For example, if you own 50 stocks and one of them doubles, it only amounts to a total gain of 2% in your overall portfolio, rather than 100%.

In addition to systematic risk factors that affect highly diverse portfolios, many seemingly diversified portfolios aren't really that diverse. A portfolio holding stock in American Express, Caterpillar, Intel, and McDonald's might appear diverse since it's exposed to four different companies and industries. However, it consists of 100% stock in Dow components, and they are all U.S. based. Even a more diverse portfolio, such as one holding a small cap stock, a commercial bond from a blue-chip company, and a certificate of deposit at a U.S. based bank still has exposure to currency risk from the U.S. dollar. As such, true diversification can be hard to come by.

As the table of annual returns for selected asset classes shows (see following chart), one year's best performing asset class can be the next year's worst. This chart shows the importance of diversification.

																2005-2019	
2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD	Ann.	Vol.
EMD USD 10.2%	EMD LCL. 15.2%	EMD LCL. 18.1%	Treas. 13.7%	High Yield 58.2%	EMD LCL. 15.7%	TIPS 13.6%	EMD USD 17.4%	High Yield 7.4%	Muni 9.1%	Muni 3.3%	High Yield 17.1%	EMD LCL. 15.2%	ABS 2.7%	EMD USD 15.0%	TIPS 9.2%	EMD USD 7.3%	EMD LCL. 10.6%
EMD LCL. 6.3%	High Yield 11.8%	TIPS 11.6%	MBS 8.3%	EMD USD 29.8%	High Yield 15.1%	Muni 10.7%	EMD LCL. 16.8%	ABS 1.3%	Corp. 7.5%	MBS 1.5%	EMD USD 10.2%	EMD USD 10.3%	Muni 1.3%	Corp. 14.5%	Treas. 8.9%	High Yield 7.2%	High Yield 10.3%
Muni 3.5%	EMD USD 9.9%	Treas. 9.0%	Barclays Agg 5.2%	ABS 24.7%	EMD USD 12.2%	Treas. 9.8%	High Yield 15.8%	MBS -1.4%	EMD USD 7.4%	EMD USD 1.2%	EMD LCL. 9.9%	High Yield 7.5%	MBS 1.0%	High Yield 14.3%	Barclays Agg 6.8%	EMD LCL. 5.3%	EMD USD 7.2%
Asset Alloc. 3.1%	Asset Alloc. 5.8%	Barclays Agg 7.0%	Asset Alloc. -1.9%	EMD LCL. 22.0%	Corp. 9.0%	Corp. 8.2%	Corp. 9.8%	Corp. -1.5%	MBS 6.1%	Treas. 0.8%	Corp. 6.1%	Corp. 6.4%	Treas. 0.9%	EMD LCL. 13.5%	Corp. 6.6%	Corp. 5.2%	Corp. 5.5%
TIPS 2.8%	MBS 5.2%	MBS 6.9%	TIPS -2.4%	Corp. 18.7%	Asset Alloc. 7.6%	Barclays Agg 7.8%	Asset Alloc. 7.6%	Asset Alloc. -1.7%	Barclays Agg 6.0%	Barclays Agg 0.6%	Asset Alloc. 4.8%	Muni 5.4%	Barclays Agg 0.0%	Asset Alloc. 9.8%	Asset Alloc. 4.2%	Asset Alloc. 4.9%	TIPS 4.8%
Treas. 2.8%	Muni 4.8%	Asset Alloc. 6.2%	Muni -2.5%	Asset Alloc. 16.5%	Barclays Agg 6.5%	Asset Alloc. 7.7%	TIPS 7.0%	Barclays Agg -2.0%	Asset Alloc. 5.4%	ABS 0.2%	TIPS 4.7%	Asset Alloc. 5.3%	Asset Alloc. -0.6%	Barclays Agg 8.7%	MBS 3.6%	Muni 4.3%	Treas. 4.6%
High Yield 2.7%	ABS 4.7%	EMD USD 6.2%	Corp. -4.9%	Muni 12.9%	TIPS 6.3%	EMD USD 7.3%	Muni 6.8%	Muni -2.6%	Treas. 5.0%	Asset Alloc. -0.4%	Barclays Agg 2.6%	Barclays Agg 3.5%	TIPS -1.3%	TIPS 8.4%	Muni 3.3%	Barclays Agg 4.2%	ABS 4.1%
MBS 2.6%	Barclays Agg 4.3%	Corp. 4.6%	EMD LCL. -5.2%	TIPS 11.4%	Treas. 5.9%	MBS 6.2%	Barclays Agg 4.2%	Treas. -2.8%	TIPS 3.6%	Corp. -0.7%	ABS 2.0%	TIPS 3.0%	High Yield -2.1%	Muni 7.5%	ABS 2.4%	MBS 4.0%	Muni 3.8%
Barclays Agg 2.4%	Corp. 4.3%	Muni 3.4%	EMD USD -12.0%	Barclays Agg 5.9%	ABS 5.8%	ABS 5.1%	ABS 3.7%	EMD USD -5.2%	High Yield 2.5%	TIPS -1.4%	MBS 1.7%	ABS 3.0%	Corp. -2.5%	Treas. 6.9%	High Yield 0.6%	TIPS 3.8%	Asset Alloc. 3.6%
ABS 2.1%	Treas. 3.1%	ABS 2.2%	ABS -12.7%	MBS 5.9%	MBS 5.4%	High Yield 5.0%	MBS 2.6%	TIPS -8.6%	ABS 1.7%	High Yield -4.5%	Treas. 1.0%	MBS 2.5%	EMD USD -4.3%	MBS 6.4%	EMD USD -0.5%	Treas. 3.7%	Barclays Agg 3.3%
Corp. 1.7%	TIPS 0.4%	High Yield 1.9%	High Yield -26.2%	Treas. -3.6%	Muni 2.4%	EMD LCL. -1.8%	Treas. 2.0%	EMD LCL. -9.0%	EMD LCL. -5.7%	EMD LCL. -14.9%	Muni 0.2%	Treas. 2.3%	EMD LCL. -6.2%	ABS 3.8%	EMD LCL. -6.3%	ABS 3.1%	MBS 2.5%

Source: Barclays, Bloomberg, FactSet, J.P. Morgan Global Economic Research, J.P. Morgan Asset Manatement. Past performance is not indicative of future returns. Fixed income sectors shown above are provided by Bloomberg unless otherwise noted and are represented by Broad Market: U.S. Aggregate Index; MBS: US Aggregate Securitized – MBS Index; ABS: J.P. Morgan ABS Index; Corporate: U.S. Aggregate Credit – Corporates – Investment Grade; Municipals: Municipal Bond Index; High Yield: U.S. Aggregate Credit – Corporate – High Yield Index; Treasuries: Global U.S. Treasury; TIPS: U.S. Treasury Inflation-Protected Notes Index; Emerging Debt USD: J.P. Morgan EMBIG Diversified Index; Emerging Debt LCL: J.P. Morgan EM Global Index. The "Asset Allocation" portfolio assumes the following weights: 20% in MBS, 5% in ABS, 20% in Corporate, 15% in Municipals ,5% in Emerging Debt USD, 5% in Emerging Debt LCL, 10% in High Yield, 15% in Treasuries, 5% in TIPS. Asset allocation portfolio assumes annual rebalancing. *Guide to the Markets – U.S.* Data are as of September 30, 2020. Sources: U.S. Bureau of Labor Statistics; Federal Reserve.

Returns shown for selected stock indices are total returns, and thus include dividends. Past performance is no guarantee of future results. This information is for illustrative purposes only and is not intended to represent any particular investment product.

Step 3: Match your investment to your goals.

Before you can decide what types of investments are appropriate from a risk perspective, you need to evaluate your savings goals. Is your goal preservation of capital, generating income for current expenses, or growing the value of your investment over and above inflation? How you answer this will enable you to find an appropriate balance between the return you hope to achieve and the risk you are willing to take.

Remember, the longer your time horizon, the more volatility you can tolerate in your portfolio. For example, if you are pursuing long-term goals, such as retirement, you will be most concerned with long-term growth and managing inflation risk. Your portfolio should be more heavily weighted in stock investments (or equities), as these have historically provided the highest long-term returns and outpaced inflation by the widest margin. You may also want to put some money into bonds to help manage the higher risks associated with equities. Keep in mind that equities offer long-term growth potential but will fluctuate and may provide less current income than other investments.

On the other hand, if you are already in retirement, you may need to rely heavily on the income from your portfolio. Therefore, you may seek to manage income and manage risk of short-term losses. Your portfolio will likely be weighted in high-quality, lower-risk bond investments, with some stocks in the mix to maintain growth potential.

When thinking about how to balance risk and return in a portfolio, don't forget that the risk of loss is not the only kind of risk. You must give some thought to the risk of investing too conservatively and not realizing a high enough return potential to provide for your financial future. Conversely, be aware of investing in equities or alternatives investments that may be too risky for your shorter-term goals.

{ A common myth in the investment world is that the more risk you take, the higher returns you should receive. At Redhawk, we firmly believe in providing you the best financial outcome with the lowest risk. We strive to increase your income at retirement by taking on the least amount of risk possible. }

Income Generation

If you need income to live on from your investments, then income generation is your primary objective. This objective may or may not have risk of principal depending upon the type of vehicle used. Preferred and utility stocks, corporate and municipal bonds, buffered notes, government agency securities such as Sallie Mae and Ginnie Mae, and senior secured loans pay higher rates of income with relative price stability. Guaranteed instruments include certificates of deposit (CDs), treasury securities, and savings bonds. Fixed indexed annuities can also provide guaranteed income with certain restrictions if income benefit riders are offered inside the contract.

Focusing on income may be more reliable in covering living expenses than relying on the stock market to keep going up, especially if you are retired or near retirement. Asset management requires focus and it works best when you have a clear financial goal. As you move into your retirement years, the markets may prove unreliable in providing the consistent, long-term capital gains required to cover spending needs. Buying and holding investments when you have a shorter timeframe to weather major down markets may no longer satisfy your lifestyle requirements.

Therefore, if you are concerned about the future of financial markets, you should consider an approach whereby your investments may be able to generate enough income to meet your expenses even when markets are flat. Additionally, once a secure and dependable foundation of investment income is achieved, any additional growth in asset values becomes a bonus.

A financial advisor that is serving in a fiduciary capacity will always discuss your income needs and put together a plan for the coming years including an income plan that you can use to monitor your financial well-being. This is a focused approach to produce regular income to meet your living requirements while seeking to protect capital in volatile markets. This is also an alternative approach to asset managers who feel they can always beat the stock market. Always trying to beat the stock market can add significant risk and isn't very useful when the market produces a negative return, as in 2008 and 2018.

In many cases, planning for income is much more reliable than relying on market values consistently going up. Achieving an income level that meets your goals can free you from the constant worry that comes with the need for prices to go up in order to maintain your lifestyle objective.

You can often compare an investment income methodology to owning a portfolio of rental properties. The first consideration for such a portfolio might be the search for, and selection of, quality properties in attractive neighborhoods with financially secure tenants. You would look to acquire these properties at a reasonable price which would provide an attractive level of income and the potential for the property values to appreciate at some unknown time in the future. Ideally, this property-based portfolio would produce a consistent rental income stream you can use for living expenses.

Now, imagine that the price of the property starts falling and your portfolio is now worth less than it was just a few months ago. If the primary objective of your property portfolio is income, you probably wouldn't worry too much about this decline in value providing the properties are still in good condition and the tenants remain financially sound. In fact, a drop in property prices may be an opportunity to review your portfolio and to pick up undervalued property that will generate higher income. This is possible because, if the price of an income producing investment drops while the income remains the same in dollar terms, your income levels (yield) will increase as a percentage.

Income investing is a journey with a long-term percentage yield as your destination. Sometimes the ride is smooth and sometimes it can get bumpy.

A good financial advisor will work with an investment manager that includes many different fixed income asset classes in their portfolio to weather the storm in down markets. The main goal is to keep the monthly income flowing throughout the journey.

Today's global markets offer a wide range of income opportunities. A prudent investment manager constructs a portfolio which benefits from diversified income streams. Diversification across non-correlated asset classes may increase yields and reduce your exposure to significant losses.

If you make income your primary investment objective, several things can change. Short-term price volatility should be less worrying because your investments are paying consistent income. The income generated can be taken and used to cover living expenses without disrupting the underlying investment portfolio. Alternatively, it can be reinvested to increase the portfolio's value.

Price volatility may be less of a concern to you as an income investor because you no longer need to rely on prices going up to fund your lifestyle. When markets become volatile, the most important concern is if the company behind the investment will still be paying income five years out in the future versus if your principal falls and you need to sell into a down market. Income often provides the conservative investor with a comfort factor in difficult markets.

Liquidity Management

Liquidity management is important for the part of your portfolio that is used to cover current or near-term cash flow needs. Assets that cannot be exchanged at a current price are considered illiquid. Investors manage liquidity risk by not leaving too much of their portfolio in illiquid markets, (such as non-traded real estate investment trusts, or REITs).

Liquidity can be different things in different situations. The main definition of *liquidity* is when investments can be liquidated or sold on the open market every day that the exchanges are open. Liquid assets are critical for planned and unanticipated cash needs. The typical instruments used for this portion of a portfolio include cash, money market accounts, demand deposits, certificate of deposits (“CD”), and short duration high quality fixed income mutual funds or ETFs. Liquidity generally means how easily and quickly one may exchange a security for cash with little price concession from its going rate. Treasury bills and corporate commercial paper with Prime-1 credit ratings are highly liquid.

“Your money was working for you, but it suddenly quit and now it’s working for me!”

CartoonCollections.com

Your investment review should be simple, easy and painless. You can even keep score.

At Redhawk, we’ve been working with clients for many years and have developed a unique process that simplifies the complete financial journey. Large financial institutions will put together several binders of information when reviewing your investments and most of the information is very technical and hard to comprehend. Our financial review process is simple, easy to understand, and includes the following:

1. Your personal risk score.

2. The risk score of your current portfolio.

3. How your current portfolio performs against its benchmarks.

4. A proposed portfolio that is in line with your goals and risk score.

5. How your proposed portfolio performs against its benchmarks.

6. A retirement map with a 95% probability that you won't run out of money in retirement (see the following retirement maps that show a proposed portfolio with a 94% probability and a current portfolio with a 74% probability of not running out of money in retirement).

7. Stress tests on your portfolio for a variety of market scenarios, such as an interest rate increase or the 2008 market crash.

8. A portfolio scorecard that compares the key components of your current portfolio to the proposed portfolio (see the scorecard on the next page that compares the current proposal to the proposed portfolio along with data for the S&P 500).

Proposed Portfolio

Source: Riskalyze.

Current Portfolio

Source: Riskalyze.

REDHAWK®
WEALTH ADVISORS

Portfolio Scorecard

Mary Jane Brown

Client Assumptions		
Maximum Monthly Withdrawal at Retirement	$3,600	
Retirement Year	2020	
Monthly Savings Until Retirement	$0	
Client Risk Score	83	
Investable Assets	$457,778	
95% Probability of a Loss Over the Next 6 Months	-19.00%	($86,978)
95% Probability of a Gain Over the Next 6 Months	29.00%	$132,756

Portfolio Comparison	Current	Redhawk	S&P 500
Portfolio Risk Score	78	42	76
95% Probability of a Loss Over the Next 6 Months (%)	-17.80%	-7.40%	-16.89%
95% Probability of a Loss Over the Next 6 Months ($)	($81,618)	($33,666)	($77,319)
95% Probability of a Gain Over the Next 6 Months (%)	24.20%	14.80%	24.15%
95% Probability of a Gain Over the Next 6 Months ($)	$110,687	$67,637	$110,553
Stocks Allocation	88%	51%	100%
Bonds Allocation		36%	0%
Cash Allocation	12%	12%	0%
Other Allocation		1%	0%
Bubble Score	82.42	87.95	88.13
Funds Average Expense Ratio	0.63%	0.28%	N/A
Potential Annual Return	6.35%	7.42%	7.26%
3-Year Upside Capture Ratio	124.55%	45.28%	99.48%
3-Year Downside Capture Ratio	113.57%	-3.19%	99.87%
Annual Dividend	1.64%	4.70%	1.85%
3-Year Alpha	2.13%	0.85%	-0.08%
3-Year Sharpe Ratio	1.04%	0.65%	0.91%
Assets Needed at Retirement Date	$732,600	$475,500	
Legacy Assets	$260,000	$470,000	
Retirement Probability	73%	95%	

Source: Redhawk Wealth Advisors.

We will be covering this in more detail in future chapters.

CHAPTER 3

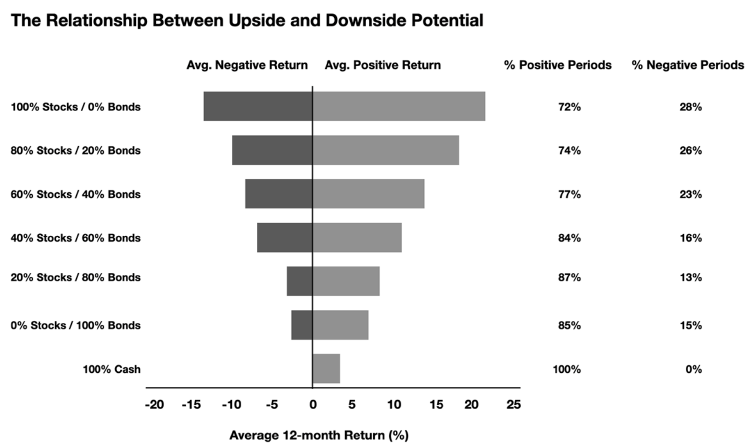
The Art and Science of Using a Tactical Asset Allocation Investment Manager.

Before we start explaining tactical asset allocation, let's start by gaining a better understanding of asset allocation in general. Asset allocation is the rigorous implementation of an investment strategy that attempts to balance risk versus reward by adjusting the percentage of each asset in an investment portfolio according to your risk tolerance, goals, and investment time frame. In other words, it describes how you divide your money among different types of investments.

{ Asset allocation is extremely important, since research suggests that 90% of your investment return is dependent on the kinds of things you invest in, rather than the specific investment choices you make. }

In other words, deciding to invest in the stock market will have a big impact on your returns, but the specific stocks you pick matter a lot less.

At the highest level of asset allocation, your main decision will be how to split your money between stocks and bonds. Stocks represent ownership in a company, and they offer both the highest potential return but also the highest risk of loss. Because of this stocks are typically a good place to invest some of your long-term money but are riskier when dealing with shorter-term goals. Bonds are loans that you give to companies. Just like a loan you take out personally, they pay an interest rate and over time the entire loan is paid back. They don't offer as much return as stocks, but they also carry less risk. Your big decision is essentially how much of your money to put toward each. The more you invest in stocks, the higher your potential return, but the higher your potential loss as well, especially in the short term.



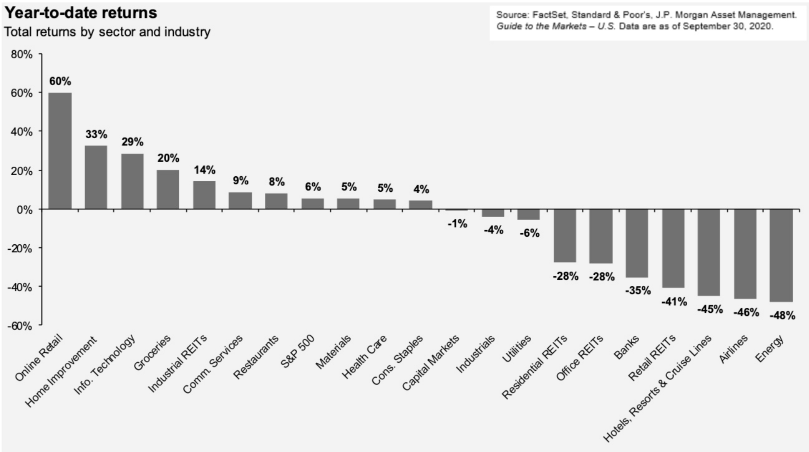
Source: Baird Research, Standard & Poor's, Barclays Capital, Citigroup.

The graph above illustrates how an increased stock allocation leads to the potential for larger positive returns over a 12 month period, but also the possibility of larger negative returns[17]. While an all-stock portfolio may provide the highest average returns over a 12 month period (21.8%), it also exhibits the largest average loss (13.6%). Conversely, following an all-bond approach has historically had limited downside (only 15% of the periods studied showed negative returns), but produced less than half the positive returns of the all-stock approach. Identifying the upside and downside thresholds that you are comfortable with is an important step in ensuring that the asset allocation plan is within your risk comfort zone.

Don't you want your investments to do well in a bull market (when prices are rising or are expected to rise) and thus preserve capital? Or go defensive in a bear market (when a market experiences prolonged price declines)? Let's look at two distinct asset allocation strategies:

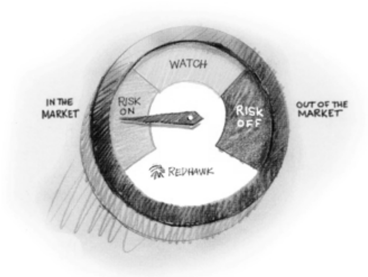
1. Strategic asset allocation is a target allocation of asset classes you expect to have in place for a long period of time. For example, a portfolio manager might have a balanced portfolio of 50% stocks and 50% bonds. The target allocation is expected to remain the same and the portfolio would be re-balanced back to the appropriate allocation as needed. Strategic asset allocation looks more at the overall risk objective of the portfolio, and therefore takes a long-term view. Strategic asset allocation is a portfolio strategy that involves setting target allocations for various asset classes and rebalancing periodically. The portfolio is rebalanced to the original allocations when they deviate significantly from the initial settings due to differing returns from the various assets. Under this type of strategy your assets are always static in the asset classes and 100% invested in the market.

2. Tactical asset allocation is an investment strategy that looks for investment opportunities in the market. Tactical asset allocation might be that within the 50% stocks part of the allocation, a portfolio manager wants to own more in small-cap companies than large-cap companies because small-caps are a better investment opportunity right now. When large-cap companies look more attractive the portfolio manager might overweight or put more money into large-caps and allocate less to small-caps. The following chart shows the year-to-date performance through 09/30/2020 for various asset classes. Tactical asset allocation will give you the opportunity to be invested in the top performing asset classes.



Tactical asset allocation allows a portfolio manager to move into and out of or overweight and underweight certain areas of the market. Under this type of strategy your assets are in growth mode when the market is doing well and go into defensive mode when the market is not doing well. Let's take a closer look at tactical asset allocation.

Take an active stance with tactical asset allocation.



Tactical asset allocation is an active management portfolio strategy that shifts the percentage of assets held in various categories to take advantage of strong market sectors. This strategy allows portfolio managers to create extra value by leveraging certain situations in the marketplace. Most tactical asset allocation strategies use a quantitative investment model to expose the imbalances among different asset classes. Many times, algorithms are developed in order to determine when the portfolio is in "risk on" mode, meaning that it is in growth orientated equities, or it is in "risk off" mode and invested in defensive asset classes.

Tactical asset allocation is the process of taking an active stance on the strategic asset allocation itself and adjusting long-term target weights over a certain time period to capitalize on market or economic opportunities. For example, tactical shifts may come within a particular asset class. Assume the 45% strategic allocation of stocks consists of 30% large-cap and 15% small-cap holdings. If the outlook for small-cap stocks does not look favorable, it may be a wise tactical decision to shift the allocation within stocks to 40% large-cap and 5% small-cap for a period until conditions change.

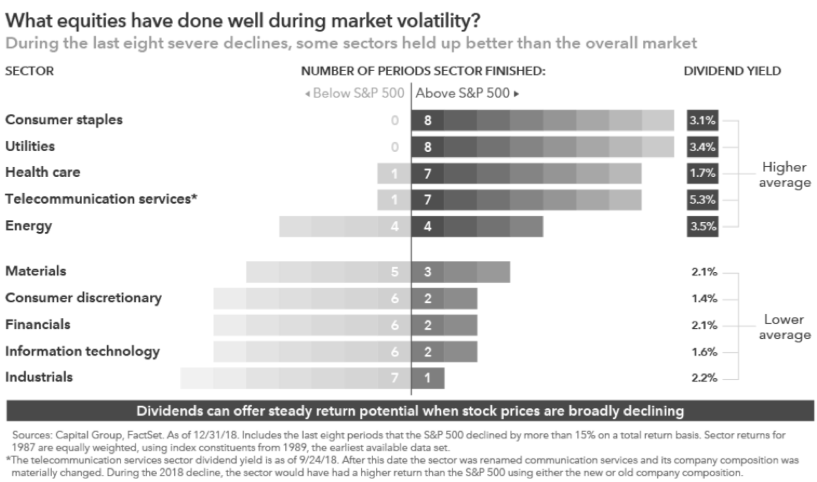
{ Tactical asset allocation is at the core of Redhawk's investment philosophy to actively manage downside risk. Our primary objective is to limit the downside and capture as much of the upside as possible. }

Our definition of downside risk management is that we will look to invest in asset classes that are not correlated to the market and we look to capture positive performance in a down market. In other words, when the market is in a downward trend, we will move to a "risk off" position, which means that we will exit the equity market and investigate asset classes that have historically done well in down markets, such as:

- Treasuries
- Consumer staples
- Utilities
- Precious metals
- Healthcare (sometimes)

The underlying premise is that up-trending markets tend to have lower volatility and that's when you want to stay invested for as long as possible. Conversely, down-trending markets tend to have higher volatility. It's important to note that we are not trying to time the market and pick market tops or bottoms or change with every 5-10% correction. Most strategies that try to pull this off end up over-trading and under-delivering. A tactical asset allocation strategy is set up to avoid a severe loss like what happened in 2008 when stocks dropped 30-50%. You can never time these moves perfectly but the goal is to miss most of the huge drawdowns.

The following chart shows the asset classes that have done well when there has been a 15% or more market decline in the S&P 500.



Tactical asset allocation is an effective means to limit your portfolio risk. During time periods when investment assets are overvalued, a tactical asset allocation strategy allows you to allocate your investments to those asset classes that have done well in down markets. When designed properly and executed successfully, tactical asset allocation portfolios have two distinct advantages:

1. They mitigate risk by going to "risk off" mode during severe bear markets.

2. They can enhance returns by going to "risk on" mode when markets are trending higher.

Tactical asset allocation's primary investment objective is to mitigate a portfolio's decline during severe bear markets. It is important to appreciate that the objective is to mitigate and not eliminate severe declines. The benefit of such "risk off" mitigation is most clearly understood by reviewing the history of bear markets. The following table shows the history of such declines for the U.S. stock market as defined by the S&P 500 Index.

Name	Start	End	Duration (in years)	Severity (in % decline)	Summary
1903 Bear	09/30/1902	10/31/1903	1.1	-26.0	Lost -2.0% per month for 13 months
1907 Bear	09/30/1906	11/30/1907	1.2	-34.1	Lost -2.4% per month for 14 months
1913 Bear	10/31/1912	10/31/1914	2.0	-25.2	Lost -1.1% per month for 24 months
1917 Bear	11/30/1916	12/31/1917	1.1	-27.9	Lost -2.1% per month for 13 months
1920 Bear	10/31/1919	06/30/1921	1.7	-26.4	Lost -1.3% per month for 20 months
1931 Bear	08/31/1929	06/30/1932	2.8	-83.7	Lost -2.5% per month for 34 months
1946 Bear	05/31/1946	11/30/1946	0.5	-21.8	Lost -3.6% per month for 6 months
1962 Bear	12/31/1961	06/30/1962	0.5	-22.2	Lost -3.7% per month for 6 months
1969 Bear	11/30/1968	06/30/1970	1.6	-29.2	Lost -1.5% per month for 19 months
1973 Bear	12/31/1972	09/30/1974	1.7	-42.7	Lost -2.0% per month for 21 months
1987 Bear	08/31/1987	11/30/1987	0.2	-29.6	Lost -9.9% per month for 3 months
2001 Bear	08/31/2000	09/30/2002	2.1	-44.7	Lost -1.8% per month for 25 months
2008 Bear	10/31/2007	02/28/2009	1.3	-50.9	Lost -3.2% per month for 16 months
Average bear market			1.4	-35.7	Lost -2.2% per month for 16 months
Median bear market			1.3	-29.2	Lost -1.8% per month for 16 months
During the remaining time periods (during the remaining 101.9 years) the market returned an average annual compound return of 18.8%					
Bear markets during the period 12/31/1894 through 9/15/2014					

You can draw several observations from the chart above that may be particularly helpful:

- On average, a new bear market starts once every 9.2 years.
- The average decline is -35.7%.
- The typical bear lasts for 1.4 years (or 17 months).
- The most recent bear market started back on 10/31/2007.
- When the market is not experiencing a bear market, the average annual compound return is 18.8%.

Tactical asset allocation's secondary objective is to provide solid performance when markets are trending higher. The phenomenon known as *trending* is best described as the market's ability to keep doing what it's been doing. If the market has been going up, then to keep going up, or if the market has been going down, then to keep going down.

"Of all the markets, in all the world, you had to walk into mine."

Understanding "sequence of returns risk."

Sequence of returns risk analyzes the order in which your investment returns occur. It affects you when you are periodically adding or withdrawing money from your investments. In retirement, it can mean that you earn a much lower internal rate of return than what you expected. The best way to understand sequence of returns risk is with an example (see chart to the right).

	"Up" Market - Mr. Green		"Down" Market - Mr. Brown	
Age	**Annual Return**	**Year End Value**	**Annual Return**	**Year End Value**
65		$1,000,000		$1,000,000
66	5%	$1,050,000	-25%	$750,000
67	28%	$1,344,000	-14%	$645,000
68	22%	$1,639,680	-10%	$580,500
69	-5%	$1,557,696	16%	$673,380
70	20%	$1,869,235	21%	$814,790
71	19%	$2,224,390	5%	$855,529
72	23%	$2,736,000	-16%	$718,645
73	9%	$2,982,240	8%	$776,136
74	16%	$3,459,398	14%	$884,795
75	23%	$4,255,059	24%	$1,097,146
76	22%	$5,191,172	14%	$1,250,747
77	-26%	$3,841,468	5%	$1,313,284
78	-15%	$3,265,247	-15%	$1,116,291
79	5%	$3,428,510	-26%	$826,056
80	14%	$3,908,501	22%	$1,007,788
81	24%	$4,846,541	23%	$1,239,579
82	14%	$5,525,057	16%	$1,437,912
83	8%	$5,967,062	9%	$1,567,324
84	-16%	$5,012,332	23%	$1,927,808
85	5%	$5,262,949	19%	$2,294,092
86	21%	$6,368,168	20%	$2,752,910
87	16%	$7,387,075	-5%	$2,615,264
88	-10%	$6,648,367	22%	$3,190,623
89	-14%	$5,717,596	28%	$4,083,997
90	-25%	**$4,288,197**	5%	**$4,288,197**
Average Return	**6%**		**6%**	

If you are taking withdrawals from your portfolio, the order or the sequence of investment returns can significantly impact your portfolio's overall value. Consider the following hypothetical investment scenarios for Mr. Green and Mr. Brown (see following chart). Mr. Green and Mr. Brown both started with a $1 million investment portfolio at age 65. Both averaged a 6% annual return that grows to the same value after 25 years, but they experience their annual returns in an inverse order from each other[18].

Age	"Up" Market - Mr. Green			"Down" Market - Mr. Brown		
	5% Annual Withdrawals	Annual Return	Year End Value	5% Annual Withdrawals	Annual Return	Year End Value
65			$1,000,000			$1,000,000
66	$50,000	5%	$1,000,000	$50,000	-25%	$700,000
67	$50,000	28%	$1,230,000	$50,000	-14%	$552,000
68	$50,000	22%	$1,450,600	$50,000	-10%	$446,800
69	$50,000	-5%	$1,328,070	$50,000	16%	$468,288
70	$50,000	20%	$1,543,684	$50,000	21%	$516,628
71	$50,000	19%	$1,786,984	$50,000	5%	$492,460
72	$50,000	23%	$2,147,990	$50,000	-16%	$363,666
73	$50,000	9%	$2,291,309	$50,000	8%	$342,760
74	$50,000	16%	$2,607,919	$50,000	14%	$340,746
75	$50,000	23%	$3,157,740	$50,000	24%	$372,525
76	$50,000	22%	$3,802,443	$50,000	14%	$374,679
77	$50,000	-26%	$2,763,808	$50,000	5%	$343,412
78	$50,000	-15%	$2,299,237	$50,000	-15%	$241,901
79	$50,000	5%	$2,364,199	$50,000	-26%	$129,006
80	$50,000	14%	$2,645,186	$50,000	22%	$107,388
81	$50,000	24%	$3,230,031	$50,000	23%	$82,087
82	$50,000	14%	$3,632,235	$50,000	16%	$45,221
83	$50,000	8%	$3,872,814	$50,000	9%	$0
84	$50,000	-16%	$3,203,164	$50,000	23%	$0
85	$50,000	5%	$3,313,322	$50,000	19%	$0
86	$50,000	21%	$3,959,120	$50,000	20%	$0
87	$50,000	16%	$4,542,579	$50,000	-5%	$0
88	$50,000	-10%	$4,038,321	$50,000	22%	$0
89	$50,000	-14%	$3,422,956	$50,000	28%	$0
90	$50,000	-25%	**$2,517,217**	$50,000	5%	**$0**
Average Return	**6%**			**6%**		

Source: Robert Baird and Co.

Once you start withdrawing income, you're affected by the change in the sequence in which the returns occurred. Now let's look at how the sequence of returns can impact a portfolio when taking distributions. Mr. Green and Mr. Brown still start with an initial $1 million investment portfolio. But in this example, they start taking 5% withdrawals (of the initial value) beginning immediately at age 65. Mr. Green begins taking withdrawals in an up market, giving him the optimal environment to maintain his portfolio value long-term.

Unfortunately for Mr. Brown, he starts taking income in a down market and depletes his entire portfolio before reaching age 83. It is important to manage this risk in retirement by maintaining sound tactical asset allocation strategies so that your portfolio changes in response to various market conditions.

During your retirement years, if a high proportion of negative returns occur in the beginning years of your retirement, it will have a lasting negative effect and reduce the amount of income you can withdraw over your lifetime. As discussed prior, this is called the sequence of returns risk. When you're retired, you need to sell investments periodically to support your cash flow needs. If the negative returns occur first, you end up selling some holdings, and so you reduce the shares you own that are available to participate in the later-occurring positive returns.

If you are near retirement or already retired, you need retirement income. But how much money should you take out each year? You want to make *sure* you don't spend down your accounts too fast. Riskalyze can help to determine a safe withdrawal rate.

{ A safe withdrawal rate is the estimated portion of money that you can withdraw from your investments each year while leaving enough principle that the funds last for your entire life, even if you retire during a time when the economy and/or the stock market is not doing well. }

For example, if you spend $4,000 for every $100,000 you have invested, you would have an initial withdrawal rate of 4%[19]. Let's review each rule.

Rule #1 - Use Riskalyze to determine your maximum monthly withdrawal using a 95% probability that you won't run out of money in retirement.

By utilizing Riskalyze's Retirement Maps, your financial advisor will marry your portfolio allocations with your retirement goals. They can then objectively express whether your retirement goals, your Risk Number, and portfolio have a high probability (will typically use 95%) of success. The map depicts the projected range of potential outcomes for a given portfolio over time using your age, retirement year, how long you will live, and inflation. You should meet with your financial advisor at least annually to go over your retirement map to see where you stand.

Rule #2 - Make sure your retirement income is keeping pace with inflation.

Specifically, your portfolio must meet a certain return so that you don't run the risk of running out of money in retirement. This is a constant balancing act and it's important to meet with your financial advisor at least annually to ensure that you are still on the right track. If you are ahead of the goal, when comparing your withdrawal rates versus the value in your entire portfolio, you can probably take some risk off the table. Conversely, if you are behind your goal, you may need to take on more risk to catch up. Using a tactical asset allocation portfolio manager is a strategy that can help you keep pace and manage your exposure to risk.

Rule #3 - Use a diversified portfolio to maximize your withdrawal rate.

A well-diversified portfolio should contain an allocation in U.S. equities, international equities, and fixed income. As we've discussed earlier in this chapter, the asset allocation will set the overall mix of the portfolio and the tactical asset allocation will adjust over time to take advantage of cycles in the market and to help mitigate the downside risk.

Rule #4 - Take retirement income withdrawals in a certain order.

When you take withdrawals, your retirement income must come from each category (or bucket of money) in a certain order. Your financial advisor will help you with this and customize it to your specific needs. It's described at a very basic level below:

- Bucket 1 is filled with extremely low risk and very liquid assets that can be converted into cash quickly. The amount should be enough to cover one year's worth of your living expenses.

- Bucket 2 is a stack of fixed income investments (sometimes called a ladder). This may include bond investments, structured income notes, and fixed indexed annuities. Each layer represents one year's worth of your living expenses. Every year, one year's worth of spending money "matures" and moves from bucket 2 to bucket number 1. This assures you always have enough cash on hand to cover your upcoming expenses.
- Bucket 3 is your growth engine and is filled with equities. You may only take money from the equity bucket when it overflows. An overflow year is any year when equities have above average returns, roughly an annual return in excess of 12% to 15%. At the end of an overflow year, you sell excess equities and use the proceeds to refill the fixed income and cash buckets.

There will be many years where your equity bucket does not overflow. It will take discipline to realize it is okay for you to let the fixed income and cash buckets get to a low level during these years. Eventually, an overflow year will happen, and all buckets will be refilled. Following this rule will prevent you from becoming a victim of your own emotions and selling investments at an unfavorable time.

Rule #5 - Reduce your retirement income during down markets.

This rule functions as a safety net to protect your future retirement income from erosion during down markets. It is triggered when your current withdrawal rate is 20% greater than your initial withdrawal rate. Sounds confusing? The best way to explain this rule is to use an example.

Assume you have a $100,000 and you start withdrawing 7% or $7,000 each year. The market goes down for several years and your portfolio value is now at $82,000. The same $7,000 withdrawal is now 8.5% of your current portfolio value. Since your withdrawals now represent a bigger piece of your portfolio, this reduction rule is triggered, and you must reduce your current year's withdrawal by 10%. In this example, your withdrawal would go from $7,000 to $6,300 for the year.

Rule #6 - Increase your retirement income during up markets.

This final rule is the opposite of the prior rule. If your portfolio had a positive return in the prior year, you can increase your retirement income. Your increase is calculated by increasing your monthly withdrawal in proportion to the increase in the consumer price index ("CPI"). If you were withdrawing $7,000 per year, the market had a positive return, and the CPI went up by 3%, then the following year you would withdraw $7,210.

These examples and rules clearly demonstrate why it is so important to make informed decisions about your money. Following these rules takes discipline and the help of a financial advisor. The reward is a higher level of retirement income and an increased ability to maintain purchasing power.

"Help! I haven't saved enough for retirement!"

Two ways portfolio managers select their investments.

Investment selection is typically based on one of two styles or a combination of the two:

"The little match girl realized too late what her mistake had been. She had failed to diversify."

CartoonCollections.com

- **Top-down Approach** – Portfolio managers who use this approach start by looking at the market, then determine which industries and sectors are likely to do well given the current economic cycle. Once these choices are made, they then select specific stocks based on which companies are likely to do best within an industry.

The top-down approach to investing focuses on the "big picture" or how the overall economy and macroeconomic factors drive the markets and ultimately stock prices. These portfolio managers will also look at the performance of sectors or industries. These portfolio managers believe that if the sector is doing well, chances are, the stocks in those industries will also do well.

Top-down investment analysis includes:

- Looking at economic growth or gross domestic product ("GDP") both in the U.S. and globally.
- Factoring in monetary policy by the Federal Reserve Bank ("Fed") including the lowering or raising of interest rates.
- Keeping a close eye on inflation and the price of commodities.

- Staying on top of bond prices and yields including U.S. Treasuries.

For example, if you are a top-down investor, you might look at rising interest rates and bond yields as an opportunity to invest in bank stocks. Typically, but not always, when long-term yields rise, and the economy is performing well, banks tend to earn more revenue since they can charge higher rates on their loans. However, the correlation of rates to bank stocks is not always positive. It's important that the overall economy is performing well while yields rise.

Conversely, suppose you believe the Fed will lower interest rates, using the top-down approach, you might determine that the home building industry would benefit the most from lower rates since lower rates might lead to a spike in new homes purchases. As a result, you might buy stocks of companies in the home building sector.

- **Bottom-up Approach** – Portfolio managers who use this approach ignore market conditions and expected trends. Instead, companies are evaluated based on the strength of their financial statements, product pipeline, or some other criteria. The idea of using this approach is that strong companies are likely to do well.

If you are a bottom-up investor, you will examine the fundamentals of a stock regardless of market trends. You will focus less on market conditions, macroeconomic indicators, and industry fundamentals. Instead, you will focus on how an individual company in a sector is performing compared to specific companies within the sector.

Bottom-up analysis focus includes:

- Financial ratios including the price to earnings ("P/E"), current ratio, return on equity, and net profit margin.
- Earnings growth including future expected earnings.
- Revenue and sales growth.

- Financial analysis of a company's financial statements including the balance sheet, income statement, and cash flow statement.
- Cash flow and free cash flow show how well a company generates cash and can fund its operations without adding more debt.
- Management's leadership and performance.
- A company's products, market dominance, and market share.

The bottom-up approach invests in stocks where the above factors are positive for the company, regardless of how the overall market may be doing.

If you are a bottom-up investor, you also believe that just because one company in a sector is doing well, that does not mean that all companies in the sector will also perform well. You will try to find the companies in a sector that will outperform the others and this is why bottom-up investors spend so much time analyzing a company. Bottom-up investors typically review research reports that analysts put out on a company since analysts often have an intimate knowledge of the companies they cover.

The smart money is on diversification.

Diversification is another term that you hear often and all it really means is investing your money in a variety of different things instead of putting all your eggs in one basket. Diversification is important because it's the only way to decrease your investment risk without decreasing your expected return.

As discussed in this book, one way to diversify is with your asset allocation. Putting some money into stocks and some into bonds means you're diversified across different types of investments. You could even go a little further by splitting those into U.S. stocks and international stocks, and U.S. bonds and international bonds, just to make sure you have everything covered.

To further this idea you can also diversify within those major asset categories. For example, instead of picking just a few U.S. stocks to invest in, you could pick an index fund that invests in the entire U.S. stock market. When you own a little bit of every company in the U.S., no single company can sink your portfolio returns. This kind of simple diversification has the benefit of decreasing your risk of loss without decreasing the return you expect to receive. Diversification works best when asset classes have low correlations with one another. Historically, this was achieved in a relatively simple manner. Expanding a large-cap, U.S.- based stock portfolio to include small-cap or international stocks would have provided enough diversification.

What is *correlation*? Correlation, in the investment world, is a statistic that measures the degree to which two securities move in relation to each other. Correlations are used in advanced portfolio management, computed as the correlation coefficient, which has a value that must fall between -1.0 and +1.0. A perfect positive correlation means that the correlation coefficient is exactly 1. This implies that as one security moves, either up or down, the other security moves in lockstep in the same direction. A perfect negative correlation (or non-correlated) means that two assets move in opposite directions, while a zero correlation implies no relationship at all.

For example, large-cap mutual funds generally have a high positive correlation to the Standard and Poor's ("S&P") 500 Index, which is very close to 1. Small-cap stocks have a positive correlation to that same index, but it is not as high, generally around 0.8. Non-correlated investments will have a negative correlation. As the stock price decreases, the non-correlated investment price goes up.

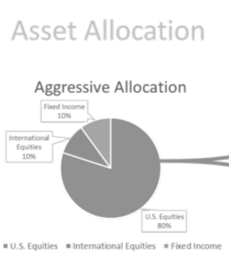
Over the past 10 years, however, the financial marketplace has become increasingly interconnected and highly correlated. Just look at the poor 2008 returns of many asset classes and how similarly different types of investments move when the market is extremely volatile. The following graphic provides various examples of how a portfolio can be diversified using more traditional and tactical methods.

Source: Redhawk Wealth Advisors, Inc.

{ If you look at how Redhawk tactically manages our S&P Aggressive portfolio, from a diversification standpoint and just within the U.S. equity allocation, we look at over 25 asset classes to invest in (see the following chart). }

The markets have become so highly correlated and change so quickly because of high powered algorithmic trading, we feel it's imperative to look at almost every asset class available.

Tactical Asset Allocation



U.S. Equities		
Small-Cap Growth	Technology	Financial
Mid-Cap Growth	Real Estate	Allocation 85%+ Equity
Large-Cap Growth	Utilities	Health
Small-Cap Blend	Infrastructure	Industrials
Mid-Cap Blend	Energy Limited Partnership	Equity Precious Metals
Large-Cap Blend	Consumer Defensive	Natural Resources
Small-Cap Value	Long-Short Equity	Equity Energy
Mid-Cap Value	Communications	
Large-Cap Value	Commodities Precious Metals	
Consumer Cyclical	Commodities Broad Basket	

Source: Redhawk Wealth Advisors, Inc.

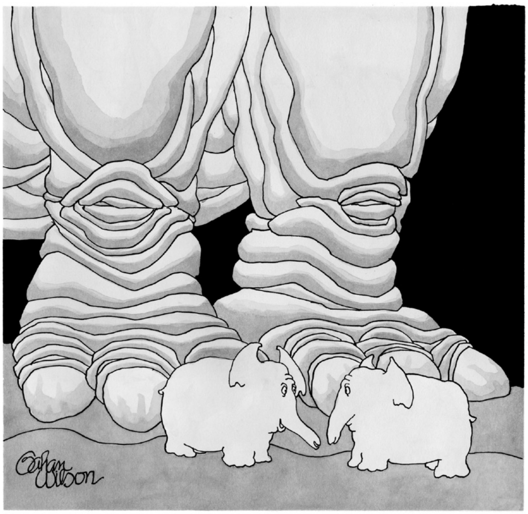
So, what is *algorithmic trading*? Algorithmic trading (also known as algo trading) is a method of stock trading that uses intricate mathematical models and formulas to initiate high-speed, automated financial transactions. The goal of algorithmic trading is to help large financial institutions execute on specific financial strategies as quickly as possible to bring in higher profits. An algorithm is a process or set of defined rules designed to carry out a certain process. Algorithmic trading uses computer programs to trade at high speeds and volume based on several preset criteria, such as stock prices and specific market conditions. Simply put, algorithms are complex math equations used to program computers to make decisions.

When the stock market turns volatile, algorithmic trading often gets the blame. Big banks, hedge funds, and institutional investors use computer-driven trading algorithms routinely in bull or bear markets. But when triggered by news events or financial rules, algo trading can escalate and worsen a stock market sell-off. For example, algo trading could use pre-programmed rules for when a stock reaches or falls below a 50 day or 200 day moving average.

From our perch: Redhawk's approach to investment management.

At Redhawk, we've developed a comprehensive active management approach for our portfolios and our tactical asset allocation and diversification methodologies are simple, but unique. In general, we allocate among U.S. equities, international equities, and fixed income investments. The portfolios can be placed into one of two categories based on their objective:

1. Growth portfolios – mirror the S&P 500 in rising markets ("risk on") and shifts to non-correlated asset classes in down markets ("risk off").
2. Income portfolios – maximize monthly or quarterly income and will rotate into better performing fixed-income asset classes.



"What are you going to do when you become enormous?"

Growth Portfolios

The growth portfolios incorporate a tactical asset allocation strategy utilizing a proprietary screening process and algorithms to maintain or reduce equity exposure. Broad market and sector related funds are over/under weighted based on momentum factors and risk. The growth portfolios have a strong correlation to the S&P 500 in rising markets and can shift to defensive non-correlated asset classes when market risk is elevated. Additionally, Redhawk has several deeply held beliefs that govern our tactical asset allocation management philosophy:

1. Turn defensive during downturns in the market.
2. Investment decisions are governed by a disciplined process.
3. Investment results are measured over a full market cycle.
4. Communicate regularly so you know what we are doing.

So, let's look at a high level overview of our risk management process for growth portfolios. The following graphic shows the three levels of algorithms we use.

Source: Redhawk Wealth Advisors, Inc.

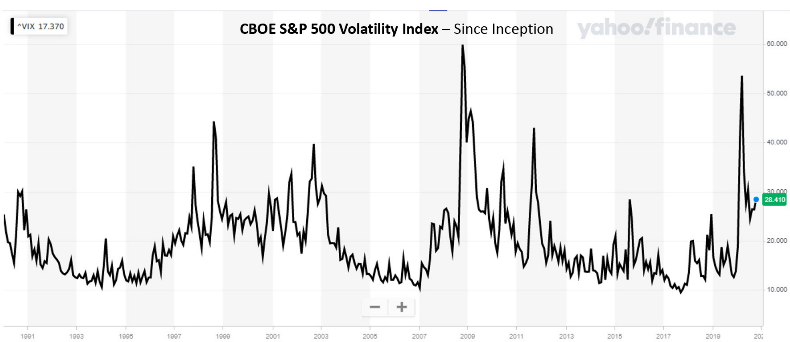
{ A very important distinction in how Redhawk actively manages its growth portfolios is that we follow a disciplined process, which takes out all emotions when making decisions. }

Redhawk has developed proprietary macro algorithms using the Chicago Board of Trade ("CBOE") S&P 500 Volatility Index ("VIX"). The VIX is the actual ticker symbol and it shows the market's expectation of 30 day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. We use the macro VIX algorithms to determine whether the portfolio should be actively invested in the market ("risk on") or defensively invested in the market ("risk off").

Put simply, the VIX is a widely watched index that gauges fear in the market. It is a measure of the expected volatility calculated as 100 times the square root of the expected 30-day variance of the S&P 500 rate of return. The variance is annualized and the VIX expresses volatility in percentage points. It is a good indicator of the expectation of market volatility and it is not representative of the actual volatility or what will happen.

A low VIX reading typically indicates a bullish outlook for stocks. As of the writing of this book, the VIX average was 18.58 since inception and 14.48 over the last 5 years. In general, when the VIX increases, it means the market volatility is increasing and typically the market is in a downturn. If your outlook on the market is bullish, bearish, or somewhere in-between, VIX futures and options can help you get a better read on the market to diversify a portfolio and mitigate risk. The chart below shows the VIX since its inception. Most people remember what happened in 2008 and look how high the VIX was.

{ One of our major beliefs is to turn defensive ("risk off") during downturns in the market, we also look for positive performance in a down market. }



Many tactical asset managers will go to cash when there is a market downturn. However, it's not uncommon that they leave and reenter the market at the same price, therefore providing no downside protection benefit for their clients. Redhawk will exit the market when the VIX has a consistent spike in volatility over several weeks, which eliminates false positive buys and sells (or whipsaw). We want to make sure that the trend is real and not a short-term spike like the flash crash that happened on August 24, 2015 when the S&P

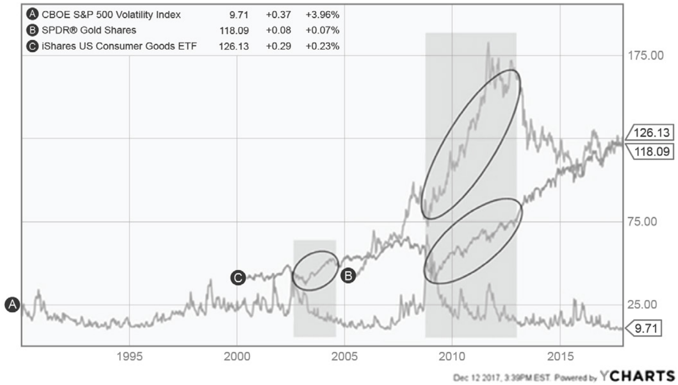
500 opened at 1,965.15 and within minutes fell to a low of 1,867.01, a 5% decline. The sell-off was fueled by a combination of factors. The main catalyst for the selling was that the market had already experienced strong selling on August 20 and 21, leaving investors wary heading into the weekend. Asian markets open before U.S. markets, and on Monday morning, the Chinese Shanghai Composite Index fell 8.5%, which led traders in U.S. markets to pull their buy orders and hit the sell button. With few bids, sell orders overwhelmed any buy order present, pushing prices lower without any support.

When we exit the market during a downturn, we look for investments that are negatively correlated to the market. As we discussed earlier, asset correlation is a measure of how investments move in relation to one another. When assets move in the same direction at the same time, they are highly correlated. When one asset tends to move up when the other goes down, the two assets are negatively correlated or another term that is used is non-correlated.

As we mentioned previously, non-correlated assets that have historically done well in down markets are:

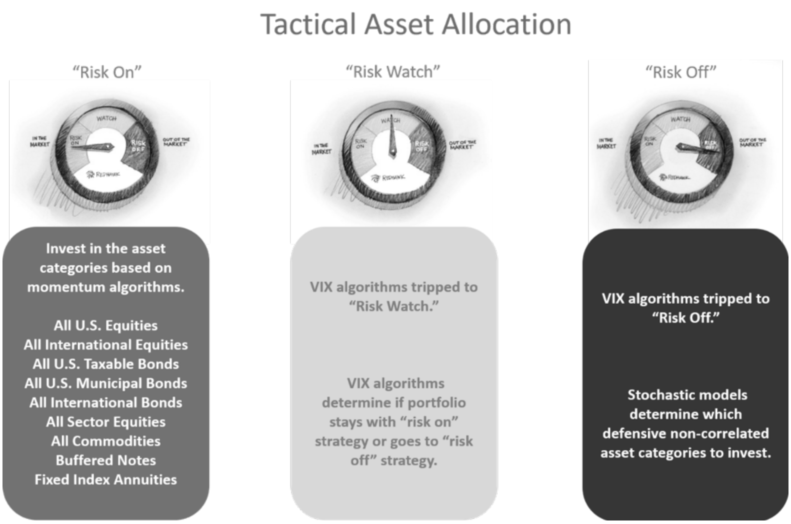
- Treasuries
- Consumer Staples
- Utilities
- Precious Metals
- Healthcare (sometimes)

The following chart compares the VIX (CBOE S&P 500 Volatility Index) to gold (precious metals) and consumer goods (consumer staples). As you can see, generally when the VIX spikes, gold and consumer goods tend to go up and are therefore non-correlated.



Source: Redhawk Wealth Advisors, Inc.

Now let's get more detailed and examine some specific examples using Redhawk's "risk on" and "risk off" strategy. The following chart shows how we determine when to go "risk on" vs. "risk off."



Income Portfolios

{ An income portfolio strategy is designed to provide a steady stream of income, while minimizing the risk of losing principal. }

Of course, this means taking on less risk and generally achieving lower returns than you'd expect in a growth portfolio.

When you retire, most of your wealth will likely reside in tax-advantaged accounts, such as IRAs and 401(k)s. At that stage of life you'll value stable income and principal preservation, and an income portfolio can help you achieve that goal and preserve your assets.

You can invest the majority of your retirement savings into an income portfolio to help provide a steady income stream, or you can use the "bucket approach," we discussed earlier by investing a portion of your retirement portfolio with an income strategy for short-term needs and leaving the rest in stocks for long-term growth.

"Right now I think the wisest strategy is to diversify among your mattresses."

Historically low interest rates have created a challenging environment for income-oriented portfolios. If you are among those trying to earn an attractive yield on your savings, it's important to balance your desire for income against the inherent risks of investing in equities or fixed income securities. When building a diversified portfolio of income-generating investments, you want to make sure that you understand the liquidity of the investments. For example, if you invest in ETFs and mutual funds, you should be able to receive cash from a sale of the securities in 2-3 days. If you invest in a private structured note, you may have restrictions as to when you can liquidate or take out a distribution. If you are invested in a fixed indexed annuity, there may be a surrender charge if you need to liquidate before the contract matures.

A diversified portfolio of income-generating funds can include investments in domestic and international stocks, government bonds, municipal bonds, corporate bonds, real estate, structured buffered notes, fixed indexed annuities, and other assets. The challenge is to pick the right combination of investments to match your time horizon, your investment goals, and your tolerance for risk.

When selecting investments for an income portfolio, the following asset classes can be used:

- Investment grade taxable bond funds - are typically composed of investment grade bonds issued by governments and corporations or secured by assets such as home mortgages. All fund yields are subject to taxes at the local, state, or federal level, and in some cases, a combination of all these. Risk Number ranges from 1 to 20.
- Municipal bond funds - invest in bonds issued by state governments and municipalities. While yields may be somewhat lower in comparison to other funds, all yields are typically free from federal income taxes. Risk Number ranges from 20 to 40.
- High yield bond funds - invest primarily in lower credit quality securities, including convertible securities. While they have the potential to provide high income and total returns, they are riskier and more volatile than their investment grade counterparts are. Risk Number ranges from 40 to 60.
- Equity income funds - invest in stocks that pay high dividends. This strategy, known as equity income investing, can be an attractive alternative to bond investing, as it seeks to offer greater protection against inflation as well as the potential for capital appreciation. Risk Number ranges from 60 to 80.
- Asset allocation funds - offer exposure to a variety of asset types. This strategy can provide diversification, seeks to reduce the impact of market volatility, and provides a source of income as well as an

opportunity for capital appreciation. The Risk Number is dependant on the asset allocation of the fund and how much is invested in equities. General Risk Number ranges are as follows: Conservative (10-30). Moderate (40-60). Aggressive (60 or more).

- International and global bond funds - invest in securities issued by companies from around the world, including those based in emerging markets. The main distinction between global and international bond funds is that the former invests in U.S. securities whereas international bond funds do not. International bond funds tend to have more risk than U.S. based bond funds and their Risk Number ranges from 20 to 40.
- Emerging market bond funds - invest primarily in bonds issued by countries with smaller, less developed economies, or by corporations headquartered in developing countries. While these types of bonds generally represent higher risk than those from developed nations, the risk profile of each fund will vary according to the credit quality of the individual bonds it holds. Emerging market bond funds carry more risk than international bond funds and their Risk Number ranges from 30 to 60.
- Stock dividends - invest primarily in stocks that pay dividends. Typically, these dividends are paid quarterly and are contingent on the financial health of the company. Since these are individual stocks, it will have the highest risk profile. Risk Number ranges from 60 to 80.
- Structured buffered notes - provide a means of linking traditional fixed income products, such as corporate notes and certificates of deposit, to the performance of equities or other asset classes. Volatile stock markets have created a demand for products that provide growth potential and reduce risk in a declining market. Structured investments are designed to meet those objectives by providing various levels of principal protection, unique payoff features, and access to a broad range of asset classes and market sectors. Risk Number ranges from 1 to 30.
- Non-traded REITs - are private placements and a form of a real estate investment method that is designed to reduce or eliminate taxes while providing returns on real estate. A non-traded REIT does not trade on a securities exchange and because of this, it is quite illiquid for long

periods of time. In addition to not being liquid, non-traded REITS carry high risk. The Risk Number ranges from 80 to 99.

- Fixed indexed annuities - A fixed indexed annuity provides you with guaranteed income by turning a portion of your savings into a stream of payments for a set period, or the rest of your life. Risk Number is typically extremely low and usually a 1.

"The damsel-in-distress thing is just one of several income streams that I pursue."

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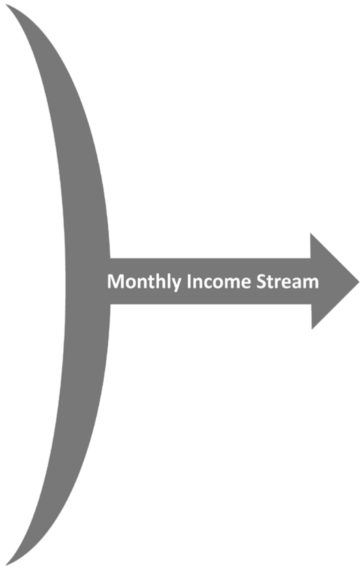
We look at several risk factors when managing income portfolios. We score the various income asset classes on a weekly basis using performance and momentum as the primary factors. We then rank the scores and invest in those top performing funds for U.S. taxable, international taxable, and tax-free municipal bonds.

As you can see in the chart below, the U.S. taxable income asset classes that are highlighted in grey are the top asset classes. From those asset classes, we will select the top performing funds for the income portfolios. The asset classes that are underlined are on the watch list and we may replace any funds in those asset classes with funds from the asset classes that are starred. The asset classes that are starred are trending higher and have been outperforming those that are underlined.

Tactical Asset Allocation

Asset Category and Sub-Category	Sub Category 1-Month	Sub Category 3-Month	Sub Category 1-Year	Sub Category Weighted	Top Performer Premium at 25%
TAXABLE FIXED INCOME - US					
Long Government	5.34	8.93	11.44	44.94	56.18
Long Term Bond	2.51	6.61	9.52	28.02	35.03
Real Estate Income (REITs)	0.50	5.15	13.45	19.03	23.78
Inflation-Protected Bond	1.91	3.73	4.14	17.17	21.46
Corporate Bond	1.33	3.89	7.03	16.62	20.77
Intermediate Core Bond	1.60	3.50	6.33	16.57	20.71
Intermediate Government	1.71	3.13	5.73	15.97	19.96
Multisector Bond	0.64	2.37	4.72	9.66	12.08
Managed Futures	-0.55	4.87	0.31	7.70	9.62
Preferred Stock	0.05	2.10	4.44	6.62	8.28
High Yield Bond	-0.63	1.47	4.41	2.63	3.28
Intermediate Core-Plus Bond	1.60	3.50	6.33	* 16.57	
Market Neutral	1.48	3.34	6.88	* 16.04	
Target Maturity	1.48	3.34	6.88	* 16.04	
Short Government	0.93	1.70	3.45	8.85	
Short-Term Bond	0.81	1.75	3.84	8.66	
Ultrashort Bond	0.32	0.91	2.65	4.43	
Nontraditio					
Multicurrer					
Long-Short					
Bank Loan					
Multialtern					
Options Ba					
Convertible					

Asset Category and Sub-Category	Sub Category 1-Month	Sub Category 3-Month	Sub Category 1-Year	Sub Category Weighted	Top Performer Premium at 25%
TAXABLE FIXED INCOME - GLOBAL					
Emerging Markets Bond	0.61	2.09	5.27	9.26	11.57
World Bond-USD Hedged	1.48	3.32	6.22	* 15.67	
World Bond	1.11	2.04	2.62	9.83	
Emerging-Markets Local-Currency Bond	0.74	-0.21	0.26	2.67	
MUNICIPAL BONDS					
High Yield Muni	1.39	4.18	6.71	17.28	21.59
Muni California Long	1.45	4.11	6.11	17.08	21.34
Muni National Long	1.36	3.94	6.39	16.52	20.64
Muni New York Long	1.28	3.89	6.39	16.10	20.12
Muni New Jersey	1.34	3.53	6.71	15.78	19.72
Muni National Intern	1.22	3.11	5.73	13.97	17.46
Muni New York Intermediate	1.17	3.06	5.48	13.54	16.93
Muni Single State Interm	1.10	2.62	5.11	12.20	15.24
Muni Single State Long	1.14	3.11	5.43	13.50	
Muni California Intermediate	1.19	2.82	5.14	12.97	
Muni Single State Short	0.80	1.63	4.02	8.47	
Muni Target Maturity	0.80	1.41	3.65	7.85	
Muni National Short	0.54	1.12	2.85	5.83	



Source: Redhawk Wealth Advisors, Inc.

CHAPTER 4

Investing with Confidence: What's Right For You?

Now that you have determined your retirement goals, it's time to select the investments that are going to achieve your goals. You must acknowledge your overall financial assets, expected income sources, and obligations that affect your portfolio under management.

Given the importance of this decision, how do you determine the right mix of investments for your specific goals? The first step is to simply understand your options and that most investments can be grouped into a small set of broad categories that share similar characteristics.

Know the major asset categories.

These were discussed in more detail earlier in this book, but a quick refresher is warranted. The asset category tells us a lot about how you can expect the fund to perform. Here's how each of the major asset categories affects your overall portfolio.

Equities

Stocks fall under the equity asset category and represent a piece of ownership in a company. Therefore, the value of that stock rises and falls based on the success of that company. Stocks have the highest expected return out of all the traditional investment options, but they also come with the biggest downside risk. For example, U.S. stocks have returned 9.5% per year over the past 87 years, but have also experienced annual declines as big as -43.84%.

Cash

Cash includes things like savings accounts, CDs, and money market funds. This asset category offers the lowest possible return of all the major investment options, but also the lowest downside risk. In fact, many cash investments (like FDIC-insured savings accounts) are guaranteed to keep your money safe.

Fixed Income

Bonds, also referred to as fixed income assets, fall under the fixed income asset category and offer a middle ground between stocks and cash. A bond is technically a loan you give to an organization in exchange for interest. Bonds offer a medium expected return with a medium level of risk. For example, U.S. government bonds have returned 5.23% per year over the past 87 years, but have also experienced annual declines as big as -11.12%.

Annuities

A variable annuity ("VA") is a tax-deferred retirement vehicle that allows you to choose from a selection of investments, and then pays you a level of income in retirement that is determined by the performance of the investments you choose. The investment options for a variable annuity are typically mutual funds that invest in stocks, bonds, money market instruments, or some combination of the three.

A fixed indexed annuity ("FIA") is a tax-favored accumulation product issued by an insurance company. The annual growth is bench-marked to a stock market index (e.g., Nasdaq, NYSE, S&P500) and provides a guaranteed payout. An FIA's growth is subject to rate floors and caps, meaning it will not exceed or fall below the specified return levels even if the underlying stock indices fluctuate outside of those set parameters. In simplest terms, the insurance company bears the risk of a sharp stock market decline with this type of annuity. You cannot lose any of your principal with a fixed indexed annuity, if you hold it beyond the period when there are surrender charges, and your potential gains are usually capped at 3% - 9% in recent years. Many fixed indexed annuities also offer premium bonuses, but usually at the expense of lower potential gains.

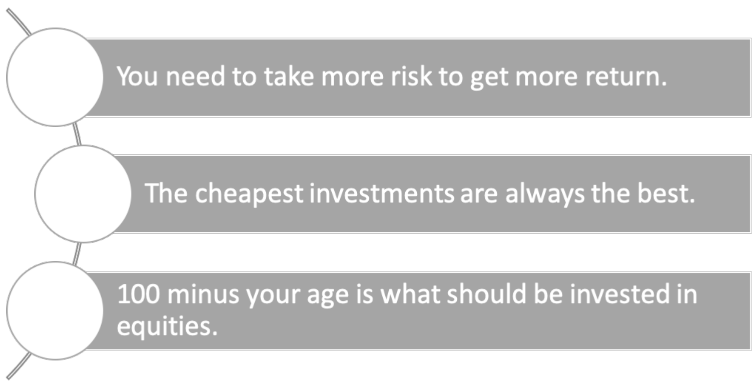
Other

There are plenty of other types of investments including real estate, commodities, options, and others. Each of these investments can be helpful in the right situations, but they aren't necessary and often cause problems when they aren't used correctly. For those reasons they won't be considered in this book.

"We love Santa, but Santa didn't know as much about investing as he thought he did."

Investment myths busted.

I've been in this industry a long time and hear the same opinions and see the same studies repeatedly. I've seen advisors ingrained with these studies and opinions and become true believers, only for these theories and ideas to be discredited and turn into myths over time (see following graphic).



Dispelling the "100-minus-your-age" rule.

Let's look at the myth of "100 minus your age is what should be invested in equities." Dana Aspach[20], wrote an article "The 100 Minus Age Rule Puts Retirees at Risk" that dispels this myth. Let's look at it more closely.

{ Is determining your investment allocation by using the "100 minus age" rule a smart approach to investing your retirement money? Research indicates this rule of thumb may harm you more than it helps. }

As we've already mentioned, the largest investment decision you'll make is your asset allocation. This is how much of each investment type, equities vs. bonds, you'll hold in your portfolio at any given time. Over the years many rules of thumb have been developed to provide guidance on this decision. One such popular rule is the "100 minus age" rule, which says you should take 100 and subtract your age: The result is the percentage of your assets to allocate to equities.

Using this rule, at 40 you would have a 60% allocation to equities and by age 65, you would have reduced your allocation to stocks to 35%. In technical terms, this is referred to as a "declining equity glide path." Each year, or every few years, you would decrease your allocation to equities thus reducing the volatility and risk level of your investment portfolio.

Practical problems with this rule.

This rule assumes that financial planning is the same for everybody. As I've outlined earlier in this book, investing decisions should be based on your financial goal, your current assets, risk tolerance, time horizon future, and any number of additional factors. If you are currently 55 and not planning on taking withdrawals from your retirement accounts until you are required at age 72, then your money has many more years to work for you before you'll need to touch it. If you want your money to have the highest probability of earning a return in excess of 5% a year then having only 50% of those funds allocated to stocks may be too conservative based on your goals and time frame.

On the other hand, you might be 62 and about to retire. In this situation, many retirees will benefit from delaying the start date of their Social Security benefits and using retirement account withdrawals to fund living expenses until they reach age 72. In this case, you may need to use a significant amount of your investment money in the next eight years, and perhaps a 38% allocation to stocks would be too high.

What the research shows.

Academics have begun to conduct retirement research on how well a declining equity glide path, which is what the 100-minus-age rule will deliver, performs compared to other options. Other options include using a static allocation approach, such as 60% equities and 40% bonds with annual rebalancing, or using a rising equity glide path, where you enter retirement with a high allocation to bonds and spend those bonds while letting your equity allocation grow.

Research by Wade Pfau and Michael Kitces[21] shows that in a poor stock market, such as what you might have experienced if you retired in 1966, the 100 minus age allocation approach delivered the worst outcome, leaving you out of money thirty years after retirement. Using a rising equity glide path where you spend your bonds first delivered the best outcome (the bucket approach we discussed earlier in this book).

They also tested the outcome of these various allocation approaches over a strong stock market, such as what you might have experienced if you retired in 1982. In a strong stock market, all three approaches left you in good shape with the static approach delivering the strongest ending account values and the rising equity glide path approach leaving you with the lowest ending account values, which were still far more than what you started with. The 100 minus age approach delivered results right in the middle of the other two options.

Plan for the worst and hope for the best.

When you retire, there is no way of knowing whether you will be entering a decade or two of strong stock market performance or not. It is best to build your allocation plan so that it works based on a worst-case outcome. As such, the 100 minus age approach does not appear to be the best allocation approach to use in retirement as it does not fare well under poor stock market conditions. In lieu of allocating portfolios this way, you should consider exactly the opposite approach by retiring with a higher allocation to bonds that can be intentionally spent, while leaving the equity portion alone to grow. This would most likely result in a gradual increase in your allocation to equities throughout retirement.

Retirement planning is complicated.

There are a lot of asset allocation strategies, but the best strategy considers a variety of factors, all of which are important to consider. Financial advisors use programs that calculate your retirement needs based on your current and projected financial picture. Although the models you find online may give you very general guidance on how to deploy your financial resources, financial planning is something to leave to an expert who has your best individual interests in mind.

"Would you like to hear about our retirement plan?"

CartoonCollections.com

{ At Redhawk, we've worked with hundreds of clients who came from other RIAs where they instilled the 100-minus-age rule and it didn't yield successful returns. You should be focusing on the end game, which is maximizing your income in retirement. }

Additionally, we've repeatedly proven to clients that you can lower the risk of your portfolio and improve your retirement income. Why wouldn't you want to lower the risk of your portfolio *and* improve your retirement income? What does this equate to? Less stress and more income to live the retirement you want!

You shouldn't solely focus on the costs of the investments in your portfolio. Don't get me wrong — while costs are important, you should also focus on net returns, or the returns after costs are subtracted from the gross return.

In other words, returns after the costs are subtracted from the gross return. You should consider the net return of the investment more than just looking at the expense ratio of the fund. If a mutual fund has an expense ratio of 0.70% and a return of 13%, isn't that better than an ETF with an expense ratio of 0.03% and a return of 11%? The higher cost mutual fund has a net return of 12.3% while the lower cost ETF has a net return of 10.97%. Which one would you want in your portfolio?

Risk-adjusted returns? We prefer "risk comfort zones."

We believe that risk and return should be considered when selecting investments for your portfolio. Risk-adjusted return ("RAR") refines an investment's return by measuring how much risk is involved in producing that return, which is generally expressed as a number or rating. Risk-adjusted returns are applied to individual securities, mutual funds, ETFs, and portfolios.

Some common risk measures include alpha, beta, R-squared, standard deviation, and the Sharpe ratio. When comparing two or more potential investments, you should always compare the same risk measures to each different investment to get a relative performance perspective.

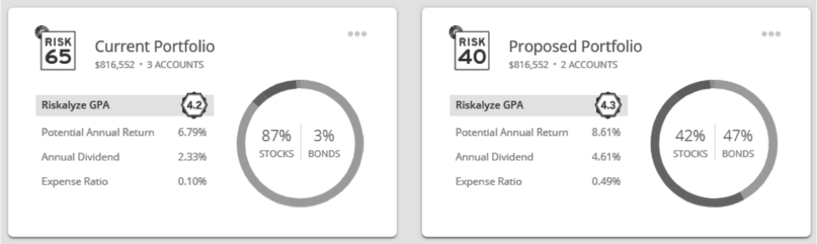
In its simplest definition, risk-adjusted return is how much return your investment has made relative to the amount of risk the investment has taken over a given period. If two or more investments have the same return over a given time period, the one that has the lowest risk will have the better risk-adjusted return. Calculating RAR is not simple. It involves making assumptions about a risk-free rate of return, selecting portfolio and market benchmarks, figuring the standard deviation of return, and/or using "beta" which is a separately calculated figure that describes the tendency of an investment to respond to marketplace swings. Unless you're a financial analyst, you might think that's more than you need to know.

That's why we use an application called Riskalyze to determine your "risk comfort zone" and the Risk Number of your portfolio[22]. We want to simplify the risk of your portfolio into a Risk Number from 1-99, with 1 being the least risky to 99 carrying the most risk.

{ Redhawk strongly believes in simplifying investment statistics and jargon into simple and easy-to-understand concepts. }

Riskalyze also calculates the potential annual return for the investment. This allows you to very easily see the Risk Number of the investment and its potential return without all the complicated statistics.

The the following graphic shows your current portfolio (left side) has a Risk Number of 65 and a potential annual return of 6.79%. The proposed portfolio (right side) has a lower Risk Number of 40 and a higher potential annual return of 8.61%. Wouldn't you want a portfolio with a lower risk and a higher potential annual return? I'm sure you will take that all day, every day!



Source: Riskalyze

What does a "better financial outcome" really mean?

We discussed what this meant at a very high level in the beginning of this book, but let's dig a little deeper. When a Redhawk financial advisor meets with you, they want to give you the best financial outcome possible based on your unique situation. They want to accomplish all three of the following objectives:

1. **Maximize your retirement income.** In other words, we want to make sure you have the highest amount of monthly income when you retire. We strive to grow your investments as much as possible before you retire.

2. **Reduce your investment risk as much as possible that will maximize your retirement income.** The first thing we do at Redhawk is determine your "risk comfort zone" and the amount of an investment loss you are willing to take over the next six months. Your pain threshold is what you are comfortable in losing. Once that comfort zone is crossed, you will most likely make the wrong decision and sell at the worst time. As we know, eliminating the pain and selling when the market is down is better than experiencing the pain.

3. **Lower your costs.** Controlling the total investment costs play an important role in reaching your retirement goals. I believe there has been too much emphasis on investing in the lowest cost passive funds available. You want the least expensive fund that has the highest risk-adjusted-return. It's a balancing act that will reward your portfolio over the long-haul.

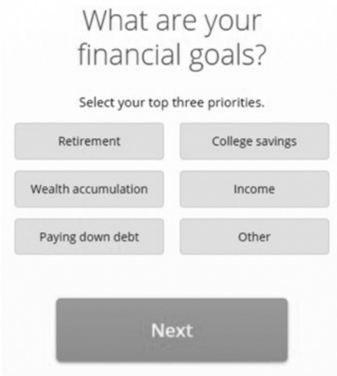
{ I'll be straight up with you: accomplishing all three of the better financial outcome objectives is very difficult to achieve. For most, we can accomplish two of the three, and sometimes all three. }

I remember working with a potential client that had a great portfolio and we couldn't improve it. We couldn't increase their retirement income, lower the risk of the portfolio, or decrease the investment costs. I was certain there was no way we would win them over. Yet they went with Redhawk because we told them the truth, they liked our process, and they liked how we communicated what we were doing on a weekly basis. They simply weren't getting that kind of service from their current financial advisor.

How to determine your risk comfort zone?

Before you can determine your risk comfort zone, you need to prioritize your financial goals. Determining what your short-term and long-term personal financial goals are is the first step. Some common financial goals are retirement, college savings, wealth accumulation, income, paying down debt, and other goals. Everyone's financial goals are different, and we've covered this in more general terms earlier in the book, but it's important that you go over it in a way that's tailored to Riskalyze and Redhawk's process.

As mentioned earlier, we use an application called Riskalyze to determine your risk comfort zone[23]. It's a simple online survey that you can complete in 3 minutes or less. First off, we want to determine your financial goals (see graphic on the right). If investing is a journey, your financial goals are the destinations you hope to reach with the wealth you build over time. A comfortable retirement is the single most common investment goal, but you may have more than one goal.



Source: Riskalyze

{ You want to look at risk and reward in the context of your own personal financial position. We all look at risk differently, based on our varying life experiences and financial position. }

Riskalyze is a unique analytical tool that objectively pinpoints your own unique risk tolerance. The Riskalyze Risk Questionnaire process was built upon decades worth of behavioral economic work including the academic framework called Prospect Theory that won the Nobel Prize for Economics in 2002.

- **Retirement.** Everyone needs to think about it. Not everyone does. We encourage you to create a financial plan, think deeply about your retirement needs, and save accordingly.

  If you have already started saving for retirement, increasing your retirement savings may be a good financial goal for you to set. For example, when you receive a raise at work, increase the contributions to your retirement account. The earlier you start saving for retirement, the better off you'll be in the end, and the less you'll need to set aside along the way.

{ If you're young and your employer offers matching contributions to a 401(k) or other retirement plan, you MUST take advantage of it. If you don't, you are leaving money on the table. }

- **College Savings.** Another popular goal is saving for an education, which is essential to avoid huge student loan debt. A plan for college savings should at least be considered before buying a house. It certainly doesn't have to be either/or, but would you rather have the biggest house on the block or be able to pay for a significant portion of your children's education?

- **Wealth Accumulation.** Planning for and managing your wealth accumulation will be important throughout your life. Primarily because as you age, your priorities change. If you are in your thirties or forties, the goal is accumulation, which is investing and saving to accumulate as much wealth as possible for your retirement goals.

  That being said, there is no need for alarm if you are in your fifties or sixties and remain in the accumulation phase as there can be many reasons why this happening. For example, you may have started saving for retirement later in life, there might have been financial or medical setbacks, or you may have hit a high point in your career and don't see a good reason to stop the flow yet.

Additionally, you may be in your forties and even fifties and beyond and you don't have any retirement savings. For you, a financial advisor may suggest starting or continuing with an aggressive investment strategy in the hope of "making up for lost time." Of course, this could be a financially dangerous approach so it should be carefully considered with a financial advisor you trust and is skilled in working with those approaching the retirement years.

- **Income.** When you retire, the goal usually switches from growth to income generating investments along with wealth preservation, where investments might become more conservative as risk management and tax reduction support the objective of making assets last. This happens in retirement because financial advisors will likely seek an asset allocation plan that will generate a regular income stream, without sacrificing your potential for growth. That being said it also must be an allocation plan that makes you comfortable as well.

- **Paying down debt.** This is one of the most important goals to achieve. The great thing about this goal is that anyone can do it, regardless of income or wealth level. If you want to get the most out of your finances, it's virtually a requirement that you get out of debt. At some point in your life, all debt is bad debt and needs to be paid off, including the mortgage on your home. Although the purpose of mortgage debt may serve a different purpose at the beginning, as time goes by it becomes a drag on your income just like any other debt. Besides making diligent payments, the best way to make real progress toward this important goal is to stop borrowing. If you don't add to your debt, paying it off becomes inevitable.

- **Other.** There are many goals that can fall under this broad category The following is a summary of some of the major ones.

- **Emergency savings fund.** Establishing an emergency fund is a short-term financial goal with long-term benefits, making it one of the good financial goals that you should plan to achieve. This is a crucial goal and it should be the first one you set, regardless of your situation. How much you save toward an emergency savings fund will vary depending on your income and needs. In general, you should save three months' income for emergencies. However, one common emergency that draws on emergency funds is job loss, and statistically, it takes an average of nine months to find a new job. So, the goal should be to save nine months' income to help survive being out of a job.

" IN CASE OF EMERGENCY I ALWAYS TRY TO HAVE SIX HOURS OF INCOME ON HAND".

- **Home ownership.** For years, buying a house has been part of the "American Dream." The yard, fence, and even mortgage are all signals to the world that we′ve ″made it″. Owning a home is something to strive for, something you should work hard for, and something you should be proud to achieve. Saving up a sizeable down payment is the best way to purchase a home as it will help you get a home loan more easily and potentially avoid the cost of Private Mortgage Insurance (″PMI″), saving you even more money. Buying a house can facilitate the goals of security and freedom by decreasing your expenses, giving you income flexibility, and allowing you to weather difficult financial situations such as losing a job.

- **Auto purchases.** After home purchases, cars are the second biggest purchase most people make in their lives and they merit a good deal of financial attention. If you want to be as well-informed as possible when buying a car, you've got to know everything that's involved. Too many people see a monthly car payment as a necessary expense and take for granted how much money they could be saving without a car payment. Instead, pay your car off as soon as possible and keep driving that paid-off car while you save for the next one. Make it your goal to pay for your next car in full, without borrowing at all.

- **Fun.** So many of these goals are big, long-term goals and it's also important to save toward things you enjoy. Vacations, a big-screen TV, a boat, or any other things you enjoy.

{ A purely recreational financial goal is great if you don't use credit card debt to pay for it. If you work hard and save diligently, you deserve to reward yourself with fun savings goals. }

Now that we've covered the important financial goals, let's move on to determining your risk comfort zone. Most investment professionals talk about risk tolerance, which measures your personal comfort level with risk. Typically to determine your risk tolerance, you must answer a questionnaire that takes time and some of the questions are very general and you may not see how the answer to a question will help determine your risk tolerance. Some people are fine with the big ups and downs of the stock market, and others aren't. Since sticking to your plan is one of the most important factors for investment success, knowing ahead of time what you're comfortable with will help you get better results.

At Redhawk, we're proponents of using Riskalyze to find out your risk comfort zone as it's a simple approach that our clients can relate to and understand. It comes down to a simple question: How much are you comfortable in losing over the next six months? The amount is expressed as a percentage and a dollar amount. For example, if you had $500,000 of investable assets, what are you comfortable in losing over the next six months? Is it $25,000, $50,000 or a $100,000 or more? The following diagram shows how all of this comes together. The person has a risk score of 54 and they are comfortable in losing 11%, or $53,466 over the next six months.

Once the amount of loss you are comfortable with is determined, the upside can be determined and is correlated to the downside. Your risk comfort zone, determined in Riskalyze, can then be used to determine your Risk Number. Redhawk will then manage your assets to maximize your retirement income based on your risk comfort zone. The wider your risk comfort zone, the more room you must reach for the higher returns in the stock market without fearing the potential negative consequences.

Source: Riskalyze

The Riskalyze Risk Number and corresponding risk and reward range empowers you with stated expectations. Gone are the days where you put your retirement fate in subjective, loosely defined groups like conservative, moderate, or aggressive investor.

{ Now you are empowered by transparent, objective, well-defined, actionable expectations, and the probability of success is quantified and unemotional. }

How is your Risk Number calculated?

The Riskalyze Risk Number is an objective, mathematical approach to removing subjectivity by quantifying the risk of you and your portfolio[24] and is calculated based on downside risk. On a scale from 1 to 99, the greater the potential loss, the greater the Risk Number. Ambiguous terms such as "conservative" or "moderately-aggressive" cause confusion in the investment arena. This generalization doesn't do any good and it may put you on the wrong course. Generalizing your risk tolerance doesn't work and you want to view your risk through your own, unique lens to gauge risk and return trade-offs.

Like most investors, you are probably always evaluating your current financial health and discerning where you're headed. In the same way, Riskalyze helps you see what risk you currently have, how much risk you're willing to handle, and how much risk you need to hit your goals. This is the focal point of the Risk Number.

1. When planning for any trip, you want to know your destination. In other words, what are your short-term and long-term plans to confirm your route and establish the destination.

2. Your road to a better financial outcome begins with understanding what you have in your current portfolio, that is analyzing your portfolio like using a GPS to know your current location.

3. The next leg of the journey is learning your personal Risk Number, or how fast you are willing to drive. Now you know your destination, how much risk you have in your current portfolio, and how much risk you can handle.

Once you know these three things, you are ready to make actionable decisions about your life and dreams. Changes may be required, whether taking on less risk because of your risk comfort zone or adopting more risk for a greater likelihood of success. Whatever changes are needed, you are empowered with the knowledge and capability to achieve it. Objectivity and understanding will lead you to be a fearless investor.

The Riskalyze risk questionnaire provides you with the opportunity to discover your risk and return preferences. The first few questions are information gathering tools, helpful to gain insights into your financial world while setting the stage for the risk and reward questions.

Riskalyze will help you understand your feelings and biases regarding financial risk in the context of your personal financial position. The questionnaire requires the context of your total investment amount and the amount you are comfortable to lose to reach the state of "financial devastation." From these data points Riskalyze then asks a series of dynamic questions to calculate your monetary utility. Upon completion of the risk questionnaire, Riskalyze converts the solution into an understandable and actionable Risk Number.

The ultimate litmus test for the calculated Risk Number and corresponding risk and reward range is your gut reaction to the number. Ultimately you need to approve of the calculated risk and reward range and corresponding Risk Number. You may even change your Risk Number once it's explained in more detail and confirm the maximum amount of loss you can tolerate before reaching the point of "financial devastation."

If you are married or a couple, a question that always comes up is whether the Risk Number should be calculated based on one of you or both of you. This is entirely up to you and your unique situation. With many couples, one spouse assumes the responsibility of managing the couple's finances. In some cases, it may make sense to focus the risk questionnaire on the spouse most likely to make the financial decisions and in some it makes sense to use both. At the end of the day, the purpose of the risk questionnaire is to assess the comfort zone for all your assets under management and the risk questionnaire can help gather information whether it is completed by each of you individually, as a couple, or both.

Once your Risk Number has been determined, a wealth of information about you is on hand, such as your age, goals, and investment amount. Your Risk Number will then be used in the context of all other relevant data to design a portfolio that fits your needs. The risk questionnaire solution allows you to objectively determine your risk comfort zone. The questionnaire will open-up a wide-range discussion of risk and reward, allowing you to adjust your comfort zone based on your experiences and goals.

The benefit of working with a Redhawk financial advisor is that they will take all your relevant information into account when making portfolio and retirement plan recommendations. For example, if you can stomach a lot of risk, it doesn't mean that a high-risk portfolio is the correct solution. They will take your tax situation, age, time horizon, estate planning needs, income needs, etc. into account when making recommendations.

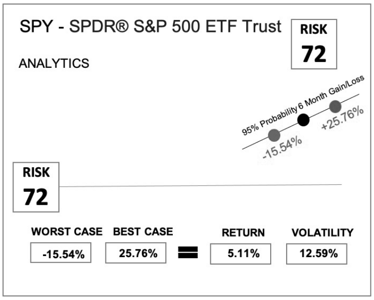
What is the Risk Number of your portfolio?

Determining your Risk Number is an important step in putting together a better financial outcome for your retirement. Our next step is to determine the Risk Number of your portfolio. The Risk Number is determined for each investment as shown below. The Risk Number will appear with information on the investment's best case, worst case, projected annual returns, as well as other information. All numbers are calculated with a 95% probability range, which is a very conservative range. Here's a breakdown of what is used in Riskalyze[25]:

- **Return Mode:** The average annual return mode will use the actual historical average annual return and the underlying volatility of the investment and apply that as the expected return and six-month probability range respectively. When calculating average annual return, Riskalyze uses all the historical data available. The average annual return will be calculated using actual price history from June 2004 to present in cases where the investment existed in June of 2004 or earlier. For newer investments, the average annual return will be calculated using inception to present price history.
- **Worst Case:** Riskalyze calculates a 95% certainty that it will perform no worse than this over the next six months. This is a very high probability, so you have comfort in knowing your likely outcome.
- **Best Case:** Riskalyze calculates a 95% certainty that it will perform no better than this over the next six months.

- **Return:** Riskalyze calculates the probable six-month return for the investment. If you want the potential annual return, you must double the six-month return.
- **Volatility:** Riskalyze calculates the potential price action swings in a six-month range based on past volatility.
- **Annual Dividend:** Riskalyze calculates the trailing twelve months ("TTM") of normal dividends. This is typically the same dividend yield that is shown on any financial site.
- **Expense Ratio:** This is the annual expense ratio of the investment that is published by the investment manager.

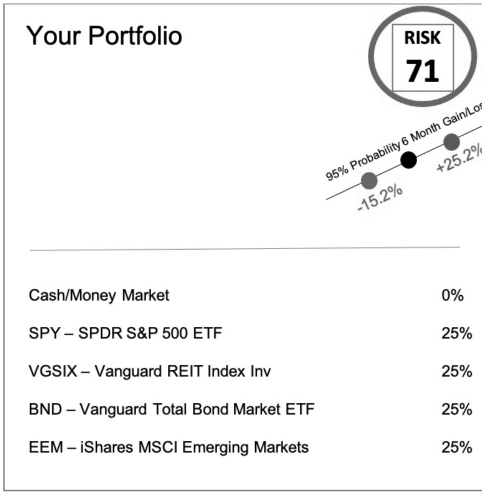
So, let's look at what Riskalyze calculates for the S&P 500 mutual fund ("SPY") as depicted in the diagram to the right:



Source: Riskalyze

- It has a Risk Number of 72, which is aggressive.
- It has a 95% probability that you are comfortable with the risk of losing 15.54% and with the prospect of gaining 25.76%
- The potential return over the next six months is 5.11% or 10.22% for the next year.
- It has a volatility of 12.59% over the next six months or 25.18% over the next year which is a high volatility number.

Now that we have assessed one investment, SPY, let's see how Riskalyze looks at an entire portfolio, or a collection of investments. Riskalyze calculates the Risk Number for each investment (as we just showed you for SPY) and then the Risk Number for the entire portfolio is calculated by taking the weighted average of all the investments. As you can see in the following graphic, the portfolio has a Risk Number of 71.



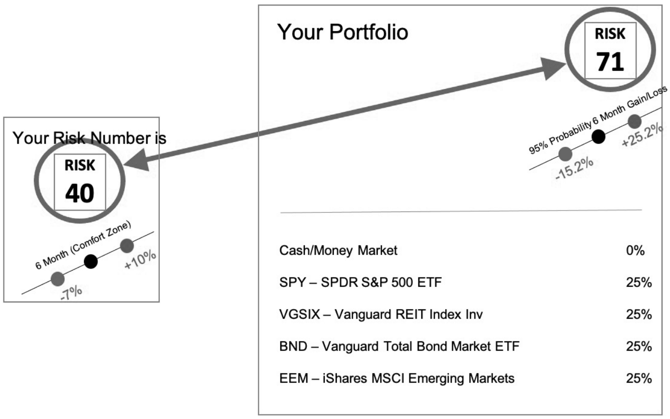
Source: Riskalyze

The next step is to compare your Risk Number with the Risk Number of your portfolio. The two Risk Numbers should be similar. If your Risk Number is significantly lower than your Portfolio Risk Number, that means you are taking on more risk than you are comfortable with. If your risk score is significantly higher than the risk score of your portfolio, you can increase the risk in your portfolio. Obviously other factors need to be considered when making changes to your portfolio.

Let's look at a real example. In the following chart, you have a Risk Number of 40 and your portfolio has a Risk Number of 71. You are obviously taking on way too much risk and you will become very uncomfortable if your portfolio loses more than 7% over the next six months. To lower your portfolio's risk, shifting some of the equity positions into fixed income would lower the Risk Number of the portfolio.

{ When working with a Redhawk financial advisor, they will make sure that the Risk Number of your portfolio is in alignment with your Personal Risk Number. After all, you want to sleep at night not worrying about your portfolio. }

Your financial advisor should also meet with you at least once a year to see if your tolerance for risk has changed and to review your portfolio and its Risk Number. The Risk Number can change quite a bit over the year and your Redhawk financial advisor will ensure that your portfolio is aligned with your personal needs (see the following chart where your risk number is a 40 and your portfolio has a risk number of 71).



Source: Riskalyze

How to determine if your investments are any good?

Now that we have determined your Risk Number, comfort zone, and the Risk Number of your current portfolio using Riskalyze, it's time to evaluate your investments and see how they are performing. There are many ways to determine how your investments are performing, but at the end of the day, it's the rate of return based on the risk taken.

So, if your current portfolio has a conservative risk score of 30, you can't expect the portfolio to have enormous gains. The gains need to be tempered with the amount of risk you are taking. Countless times clients with a conservative Risk Number and a corresponding portfolio have called inquiring into why their portfolio isn't performing as well as the S&P 500 Index. In discussing the clients' portfolios with them, we compared the client's Risk Number to the S&P's, which at the time of writing this book was an aggressive number of 72. After explaining to the clients that a discrepancy in Risk Number will equate to a discrepancy in gains, the clients understood that comparing their own portfolio to the S&P 500 Index was an apples to oranges comparison & would always disappoint them. First off, at the time of this writing, the Risk Number for the S&P 500 was 72. This is considered aggressive. If your portfolio has a Risk Number of 35 (moderate conservative) should you expect the same return as the S&P 500? Of course not. It is like comparing apples to oranges.

The best benchmark is a peer group benchmark.

According to the Chartered Financial Analyst Institute[26], for a benchmark to be a valid and effective tool for measuring an investment manager's performance, it must be:

- Unambiguous
- Investable
- Measurable
- Appropriate
- Reflective of current investment opinions
- Specified in advance

There are two common types of benchmarks, a market index benchmark and a peer group benchmark. You probably look to market indexes as benchmarks to help you gauge not only how well the markets are performing, but also how well your investments are performing. Some of the most common market index benchmarks are the Standard & Poor's 500[27], the Dow Jones Industrial Average[27], and the Nasdaq Composite[28]. The values of these indexes are displayed every day by financial media outlets all over the world. You probably want your portfolio to meet or exceed the returns of these indexes over time. The major market indexes are defined below:

- The Standard & Poor's 500 Index ("S&P 500") is an index of 500 stocks issued by 500 large companies with market capitalizations of at least $6.1 billion. It is seen as a leading indicator of U.S. equities and a reflection of the performance of the large-cap universe.

- The Dow Jones Industrial Average ("DJIA") is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange ("NYSE") and the Nasdaq. The DJIA was invented by Charles Dow in 1896 and it's often referred to as "the Dow." The DJIA is one of the oldest, single most-watched indices in the world and includes companies such as General Electric, Apple, Exxon Mobil, and Microsoft. When the TV networks say "the market is up today," they are generally referring to the Dow.
- The Nasdaq Composite Index is the market capitalization-weighted index of over 3,300 common equities listed on the Nasdaq stock exchange. The Nasdaq Stock Market (also known as "Nasdaq") is an American stock exchange. It is the second-largest stock exchange in the world by market capitalization, behind only the New York Stock Exchange located in the same city. "Nasdaq" was initially an acronym for the National Association of Securities Dealers Automated Quotations. It was founded in 1971 by the National Association of Securities Dealers ("NASD"), which divested itself of Nasdaq in a series of sales in 2000 and 2001. The types of securities in the index include American Depositary Receipts ("ADRs"), common stocks, real estate investment trusts ("REITs"), and tracking stocks, as well as limited partnership interests. The index includes all Nasdaq listed stocks that are not derivatives, preferred shares, funds, exchange-traded funds ("ETFs") or debenture securities.

The major problem with using a market index as a benchmark is that your expectation is immediately put to a disadvantage because they are not comparing apples to apples. A better approach is to use a peer group as the benchmark.

The most important advantage of a peer group benchmark over a market index benchmark is that it accounts for the style characteristics of the investment manager. If the investment manager specializes in small-cap growth stocks, then the benchmark should be made up of small-cap growth stocks. In fact, the ideal benchmark explains all the returns of the manager that come from systematic factors such as style and market movements. If this is the case, any performance over (or under) the benchmark can be attributed to the manager's skill.

Morningstar[29] asset classes are suitable peer-group benchmarks for most mutual funds and ETFs. Depending on what a fund owns, it can land in one of more than 40 Morningstar asset classes. If a fund's portfolio features large-company stocks with high earnings growth, the fund is categorized as a large-growth fund. If the fund has smaller companies that are inexpensive, it lands in the small-cap value asset class. If U.S. government bonds with comparatively short maturities populate the portfolio, the fund qualifies as a short-term government-bond fund.

How to assess the performance of your portfolio?

Now that you understand benchmarks and why they are used to evaluate the performance of an investment manager, it's time to determine how your portfolio is performing.

"The little pig with the portfolio of straw and the little pig with the portfolio of sticks were swallowed up, but the little pig with the portfolio of bricks withstood the dip in the market."

Portfolio monitoring refers to the evaluation of the ongoing performance of an investment portfolio. It is essentially the process of comparing the return earned on your portfolio with the return earned on one or more benchmarks.

Portfolio monitoring is essentially comprised of two functions, performance measurement and performance evaluation. Performance measurement is an accounting function which measures the return earned on your portfolio during the holding period or investment period. Performance evaluation, on the other hand, address such issues as whether the performance was superior or inferior.

{ You may mistakenly base the success of your portfolios on returns alone. You probably don't consider the risk that you took to achieve those returns. }

If you lived in the 1960's, you may have known how to quantify and measure risk with the variability of returns, but no single measure looked at both risk and return together. Today, you have three recognized sets of performance measurement tools to assist you when monitoring a portfolio. These may seem technical in nature, but I think they are valuable for you to learn.

Treynor Measure[30]

Jack L. Treynor was the first to provide investors with a composite measure of portfolio performance that also included risk. Treynor's objective was to find a performance measure that could apply to all investors, regardless of their personal risk preferences. He suggested that there were really two components of risk, the risk produced by fluctuations in the stock market and the risk arising from the fluctuations of individual securities.

Treynor introduced the concept of the security market line, which defines the relationship between portfolio returns and market rates of returns, whereby the slope of the line measures the relative volatility between the portfolio and the market (as represented by beta). The beta coefficient is simply the volatility measure of a stock portfolio to the market itself. The greater the line's slope, the better the risk-return trade off.

The Treynor measure, also known as the reward-to-volatility ratio, can be easily defined as:

(Portfolio Return – Risk-Free Rate) / Beta

The numerator identifies the risk premium and the denominator corresponds with the risk of the portfolio. The resulting value represents the portfolio's return per unit risk.

To better understand how this works, suppose that the 10 year annual return for the S&P 500 (market portfolio) is 10%, while the average annual return on Treasury bills (a good proxy for the risk-free rate) is 5%. Then assume you are evaluating three distinct portfolio managers with the following 10 year results:

Manager	Average Annual Return	Beta
Manager A	10%	0.90
Manager B	14%	1.03
Manager C	15%	1.20

The Treynor value for each:

- S&P 500: (.10-.05)/1 = .05
- Manager A: (.10-.05)/0.90 = .056
- Manager B (.14-.05)/1.03 = .087
- Manager C: (.15-.05)/1.20 = .083

The higher the Treynor measure, the better the portfolio. If you had been evaluating the portfolio manager (or portfolio) on performance alone, you may have inadvertently identified manager C as having yielded the best results. However, if you considered the risks that each manager took to attain their respective returns, Manager B demonstrated the better financial outcome. In this case, all three managers performed better than the aggregate market.

Because this measure only uses systematic risk, it assumes that you already have an adequately diversified portfolio and, therefore, unsystematic risk (also known as diversifiable risk) is not considered. As a result, this performance measure should only be used if you have a diversified portfolio.

Sharpe Ratio[31]

The Sharpe ratio is the most popular measurement and is almost identical to the Treynor measure, except that the risk measure is the standard deviation of the portfolio instead of considering only the systematic risk, as represented by beta. Conceived by Bill Sharpe, this measure closely follows his work on the capital asset pricing model ("CAPM") and by extension uses total risk to compare portfolios to the capital market line.

The Sharpe ratio can be easily defined as:

(Portfolio Return – Risk-Free Rate) / Standard Deviation

Using the Treynor example from above, and assuming that the S&P 500 had a standard deviation of 18% over a 10 year period, let's determine the Sharpe ratios for the following portfolio managers:

Manager	Annual Return	Portfolio Standard Deviation
Manager X	14%	0.11
Manager Y	17%	0.20
Manager Z	19%	0.27

The Sharpe Ratio for each:

- S&P 500: (.10-.05)/.18 = .278
- Manager X: (.14-.05)/.11 = .818
- Manager Y: (.17-.05)/.20 = .600
- Manager Z: (.19-.05)/.27 = .519

Once again, you may find that the best portfolio is not necessarily the one with the highest return. Instead, it's the one with the most superior risk-adjusted return, or in this case the fund headed by Manager X.

Unlike the Treynor measure, the Sharpe ratio evaluates the portfolio manager on the basis of both rate of return and diversification (as it considers total portfolio risk as measured by standard deviation in its denominator). Therefore, the Sharpe ratio is more appropriate if you have a well-diversified portfolio, because it more accurately takes into account the risks of the portfolio.

Alpha[32]

Like the previous performance measures discussed, Alpha is also based on CAPM. Alpha was developed by Michael C. Jensen and it measures the excess return that a portfolio generates over its expected return. Alpha measures how much of the portfolio's rate of return is attributable to the manager's ability to deliver above-average returns, adjusted for market risk. The higher the ratio, the better the risk-adjusted returns. A portfolio with a consistently positive excess return will have a positive Alpha, while a portfolio with a consistently negative excess return will have a negative Alpha.

The formula is broken down as follows:

Alpha – Portfolio Return-Benchmark Portfolio Return

Where Benchmark Portfolio Return CAPM = Risk-Free Rate of Return + Beta (Return of Market – Risk-Free Rate of Return).

So, if we once again assume a risk-free rate of 5% and a market return of 10%, what is the alpha for the following funds?

Manager	Average Annual Return	Beta
Manager D	11%	0.90
Manager E	15%	1.10
Manager F	15%	1.20

First, we calculate the portfolio's expected return:

- Manager D: .05 + 0.90 (.10-.05) = .0950 or 9.5% return
- Manager E: .05 + 1.10 (.10-.05) = .1050 or 10.50% return
- Manager F: .05 + 1.20 (.10-.05) = .1100 or 11% return

Then, we calculate the portfolio's alpha by subtracting the expected return of the portfolio from the actual return:

- Alpha for Manager D: 11%- 9.5% = 1.5%
- Alpha for Manager E: 15%- 10.5% = 4.5%
- Alpha for Manager F: 15%- 11% = 4.0%

Manager E did best because, although manager F had the same annual return, it was expected that manager E would yield a lower return because the portfolio's beta was significantly lower than that of portfolio F.

Of course, both rate of return and risk for portfolios will vary by time-period. The Alpha measurement requires the use of a different risk-free rate of return for each time interval considered. So, let's say you wanted to evaluate the performance of a fund manager for a five-year period using annual intervals, you would have to also examine the fund's annual returns minus the risk-free return for each year and relate it to the annual return on the market portfolio, minus the same risk-free rate.

Conversely, the Treynor and Sharpe ratios examine average returns for the total period under consideration for all variables in the formula (the portfolio, market and risk-free asset). Like the Treynor measure, Alpha calculates risk premiums in terms of beta (systematic, undiversifiable risk) and therefore assumes the portfolio is already adequately diversified. As a result, this ratio is best applied to something like a mutual fund.

Portfolio performance measures should be a key aspect of the investment decision process. These tools provide the necessary information for you to assess how effectively your money has been invested (or may be invested). Remember, portfolio returns are only part of the story. Without evaluating risk-adjusted returns, you cannot possibly see the whole investment picture, which may inadvertently lead to clouded decisions.

{ At Redhawk, we are fiduciaries and believe in being fully transparent with you. To this point I have described the most popular methods to evaluate performance. While these evaluation methods are very important, we use them behind the scenes in our fiduciary process. }

Like most investors, you may not fully understand these measurements, nor do you want to take the time to learn them. Because of this, we use easy to understand bubble charts, which we will explain in more detail later in this book, to evaluate the performance of the portfolio.

What's the upside to understanding Upside Capture Ratio?

Upside capture ratio is the statistical measure of an investment manager's overall performance in up-markets. In other words, it measures the percentage of market gains captured by a manager when markets are up. You can use the upside capture ratio to evaluate how well an investment manager performed relative to an index during periods when that index has risen. The ratio is calculated by dividing the investment manager's returns by the returns of the index during the up-market and multiplying that factor by 100.

$$\text{Upside/Downside Capture Ratio} = \frac{\text{Manager's Returns}}{\text{Index Returns}} \times 100$$

An investment manager who has an upside capture ratio greater than 100 has outperformed the index during the up market. For example, a manager with an upside capture ratio of 120 indicates that the manager outperformed the market by 20% during the specified period. Many analysts use this simple calculation in their broader assessments of individual investment managers.

If an investment mandate calls for an investment manager to meet or exceed a benchmark index's rate of return, upside capture ratio is helpful for spotting those managers who are doing so. This is important if you use an active investment strategy or those more considered with relative returns, rather than absolute returns.

Upside capture ratio is just one of many indicators used by Redhawk to monitor portfolios. Because the ratio focuses on upside movements, some critics offer compelling evidence that it encourages investment managers to "shoot for the moon," as the metric doesn't account for downside (losses) moves.

{ It is said that the two elements that drive the market are "greed" and "fear." Upside capture and downside capture ratios are a useful way of separating the two, so they can be analyzed independently. Consequently, we use both ratios in our fiduciary process. }

So, what is Downside Capture Ratio?

You can use downside capture ratio to evaluate how well or poorly an investment manager performed relative to an index during periods when that index has dropped. In other words, it measures the percentage of market losses endured by a manager when markets are down. The ratio is calculated by dividing the manager's returns by the returns of the index during the down-market and multiplying that factor by 100. Downside capture ratio is calculated by taking the fund's monthly return during the periods of negative benchmark performance and dividing it by the benchmark return.

Downside capture ratios should be less than 100%, meaning that when the market went down the manager caught only a fraction of the losses. The lower downside capture, the better. Although rare, it is possible to see negative downside capture ratios, indicating that when markets are down the manager tends to be up.

The goal of any portfolio manager is to have a higher upside capture ratio than downside capture ratio. For example, if your portfolio's upside capture ratio is 95 and downside capture ratio is 60, that means you are capturing most of an up market yet minimizing the loss in a down market. The ratios must be put in perspective based on the risk score of the portfolio.

At Redhawk, we feel that downside capture ratio is extremely important in protecting your portfolio from losses. Remember we are primarily concerned with moving to a risk off strategy to minimize losses in a down market.

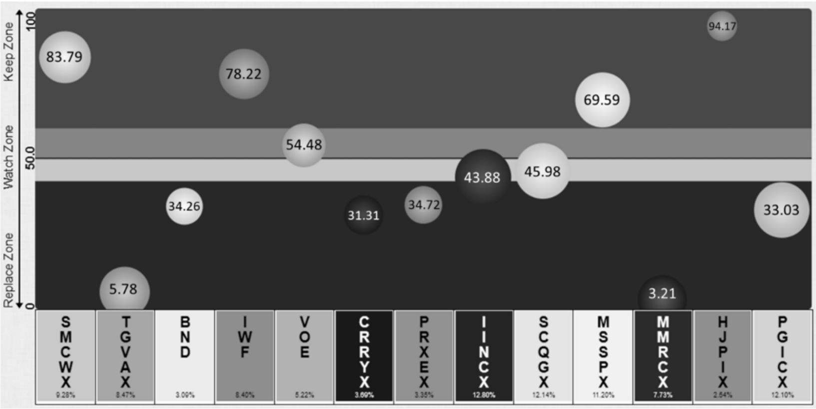
Did you know your portfolio has a bubble score?

It's an unconventional term in the financial analyst world, but it makes it extremely easy for you to see how the investments in your portfolio are performing. We've previously explained the Treynor Measure, the Sharpe Ratio, and Alpha. These are very technical measurements and may be difficult for you to understand.

{ At Redhawk we use an application called The E-Valuator[33] to make it easier for you. It calculates a bubble score for the investments held in your portfolio. }

This application takes the same underlying concepts of the performance measurements described above but simplifies them into an easy to understand chart with bubbles.

Let's look at an example. The following chart shows the bubble scores for each underlying investment in a portfolio.



Source: The E-Valuator

Before we start analyzing the performance right away, we must explain the methodology to you that's behind the scoring:

- Size of the bubble: The size of the bubble is based on how much you have invested in that fund. The bigger the bubble, the more assets you have in that fund.
- Bubble score: The bubble score is derived based on how the fund performed in your portfolio compared to the Morningstar assigned benchmark[34]. The performance is weighted based on the performance for that particular time frame (as shown below). We've found that a shorter time frame is better suited for individual investments such as brokerage accounts, IRAs, etc. For investments in a 401(k) or retirement plan, we place more weight to longer-term performance numbers since the time horizon is longer term focused.

Performance Time Frame	Weighting
1-Month	10%
3-Month	20%
6-Month	20%
1-Year	20%
2-Year	20%
3-Year	10%
Total	100%

Source: Redhawk Wealth Advisors, Inc.

- Keep Zone: If a fund in your portfolio scores between 60 and 100, it gets placed in the "keep zone" and is considered a fund that you should keep in the portfolio.
- Watch Zone: If a fund in your portfolio scores between 42.5 and 60, it gets placed in the "watch zone" and is considered a fund that you should watch closely since it's not performing as well as other funds that are in the same Morningstar asset class.
- Replace Zone: If a fund in your portfolio scores below a 42.5, it is placed in the "replace zone" or the deep red sea and you should replace it immediately since it's performing poorly compared to similar funds in the same Morningstar asset class.
- Morningstar categories[35]: The Morningstar category classifications were introduced in 1996 to help you make meaningful comparisons between mutual funds. Morningstar found that the investment objective listed in a fund's prospectus often did not adequately explain how the fund was invested. For example, many funds claimed to be seeking "growth," but some were investing in established blue-chip companies while others were seeking growth by investing in small-cap companies.

The Morningstar category classifications solved this problem by breaking portfolios into peer groups based on their holdings. The categories help you identify the top-performing funds, assess potential risk, and build well-diversified portfolios. Morningstar regularly reviews the category structure and the portfolios within each category to ensure that the system meets the needs of investors.

In the United States, Morningstar supports 64 asset classes, which map into four broad asset categories (U.S. Stock, International Stock, Taxable Bond, and Municipal Bond). The primary and secondary indexes listed with each asset class are used in Morningstar's tools and reports to show performance relative to a benchmark.

So now that we've explained the risk number of a portfolio and the bubble score, let's put the two together. As we've discussed earlier, we use Riskalyze to determine the Risk Number of your portfolio. This makes it very easy for you to be sure that you are in a portfolio that fits your Risk Number and risk comfort zone. You know exactly what the potential downside and upside is for the portfolio over the next six months. The following chart shows three portfolios with various asset allocations along with the Risk Number. The Risk Number ranges from 1 – 99 with 1 being extremely conservative and 99 being extremely aggressive. If you look at the aggressive portfolio, it has a Risk Number of 81 and has the potential to lose 18.76% over the next six months. Now compare it to the conservative portfolio, which has a Risk Number of 42 and has the potential to lose 7.48% over the next six months.

We also use The E-Valuator to calculate the bubble score (the performance score) of your portfolio. This makes it very easy for you to see how your portfolio is comparing to its benchmark. The following chart shows the bubble scores for each portfolio. The bubble score ranges from 1 – 100, with 1 having extremely poor performance and 100 having exceptional performance. If you look at the aggressive portfolio, it has a bubble score of 81.16 as compared to the conservative portfolio with a bubble score of 83.46.

Sources: Riskalyze and The E-Valuator

CHAPTER 5

Monitor Your Investments. Replace as Needed.

Like a lawn or garden or most things that grow, your investments need regular care and attention. Achieving your goals means keeping a watchful eye on your investments and doing what you can to keep them on track. We suggest that you check the performance of your portfolio a minimum of once a year, and ideally more frequently, since the stock market constantly changes. So it's a good idea to always check that your investments are still in line with your goals.

{ At Redhawk, we utilize a wide range of tools that let us monitor your portfolio frequently. First, we need to understand where you want to go and then monitor the investments to make sure you are still on track to get there. }

Now, let's spend some time to determine your retirement map, which should lead to your destination — as planned.

Charting your Retirement Map.

Riskalyze assembles your retirement map[36] using all the information we've discussed so far. It is a financial plan that helps you determine how much risk you need to take to potentially earn the types of returns to fund your goals over the desired time frame. Moreover, your financial plan should spell out the types of investments, equities, fixed income, alternatives, or cash and the appropriate allocations needed to meet your goals, while remaining consistent with your risk tolerance.

"Very good, Larry! Just one more step and you'll have the entire aisle blocked!"

The retirement map will help you marry your Risk Number and portfolio allocations with your retirement goals. When looking at your personal retirement map, you will be able to determine whether your retirement goals, Risk Number, and existing portfolio have a high probability of success.

Your personal retirement map provides an opportunity for you to address important questions such as:

- Am I saving enough given my portfolio allocation?
- Is retirement at 55 possible without additional savings?
- What would buying a second home do to my retirement goals?
- Can I be invested this conservatively and still make retirement by 60?

When we construct your personal retirement map, we need the following data points:

- **Investment Amount** – This is the starting principal amount in today's dollars. It's the amount of investments you have today.
- **Monthly Savings** – This is the amount of assumed monthly savings from today until your retirement date. Once you reach your retirement date, your personal retirement map will assume that you won't be putting the monthly savings amount away.
- **Retirement Year** – This is the year that you want to retire, and you start taking monthly withdrawals. Your personal retirement map assumes retirement in the same month as 'today' in the retirement year selected. For example, if it is April 15th, 2020 and you enter 2033 as the retirement year, your personal retirement map will calculate retirement as April 2033.
- **Monthly Withdrawal** – This is the amount, in today's dollars, you need after retirement, minus any other income such as from Social Security, pensions, annuities, etc. The "Monthly Withdrawal" is the income burden that your portfolio will bear in retirement. For example, if you need $5,000 of monthly income at retirement and your pensions and Social Security will be paying you $3,000 of monthly income, the "Monthly Withdrawal" will be $2,000. You will be withdrawing $2,000 each month in retirement against your portfolio.
- **Needed by Retirement Date** – This is the amount of your total investments required at the time of your retirement in today's dollars. Your personal retirement map automatically calculates this for you.

Additionally, Riskalyze can make certain assumptions for your future. These assumptions should be very conservative and not aggressive. Your Redhawk financial advisor wants to make sure that your retirement map paints a realistic and achievable outlook.

- **Birth Year** – This will work in conjunction with your Life Expectancy for modeling purposes. The birth year will automatically be included for you when completing the risk questionnaire. It may be prudent for you to adjust the birth year if you are married and have a large age difference.
- **Life Expectancy** – This is the age at which your personal retirement map will cease based on your longevity. You can adjust your life expectancy at any time to see how different scenarios will play out.
- **Inflation Rate** – This is the rate that is used to calculate your personal retirement map. You can adjust this number based on your assessment of the current or anticipated inflation rate.
- **Annual Savings Increase** – This allows you to model an annual increase in monthly savings. The annual savings increase will increase your monthly savings, annually, by this percent increase. For example, if you are saving $100/month and you want to increase your annual savings rate by 2%, in year two your savings rate will increase to $102/month, in year 3 $104.04/month and so on until your retirement year.

Your personal retirement map is presented in today's dollars and adjusted for inflation at the rate you select under the assumptions. The shaded area above and below the solid line on the following chart, displays a range of possible investment returns based on a 95% probability analysis. It's important to note that the calculations do not include income tax.

In order to create your personal retirement map, we need to understand a few key concepts, starting with risk capacity. We've already talked about risk tolerance, which is the risk you can stomach before you are in danger of making an emotional decision. We sometimes refer to this as the risk that you "want." Then there's the portfolio risk, which is how much your portfolio may fluctuate up or down. This is the risk your investments "have." The Riskalyze Risk Questionnaire helps you align your risk tolerance (want) with your portfolio risk (have), preventing you from making an emotionally charged decision over the next six months.

Let me summarize this point:

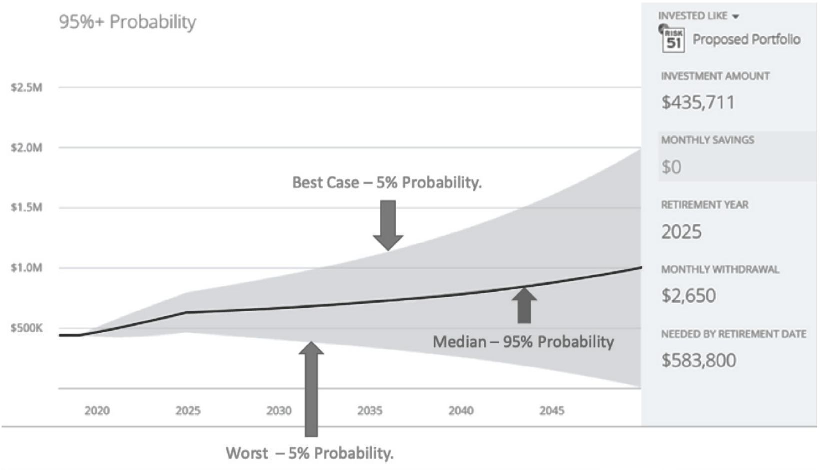
- **Have** – This refers to the Risk Number of your current portfolio.
- **Want** – This refers to how much risk you are willing to take, and it represents your Risk Number that was derived from taking the Riskalyze questionnaire.
- **Need** – This refers to how much risk you need to take in order to reach your financial goals.

Now that we understand how much risk you *want* and *have*; we need to determine how much you really *need*. For example, if you can invest $500 per month, and you would like to retire when you reach age 65, how should you invest in order to get there? This is how much risk you need to take without jeopardizing your goals, hence your risk capacity. Your risk capacity can depend on the following factors:

- **Lifestyle** - How do you want to prepare for retirement? What are you hoping for in retirement?
- **Timing** - When do you want to retire?
- **Investible Assets** - What do you have to work with?

The following graphic could be your personal retirement map where you want to retire in 2025 when you reach the age of 65. You have $435,711 of investible assets today and that needs to grow to $583,800 by 2025 when you retire. Your hypothetical personal retirement map shows that you have a 95% probability that you will be able to withdraw $2,650 per month when you retire.

The bottom edge of the map represents the worst case (which has a 5% probability) that you will run out of money in the year 2050. The top edge of the map represents your absolute best case (again a 5% probability) that you will have $2 million in 2050. The black line represents your median (95% probability) that you will have $1 million in 2050.



Source: Riskalyze

Assessing your portfolio's performance.

To understand how your portfolio has performed, you must compare its results to an appropriate benchmark. We've already covered earlier in this book that it is misleading to compare a fund that invests only in equities to a fund that invests in both equities and bonds, or a fund that invests in large-cap stocks to a fund that invests in small-cap stocks. It would be comparing apples to oranges, and the comparison wouldn't be meaningful or beneficial.

Let's start by using the The E-Valuator to check your portfolio's returns. We want to make sure that your portfolio is performing to meet your goals, and whether it's performed as well as its benchmark over the same period. In addition to this, you should also review each underlying investment in your portfolio to gain an adequate picture of your portfolio's performance. Different investment managers perform well in different circumstances and since your circumstances and those of your investments will change over time, it's important to check that each one is performing as well as it can.

For example, let's say your large-cap fund is up 8% for the year. You feel pretty good about this until you look at the fund's relevant benchmark, the

S&P 500®, which returned 12% for the year. On the other hand, if your small-cap fund is up 12% and its relevant benchmark, the Russell 2000, is up 9%, you should be pleased.

It's prudent for you to hold an investment long enough to evaluate its performance. You shouldn't err on the side of selling investments without giving them time to show what they can do over a full market cycle. With this in mind, you must carefully evaluate the track records of the investments by focusing on both the short-term and long-term ones. A long-term track record moderates the effects of good or bad short-term performance can have on an investment's performance. You need the right balance between short-term and long-term results in order to make a prudent evaluation.

Another reason for under-performance could be the quality of your portfolio. If some of the investments in your portfolio are under-performing its benchmark, your entire portfolio will lag, and it might not be able to keep pace with the broader indices as well as its peer group. Remember, getting emotional about non-performing investments or waiting endlessly in the hope of recovering losses can be a fruitless exercise.

For such investments, the right strategy might be for you to weed them out and reinvest the money in better performing investments. By doing so and reinvesting the money in investments that have a better track record, you can enhance the chances of improving your portfolio returns over time. However, while doing so, your priority should be to have exposure in a manageable number of appropriate performing investments and to avoid over-diversification which is not good for the long-term health of your portfolio.

{ At Redhawk, our first criterion in monitoring the investments in your portfolio is to make sure that we are investing in the asset classes that are performing best. }

The market is an ever-flowing dynamic environment that rewards better performing companies over under-performing companies. Depending on the economic cycle we are in, large-cap stocks may be favored over small-cap stocks. Or on the fixed income side, short duration investment grade bonds may be favored over longer duration high yield bonds. The point is that you always want to be invested in those asset classes that are being rewarded in the market.

The following chart shows how we score each asset class on a weekly basis and select those that are outperforming. As you can see, the large-growth asset class (fund symbol QQQ) is under-performing, prompting us to put it on our "watch list" with the idea of replacing it with the consumer defensive asset class (circled) if it continues to under-perform.

Asset Category and Sub-Category	Sub Category 1-Month	Sub Category 3-Month	Sub Category 1-Year	Sub Category Weighted	Top Performer Premium at 15%	Fund Risk Score	Fund Bubble Score	Fund Symbol	Fund Name	Redemption Fee	Fund Expense Ratio
US Equity											
Utilities	*1.41*	*3.20*	*4.05*	*14.07*	*16.17*	*81*	*100.00*	*PSCU*	*Invesco S&P SmallCap Utilities ETF*	*None*	*0.29%*
Large Growth	*-3.03*	*-2.74*	*12.40*	*-11.40*	*-9.69*	*79*	*93.67*	*QQQ*	*PowerShares QQQ Trust 1*	*None*	*0.20%*
Consumer Defensive	2.72	0.82	6.68	15.86							
Real Estate	2.21	-1.64	0.82	5.97							
Consumer Cyclical	-0.40	-2.78	12.28	-1.02							
Communications	-1.29	0.18	6.19	-1.71							
Health	-2.13	-1.11	16.19	-2.65							
Large Value	-2.07	-1.33	6.83	-7.53							
Large Blend	-2.40	-1.77	8.74	-8.77							
Allocation 85%+ Equity	-2.61	-3.81	3.44	-16.34							
Small Growth	-3.49	-4.82	14.24	-16.48							
Mid-Cap Value	-2.66	-3.90	3.85	-16.52							
Mid-Cap Growth	-3.38	-4.55	9.42	-17.91							
Mid-Cap Blend	-3.05	-4.58	5.09	-18.82							
Technology	-3.27	-5.56	9.22	-19.59							
Small Blend	-3.35	-6.42	5.43	-23.53							

Source: Redhawk Wealth Advisors, Inc.

Now that we have determined which asset classes are performing well in the market, we will use The E-Valuator to select the best performing fund within that asset class. In doing so, we evaluate the performance of each investment that is held in the portfolio to its Morningstar assigned benchmark. As you can see in the following chart, the investments for the large growth asset class are ranked by their bubble score and performance over 1, 3, and 5 years. It's clear to see which investments have been performing well (higher E-Val Score/bubble score).

Ticker	Name	Benchmark	E-Val Score	1 Year Return	3 Year Return	5 Year Return
AKREX	Akre Focus Fund;Rtl	Large Growth	100.00	5.26%	14.15%	11.01%
AKRIX	Akre Focus Fund;Inst	Large Growth	100.00	5.55%	14.47%	11.31%
AKRSX	Akre Focus Supra Institutional	Large Growth	100.00	5.66%	14.57%	11.38%
AMIGX	Amana:Growth;Inst	Large Growth	98.97	2.67%	12.71%	10.30%
AMAGX	Amana:Growth;Inv	Large Growth	98.72	2.44%	12.45%	10.05%
APGYX	AllianBer Lg Cap Gr;Adv	Large Growth	98.72	2.18%	11.50%	11.83%
ALLIX	AllianBer Lg Cap Gr;I	Large Growth	98.72	2.17%	11.53%	11.88%
APGAX	AllianBer Lg Cap Gr;A	Large Growth	98.72	1.93%	11.23%	11.55%
APGZX	AB Large Cap Growth Z	Large Growth	98.72	2.27%	11.62%	11.82%
FAOFX	Fidelity Adv Srs Gro Opp	Large Growth	98.70	17.03%	16.74%	13.27%

Source: The E-Valuator

You also want to be in investments that are performing well in their respective asset class. If an investment has a bubble score of less than 60 (out of 100), we will replace that investment with a better performing one that has a higher bubble score. So, when reviewing your current portfolio, we look at the bubble score for the last 15 months for each underlying investment.

In the example below, we would have replaced the FCNTX fund back in August 2018 when the 2 Month Average bubble score went from 74.62 to 55.20. We've found that once an investment dips below a bubble score of 60, it may take that investment manager 6-18 months to turn the performance around to where it starts scoring above 60. Why should you stay in an under-performing investment when there are better performing investments?

FCNTX Fidelity Contrafund — E-Valuator Indicator: R — E-Valuator Score: 34.76 — % of Assets: 4.73%

	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19
Total Credits	73.87	84.64	91.20	81.36	74.60	72.25	94.68	54.55	55.85	53.46	31.29	27.90	53.39	44.33	25.19
Monthly Indicator	K	K	K	K	K	K	K	W	W	W	R	R	W	W	R
2 Month Avg.	74.29	79.25	87.92	86.28	77.98	73.43	83.47	74.62	55.20	54.66	42.38	29.59	40.64	48.86	34.76
Average Monthly Credits from the previous 2 months, on a rolling basis.															

Source: The E-Valuator

Let's examine how we find a better performing investment. In the example below, the PowerShares QQQ Trust 1 (ticker QQQ) bubble score went below 60 (scored a 46.81) and we replaced it with an investment that's in the same asset class since the asset class was still a top performer. As you can see, there are many investments that have a higher bubble score and better overall returns (1 year, 3 year, and 5 year) than QQQ. Look at FAOFX which has a 1 year return of 30.61% vs. 3.82% and a 2 year return of 28.04% versus 19.47% compared to QQQ.

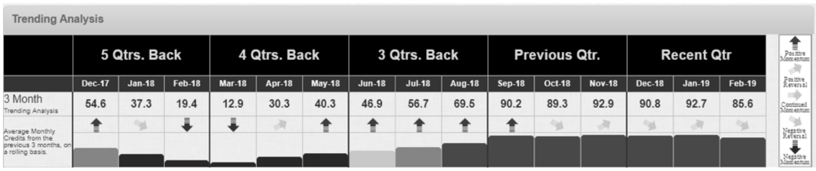
		Ticker	Name	Benchmark	E-Val Score	1 Year Return	3 Year Return	5 Year Return	Mgr Tenure	Exp Ratio	12b-1 Fee	Yield
		QQQ	**PowerShares QQQ Trust 1**	**Large Growth**	**46.81**	**3.82%**	**19.47%**	**15.94%**	**20**	**0.2**		**0.81%**
☐		FSBDX	Fidelity Srs BlueChp G	Large Growth	95.13	11.97%	22.33%	13.89%	5	0		0.72%
☐		FAOFX	Fidelity Adv Srs Gro Opp	Large Growth	100.00	30.61%	28.04%	15.83%	4	0.01		0.64%
☐		PXLG	PowerShares Fundamental Pu	Large Growth	98.04	8.79%	20.16%	13.82%	8	0.39		0.83%
☐		ACFNX	American Century Focused Dy	Large Growth	100.00	17.27%	24.69%	13.76%	3	0.5		0.00%
☐		FDTRX	Franklin Cust:Dyna;R6	Large Growth	100.00	12.51%	25.17%	13.87%	51	0.51		0.00%
☐		NWJFX	Nationwide:Zie NYSE A;IS	Large Growth	91.99	10.77%	23.04%	13.29%	17	0.51		0.49%
☐		PGOEX	Putnam Growth Oppty;R6	Large Growth	97.00	10.18%	21.01%	12.85%	2	0.53		0.35%
☐		MGRPX	Morg Stan I:Growth;IS	Large Growth	100.00	14.25%	26.89%	15.05%	15	0.54		0.00%
☐		TRLGX	T Rowe Price I LgCp Gro	Large Growth	95.09	8.93%	23.53%	13.84%	2	0.56		0.23%
☐		TPLGX	T Rowe Price I LC Cor Gr	Large Growth	95.50	7.11%	21.59%	13.63%	15	0.57		0.14%
☐		TBCIX	T. Rowe Price Blue Chip Grow	Large Growth	95.42	7.04%	21.64%	13.61%	26	0.57		0.05%

Source: The E-Valuator

Now that we have assessed each underlying investment in your portfolio, we will use The E-Valuator to calculate how your entire portfolio performed. Let's look at an example. As shown below, a portfolio we were evaluating scored an 85.60 out of 100. I always equate this score to taking a test in high school. Would you have been happy with an 85.6 on a test that's a solid B? There is some room for improvement, but this is a good score for a portfolio.

Source: The E-Valuator

Let's look at how the performance of this portfolio has been trending over the past 15 months to confirm that it is moving in the right direction. In the following chart, this portfolio was severely under-performing its benchmark until September 2018. Since that time, the portfolio has been consistently scoring in the 80's and 90's — a pretty good performance.



Source: The E-Valuator

We covered many of the key statistics for your portfolio earlier, but let's review those concepts. I always like to look at the 3 year upside/downside capture ratios because it will tell me how much this portfolio will participate in certain market conditions. As you can see in the following chart, the 3 year upside capture ratio is 93.08%, which means that it will participate in 93.08% of an up market. Conversely, the 3 year downside capture ratio is 59.71%, which means that it will only participate in 59.71% of a down market. So, what these ratios are telling us is that it captures almost all of an up market, but about half of a down market. It's the best of both worlds!

Sharpe Ratio

	1-Year	3-Year	5-Year
Investment	+1.06%	+1.05%	+0.82%
Benchmark	+0.31%	+0.80%	+0.50%
+/-	+0.76%	+0.26%	+0.31%

Standard Deviation

	1-Year	3-Year	5-Year
Investment	+15.24%	+12.72%	+12.66%
Benchmark	+15.18%	+13.48%	+13.76%
+/-	+0.06%	-0.76%	-1.09%

α Alpha

	1-Year	3-Year	5-Year
Investment	+12.48%	+4.08%	+4.30%
Benchmark	+2.57%	+1.27%	+0.55%
+/-	+9.91%	+2.81%	+3.75%

β Beta

	1-Year	3-Year	5-Year
Investment	+0.92%	+0.83%	+0.79%
Benchmark	+0.73%	+0.76%	+0.76%
+/-	+0.19%	+0.06%	+0.03%

Upside Capture Ratio

	1-Year	3-Year	5-Year
Investment	+136.90%	+93.08%	+93.06%
Benchmark	+78.07%	+73.97%	+72.84%
+/-	+58.82%	+19.11%	+20.23%

Downside Capture Ratio

	1-Year	3-Year	5-Year
Investment	+63.60%	+59.71%	+64.40%
Benchmark	+60.96%	+57.94%	+71.08%
+/-	+2.64%	+1.77%	-6.68%

Source: The E-Valuator

Evaluating your portfolio's Risk Number.

It is worth checking to see if your portfolio is sufficiently diversified and if are you invested in equities only or other asset categories. If your portfolio was split up equally into equity and bond investments, will this ratio be the same after a year? The performance of different investments can vary, so over time your portfolio may change from how it started out. Also, keep in mind that your priorities might have changed since you first invested, so it's worth making sure your portfolio and plans are still right for you.

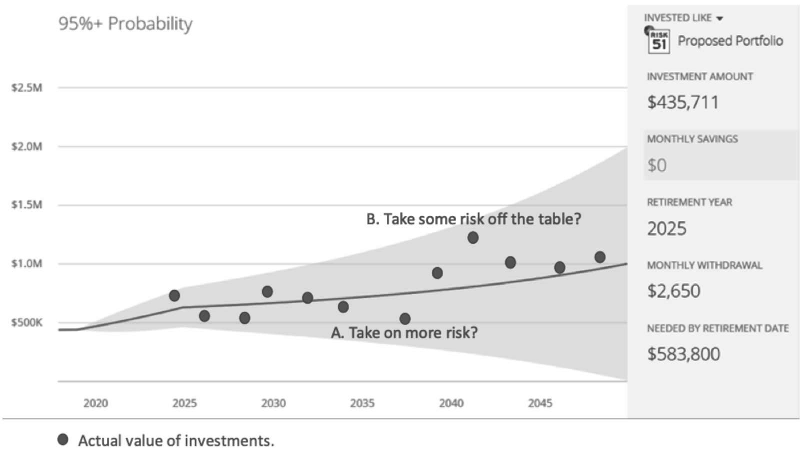
{ Your financial advisor should periodically touch base with you to make sure that your portfolio's Risk Number continues to align with your retirement, budgeting, goal planning, and most importantly your level of risk. }

"Well, for starters, Matt has been showing definite improvement in risk-taking."

As I've already mentioned, risk isn't something you just "set and forget" but instead must be monitored for changes. When your financial advisor meets with you, they should ask about your comfort level of risk and make sure that your portfolio is in line with your risk comfort zone.

Comparing your actual results to your retirement map.

Remember: the main reason you began investing in the first place was to achieve your financial goals. It's essential to always have a clear idea of what these goals are and whether your portfolio is on track to achieve them. For example, if you're saving up for a new house, you'll want to check that your portfolio is built for growth, rather than income.



Source: Riskalyze and Redhawk Wealth Advisors, Inc.

The chart above may be your account balance over time compared to your personal retirement map. You can see how it changes over time therefore it is critical that you review your goals and investible assets with your financial advisor at least annually. As you can see, in 2037 (point A), you are behind your retirement goals. Maybe you should take on more risk or change your portfolio allocation to have a higher potential annual return. Maybe you should lower your retirement goal. Maybe you should save more every month. These are critical questions a financial advisor can help you answer. The important thing is that you know where you stand so you can adjust along the way.

The same goes with point (B) where, in 2042, you are ahead of your retirement goal. Should you change your portfolio allocation to a more conservative approach? Should you take a portion of the investments and put it in a fixed indexed annuity that guarantees an income stream at retirement? Should you stay as is and try to achieve more income in retirement? Again, by reviewing your actual results with your financial advisor, you have time to make the necessary adjustments for retirement.

CHAPTER 6

Monitor Your Financial Advisor. It's Worth It.

It's imperative that you continue to monitor your financial advisor throughout the relationship. You are hiring the financial advisor to fulfill your goals and objectives, meeting your needs and living up to the high standards you are setting. Everyone is different, so what makes a relationship with a financial advisor "successful" for you may be different than the next person. So, when evaluating the performance of your advisor, you should review the following:

1. The investments and planning services outlined by your financial advisor at the time of engagement. Have the investments met what was outlined in your Investment Policy Statement? Have the recommended services been provided? Has your financial advisor's "activity" been documented and proven to support your stated goals?
2. The compensation you are paying the financial advisor. Have you paid the financial advisor anything other than what was specified in your Investment Management Agreement?

3. The timeliness of response to any questions or concerns. Has your financial advisor responded to your requests in a timely manner?

4. The effectiveness in working with other members of your financial advisor's team. Has the experience of working with others on the financial advisor's staff met your expectations?

5. Overall communication with your financial advisor. Has your financial advisor been accessible when needed? Are you hearing from them frequently? Does your financial advisor have a genuine interest in you, your family, and your situation?

6. The performance of investments relative to stated benchmarks. If your financial advisor stated a benchmark or goal for investment returns, have the investments met it? Has your financial advisor met with you at least annually and compared the results of this review from previous reviews?

7. Does your financial advisor spend most of their time helping you fine-tune your most important objectives and developing recommendations that uniquely fit you?

8. Does your financial advisor's process provide you with increased clarity and perspective over your total financial picture (not just investments) so you have the confidence to move forward with a strategy?

9. Is your financial advisor holding you accountable to your goals and helping you complete your financial projects, such as implementing an estate, asset protection, or retirement planning strategy?

10. Is your portfolio tailored to meet your objectives and risk tolerance?

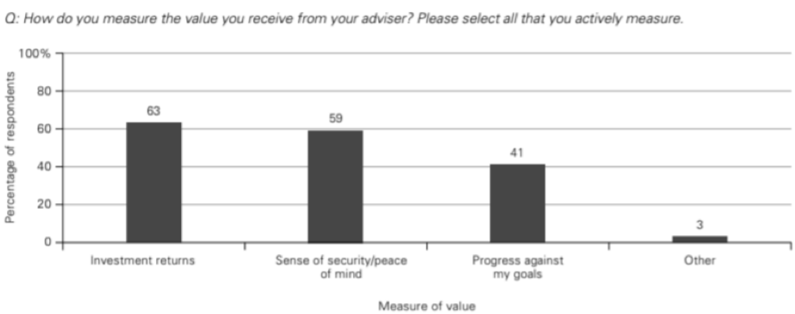
Financial advisors play an important role in enabling you to achieve your financial goals and guide you to making smarter decisions with your wealth. An effective financial strategy will include recommendations that stretch far beyond your investment portfolio, and should address areas such as estate planning, cash flow, taxes, insurance, business succession, and asset protection. The key consideration is whether your financial advisor is effectively helping you move closer to your end goal.

{ Having a financial advisor, even a person with great credentials, is no substitute for devoting some attention to your personal finances. It's your money, so you need to remain involved. Make sure that your financial advisor is a fiduciary and will act in your best interest. }

How do you measure your financial advisor's value?

We want to help you understand how to evaluate the advice you are paying for so you can focus on achieving your financial goals. Adviser Impact conducted a study to find out how investors measured the value they receive from their financial advisor. You should be measuring the progress against your goals since it is the most important measurement of a financial advisor. As shown in the following graph, most people measure their financial advisor by:

1. The investment returns.
2. Sense of security and peace of mind.
3. Progress against their goals.



Source: Adviser Impact

You should measure the value of your financial advisor by more than just the performance of your portfolio. Your financial advisor performs a critical function by assessing your willingness and ability to take on investment risk.

"Actually, 'Monkey see, monkey do' has served me quite well in this market."

They also will invest your money according to your financial goals. Additionally, and most importantly, they will help manage your emotions and hold you accountable to stay on the right path. Knowing this, you should evaluate your financial advisor on the following:

- **Risk**
  You know that financial markets don't always go up and neither does your portfolio. Investing is inherently risky so it's critical to consider the amount of money your financial advisor is risking achieving the return you need to obtain your retirement objectives. The investments you own in your portfolio change over time and a good measure of risk is understanding how your current portfolio performs during historical market cycles. This will give you an idea of how much risk you are taking today. The risk that you are taking should never be more than what you are comfortable in losing.

- **Allocation**

  Your financial advisor should recommend a portfolio that fits your risk tolerance, which is the amount of investment risk you are willing and able to take. The leaders in asset allocation research (2010; Xiong, Ibbotson, Idzorek, Chen) found that 75% of the variation in your overall return relates to being invested in the market. Of the remaining 25% of investment return variation that your financial advisor can control, 50% is attributed to the mix of asset categories that you are invested in. If that mix of asset categories are inappropriate given your risk tolerance, you can have a terrible investment experience whether the market goes up or down.
- **Fees**

  You should measure your financial advisor's performance when it comes to fees as well. Many financial advisors charge an investment management fee. Don't lose sight of this and set clear expectations with your financial advisor about what you are willing to pay over time. However, that's not all the fees you could be charged so you should be aware of the fees that come from ETFs, mutual funds, and other investment vehicles. Make sure you have the full picture.
- **Returns**

  It's hard not to focus on your financial advisor's returns and you are probably happiest when your investments increase year after year, but make sure that the benchmark is reflective of the objectives of your portfolio. Your portfolio's performance should be measured in both absolute terms, against your goals (I need to have $500,000 when I retire), and in relative terms (How did my portfolio perform against its benchmark?).
- **Monitoring**

  It's important to have a personalized Investment Policy Statement. The IPS is your master document that outlines how your portfolio will be structured and managed on an ongoing basis. For this reason, the IPS is the reference point against which portfolio monitoring should occur. You should meet with your financial advisor on an annual basis under normal circumstances and more frequently if you have life changes that may alter your retirement goals.

- **Final Analysis**
  Assessing your financial advisor, looking at your portfolio and understanding the health of your returns, allocation, risk, and fees can have a huge impact on your financial future. It's important to understand them now and to continuously monitor them. You pay for financial advice and you need to be sure you are paying for expert advice from someone who has your best interest in mind.

How to avoid financial advisor fraud. (It happens.)

Fraud by financial advisors is exceedingly rare. Nonetheless, there are enough front-page news stories about fraudulent financial advisors and the tragic losses suffered by investors that make people wonder if their financial advisor is acting in their best interests. The National Association of Personal Financial Advisors ("NAPFA")[37] offers the following advice about how to protect yourself as you work with your financial advisor.

1. **Know where your money is.**
   Make sure that an independent financial institution will hold your money. This company has "custody" of your money so make sure you know which company it is, how to contact the company, and your account numbers.
2. **Read your financial statements.**
   The firm that has custody, typically a broker-dealer, bank, or trust company (known as the "custodian firm") is required to provide you with financial statements at least quarterly. Read them and most importantly, make sure that these statements are coming to you directly from your custodian firm and not from your financial advisor.
3. **Stay in contact with your financial advisor.**
   It's required that your financial advisor meets with you at least annually and stay in contact by e-mail or telephone. Holding regular meetings has the added benefit of making sure that you and your financial advisor are clear about your financial goals, risk tolerance, and investment strategy.

Unhappy with your financial advisor? (It also happens.)

You may have trusted an advisor with your savings and retirement without fully knowing their capabilities and credentials. That can often lead to you not getting the service you expect and deserve. Listed below are the warning signs:

1. They still don't know your needs.

If your financial advisor doesn't take the time to get to know your complete story, how can they possibly make a proper recommendation? If you went to see your doctor and before she made a diagnosis was already suggesting you have surgery wouldn't you want a second opinion? A financial advisor that acts in a fiduciary capacity is going to take the time to ask the right questions:

- How much credit card debt do you have?
- How is your health?
- How safe is your job?
- Do you want to buy a home?
- Do you have a will or trust?
- Do you have enough in your emergency fund?
- How do you plan to take care of your kids' college educations?
- When is the last time you checked your beneficiaries?

Your financial advisor needs to know if it makes sense for you to invest, or if you should first take care of other pressing needs.

2. They don't tell you how they're paid.

There are many different ways that a financial advisor can get paid. Asking what the financial advisor charges will help you to know exactly what you are paying throughout the working relationship. If even after they explain it to you it doesn't make sense, have them put it in writing. There is a cost associated with any investment that is made and it is most likely that you will pay the financial advisor a fee or commission. Therefore, the financial advisor needs to be clear on what it is going to cost you.

3. They make you feel rushed or pressured.

When it comes to investing for your retirement, the last thing you want is to be in an investment that does not meet your needs. *Never* feel pressured to "act now or else"; *never* feel pressured to sign anything that you are uncomfortable with or you don't understand.

4. They want to put everything in one investment.

If your financial advisor is adamant about putting all your money into one investment, be wary. As we learned, diversification is typically the fundamental principle of any investment portfolio.

5. They don't inform you of changes.

You want to make sure your financial advisor is on top of your investments and looking out for you. They should inform you when there are any changes in the holdings of your portfolio. In some cases, you can give your financial advisor discretionary control where they can make trades on your behalf. If that's the case, you still want to know what factors are leading the financial advisor to making a significant change to your portfolio holdings.

The number one reason why you might fire your financial advisor is their failure to communicate on a regular basis. Poor communication from your advisor can lead to poor investor behavior, such as buying or selling at the wrong time, and can make you feel like your advisor is "asleep at the wheel." You most likely can tolerate the ups and downs of the market, changing economic conditions, and an unpredictable interest rate environment if, and only if, you feel that your financial advisor is monitoring the situation and keeping you informed. You certainly don't want to be in the dark when it comes to your money, especially in troubling times. You want to know that a plan is in place and that you are being cared for, so your financial advisor should give you the reassurance you need to maintain and build a strong working financial relationship.

Since we at Redhawk are passionate believers in communication we send out a weekly podcast via email that includes an overview of what happened in the market the prior week and highlight any changes to the portfolios. We go over each portfolio and what we are doing so that you know exactly how we are managing your money and why we are doing it. We make sure you are always aware of what is going on.

In 2018 when the market plunged by 16% from December 3 to the 24th, we received very few phone calls. We believe the reason was that we communicated what we were doing with our clients′ money faithfully every Monday and clients knew that Redhawk moved into defensive asset classes on December 19th. Frequent and meaningful communication is a must with your financial advisor.

6. They don't give you legitimate monthly statements.

Your financial advisor should send you a statement summarizing all that month's transactions, including deposits, withdrawals, and current positions held. This statement must come directly from the brokerage firm or custodian that's holding your money. At minimum, you should receive quarterly and annual reports from the custodian. These reports should illustrate all the realized gains or losses (all the money you made or lost from selling an investment) and all the unrealized gains and losses (investments you own but have not yet sold and thus that have not yet realized a profit or loss). These reports should also include portfolio returns. You should also get online access to your accounts so you can routinely check your account balances.

7. Your financial advisor wants a check directly made out to them.

If you are making an investment into an investment product, always make the check payable to the custodian. You should never write a check out to the name of your financial advisor. If you are paying your advisor for a specific service such as developing a financial plan, the check should be made out to the financial advisor's firm and not to the name of the financial advisor.

8. They don't know how much risk you're comfortable taking.

Make sure your financial advisor has you complete some type of risk tolerance questionnaire to determine your comfort with risk. They should also explain the risk characteristics of your portfolio to ensure that it is in alignment with your risk tolerance.

9. They don't return your phone calls or emails.

A good financial advisor will return your phone call or email within 24 hours. Everyone wants to get an answer in a timely manner, and it shouldn't be any different with your financial advisor. Even if they don't have an answer to your question immediately, they should let you know that they are working on your issue.

Want to file a complaint on your financial advisor? You have rights.

When you entrust your money to a financial advisor, they have a duty to perform to a certain standard. In other words, as an investor, you have several rights. The North American Securities Administrators Association ("NASAA")[38] details your entitlements in its Investor Bill of Rights. Odds are, if any of these rights have been declined by your financial advisor, you might have a case.

When you invest, you have the following rights:

- To ask for and receive information from a firm about the work history and background of the person handling your account, as well as information about the firm itself.
- To receive complete information about the risks, obligations, and costs of any investment before investing.

- To receive recommendations consistent with your financial needs and investment objectives.
- To receive a copy of all completed account forms and agreements.
- To receive account statements that are accurate and understandable.
- To understand the terms and conditions of transactions you undertake.
- To access your funds in a timely manner and receive information about restrictions or limitations on access.
- To discuss account problems with the compliance department of the firm and to receive prompt attention and fair consideration of your concerns.
- To receive complete information about commissions, sales charges, maintenance or service charges, transaction or redemption fees, and penalties.

To contact your state or provincial securities agency for any of the following reasons: to verify the employment and disciplinary history of a securities salesperson and the salesperson's firm, to find out if an investment is permitted to be sold and to file complaints.

Don't jump the gun.

Keep in mind that simply losing money on an investment doesn't mean you can sue your financial advisor for bad advice. It's important to understand that investors are not guaranteed a return. Markets are risky by nature and when you invest, you must take on some risk against which no law or regulation can provide protection. You should file a complaint only if you believe you've been defrauded and not if you simply lost money.

According to the Financial Industry Regulatory Authority ("FINRA")[39], the most common complaints against financial advisors are misrepresentation and unsuitability:

- Misrepresentation: Falsehood or omission of facts in relation to an investment. This is a classic case where you believe that you were told one thing and then found out after the fact that what you understood to be true was not the case.
- Unsuitability: When a financial advisor invests your money in a security that is not suitable for your investment objectives. An example of this is a financial advisor investing large sums of money in high-risk securities for a person who is 75 years of age and has a low-risk tolerance.

"I still haven't found any gold for my portfolio."

How do I file a complaint?

If you think that you have a legitimate dispute with your financial advisor, you need to file a dispute with either the Securities and Exchange Commission ("SEC")[40] or FINRA. Many financial advisors are members of a charter organization (you can usually tell by the designations listed after their name). These organizations also have standards and codes of ethics, so it's worth lodging a complaint with them as well. For example, if your complaint is against a Certified Financial Planner ("CFP"), you can file with the Certified Financial Planner Board of Standards. If it is against a Chartered Financial Analyst ("CFA"), you can contact the Association of Investment and Research.

Contacting your state securities commission is another avenue to take. Each state has a division that handles complaints against financial advisors. If these options don't work, your final course of action is to hire an attorney.

CHAPTER 7

Benchmark Your Success. It Makes Sense.

The most important, yet often missed, step of having a financial plan created is implementing the plan. One of the top reasons for this is that life gets in the way and managing every aspect of one's finances takes time.

{ Having a financial advisor that makes sure you implement the steps laid out in your plan is one of the best ways to make sure the items get completed. }

The core areas to benchmark are:

- Income
- Expenses
- Debts
- Net worth
- Income tax planning
- Insurance planning

- Estate distribution
- Investment performance
- Investment allocation
- Account contributions or withdrawals

The work needed in each of these areas is explained briefly below along with how often each should be completed:

Monthly

You should track your spending and compare how you are doing versus the target amounts set in your financial plan. This is one of the most important steps in implementing your plan because it is where you have the most control and the most impact on your financial situation. Reviewing this regularly provides great feedback if your spending is in line with your values.

Quarterly

- **Income** – Compare your income against plan targets to see if it is on track. Earning more or less than planned may mean you need to adjust your savings or spending amounts accordingly.
- **Debts** – Follow the targets in your plan for the optimal amount to pay toward any debts you may have. Monitor interest rates to evaluate if a better option might be available, such as refinancing or making additional payments.
- **Investment Performance** – Regularly review your investment performance compared to an appropriate benchmark. Also compare targeted account balances versus actual account balances to determine if you are on the right path to your financial goals.
- **Investment Allocations** – Determine appropriate asset allocation ranges for equities, bonds, and cash in your plan, and review your investment portfolio regularly. Implement the investment strategy that works best for your situation and rebalance assets when needed, not when your emotions are telling you to. Allocation

ranges in your plan should be chosen based on analysis of your risk capacity and risk tolerance. As life changes, the appropriate investment allocations will change, so it will need to be updated periodically.

- **Account Contributions & Withdrawals** – Review, calculate, and adjust contributions and distributions from investment and savings accounts to stay close to targeted amounts set in the plan. Check things like Roth IRA contributions, 401(k) contribution rates, or IRA distributions throughout the year.

Annually

- **Net Worth** – Net worth is the value of your assets minus your debts. A healthy financial plan is typically one in which your net worth is increasing during your accumulation years and then gradually decreasing in retirement.
- **Income Tax Planning** – Review your income tax scenario prior to year-end to take advantage of tax efficiencies and cost savings (deductions not being utilized, taking advantage of tax-deferred accounts, Roth conversions, maximizing your tax bracket, etc.).
- **Insurance Planning** – Your plan should identify areas where current insurance amounts are over or under insured. Review annually to see if your coverage is enough as life changes. This includes all insurance types (life, disability, property, long-term care, umbrella, and more) for any potential changes that may be needed.
- **Estate Distribution** – Review and update estate documents and beneficiary designations on retirement accounts and life insurance policies to assure that assets are structured the way you want them to transition after death.

{ If you don't have the time, the interest, or the knowledge to adequately monitor your plan, this is where having help matters.}

Hiring a financial advisor assures not only that recommendations from your plan are completed, but you can rest assured that you will have a regular review process to take advantage of opportunities that arise as life changes and limit big mistakes. This allows you to spend time on your highest value activities, while providing peace of mind around your financial journey.

"Who can say? I suppose I'm as happy as my portfolio will allow me to be."

CHAPTER 8

Putting It All Together: A Better Financial Outcome Case Study.

I want to show you an actual portfolio review case study (on the following page) that brings everything discussed in this book together. Let's review what I covered in the very beginning.

When you are considering a retirement planning strategy, always try to accomplish these three objectives:

1. Increase your retirement income.
2. Lower your risk.
3. Reduce your investment costs.

This case study will hit on each one of the better financial outcome objectives. More importantly, it will show how their investments would have performed in historical market cycles. This case study does not include any pension assets or social security. It's based only on investable assets.

Assumptions:
Investment Amount: $531,299
Monthly Savings: $0
Birth Year: 1958
Retirement Year: 2023
Life Expectancy: 90
Inflation Rate: 2%
Objective: Income
Risk Number: 45

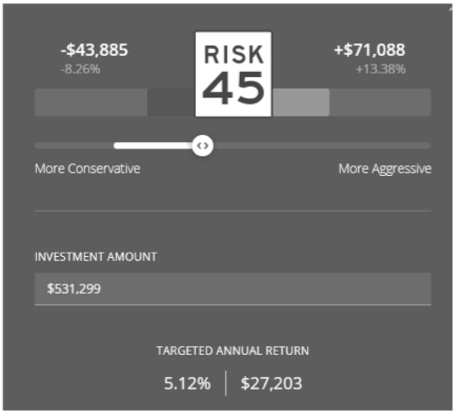
Risk Number

This client is 61 years old and has a personal Risk Number of 45, which is moderate. With a Risk Number of 45, they are comfortable with the risk of losing $43,385 (or -8.26%) over the next six months with the prospect of gaining $71,088 (or 13.38%). Additionally, their targeted annual return is 5.12% or $27,203.

Portfolio Risk Numbers

Let's look at their current portfolio and a proposed portfolio's Risk Numbers (see the following diagrams).

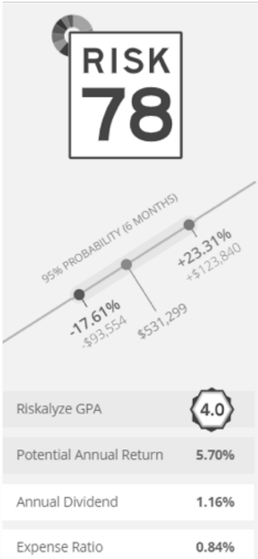
Their current portfolio has a Risk Number of 78 (similar to the Risk Number of the S&P 500), which is aggressive and much higher than their personal Risk Number of 45. The maximum downside (with a 95% probability) over the next six months is -17.61% or $93,554, which is over twice of what they are comfortable with. The potential annual return is 5.70% and it's paying a 1.16% annual dividend with an annual expense ratio of 0.84%



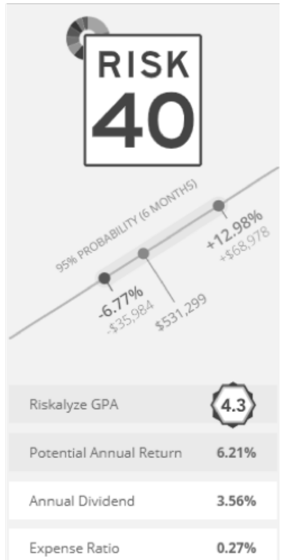
Source: Riskalyze

The proposed portfolio has a Risk Number of 40 which is lower than their personal Risk Number. The maximum downside (with a 95% probability) is -6.77% or -$35,980, which is lower than their downside of -8.26%. The maximum upside over the next six months is 12.98% which is almost in line with their upside of 13.36%. The potential annual return is 6.21% and it's paying a 3.56% annual dividend with an annual expense ratio of 0.27%. Let's look at a couple of key comparisons between the two portfolios:

1. The current portfolio carries much more risk than what this person is comfortable with (78 vs. 45).
2. The proposed portfolio has slightly less risk than what this person is comfortable with (40 vs. 45).
3. The proposed portfolio has significantly less downside than the current portfolio (-6.77% vs. -17.61%).
4. The potential upside of the proposed portfolio is about what this person is comfortable with (12.98% vs. 13.38%) with less risk.
5. The proposed portfolio has a higher potential annual return of 6.21% vs. 5.70%.
6. The proposed portfolio has a lower expense ratio of 0.27% vs. 0.84%.



Current Portfolio

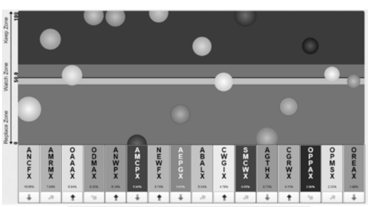


Proposed Portfolio

Source: Riskalyze

Portfolio Bubble Scores

Next, let's look at their current and a proposed portfolio (see the following diagrams).



Upside Capture Ratio

	1-Year	3-Year	5-Year
Investment	+101.35%	+99.41%	+98.43%
Benchmark	+102.12%	+97.63%	+97.15%
+/-	-0.76%	+1.78%	+1.28%

Downside Capture Ratio

	1-Year	3-Year	5-Year
Investment	+101.30%	+93.45%	+92.07%
Benchmark	+105.33%	+98.01%	+97.33%
+/-	-4.03%	-4.56%	-5.26%

Current Portfolio

Upside Capture Ratio

	1-Year	3-Year	5-Year
Investment	+76.69%	+75.17%	+62.78%
Benchmark	+57.54%	+74.88%	+72.06%
+/-	+19.15%	+0.30%	-9.28%

Downside Capture Ratio

	1-Year	3-Year	5-Year
Investment	+21.65%	+35.65%	+38.02%
Benchmark	+27.07%	+24.82%	+53.67%
+/-	-5.41%	+10.83%	-15.65%

Proposed Portfolio

Source: The E-Valuator

Their current portfolio has some good performing funds that score above 60 and are in the "keep" zone. They also have some not-so-good funds that score below 60 and are either in the "watch" zone or the "replacement" zone. The entire portfolio scored a 65.56. I always equate this score to a test score in high school. If you scored a 65 on a test in high school, you probably weren't very happy and there was some room for improvement. My mom would have probably grounded me and sent me to my room without dinner. Good thing that was before smart phones, because she would have taken that away. The current portfolio has a 3 year upside capture ratio of 99.41%. The good news is that when the market is going up, this portfolio will share in 99.41% of the up market. The not-so-good news is that when the market is going down, it will share in 93.45% of it (see the 3 year downside capture ratio). Therefore, this portfolio will go up and down with the market (it will perform and have the same volatility as the S&P 500).

Now let's look at the proposed portfolio. All the funds, except for one, scored above 60 and are in the "keep" zone. Additionally, this portfolio had a total score of 92.94. Now I don't know about you, but I would take that score on a test in high school every day of the year! And most importantly, my mom would have been proud. The real advantage of this portfolio is that it has a risk score of 40, which is moderate conservative, yet it has a 3 year upside capture ratio of 76.17%. However, it's also defensive and has a 3 year downside capture ration of 35.48%. That means when the market is going down, this portfolio will only share in 35.48% of the down market. In other words, this portfolio captures most of the upside and a small amount of the downside risk.

Retirement Maps

Look at the retirement maps using the current and proposed portfolios. It shows where the proverbial "rubber meets the road." How well are these portfolios going to provide a financially secure retirement? When using the retirement maps, I always like to maximize the monthly income and have a 95% probability that they won't run out of money in retirement.

Let's mix it up a bit and look at the proposed portfolio first (see the following chart). As you can see, this portfolio is projected to grow from $631,299 to $747,090 in 2023 when they retire. The maximum monthly withdrawal, with a 95% probability when they reach retirement, is $2,550. The top edge of the retirement map represents their best-case scenario (if we hit home runs and do everything right) and they have a 5% chance of having $1.3M at age 90. Conversely, the bottom edge of the retirement map is their worst-case scenario (if we strike out a lot and do everything wrong) and they have a 5% chance of running out of money at age 90. The dark line represents the median, which represents the average-case scenario (if we hit to get on base).

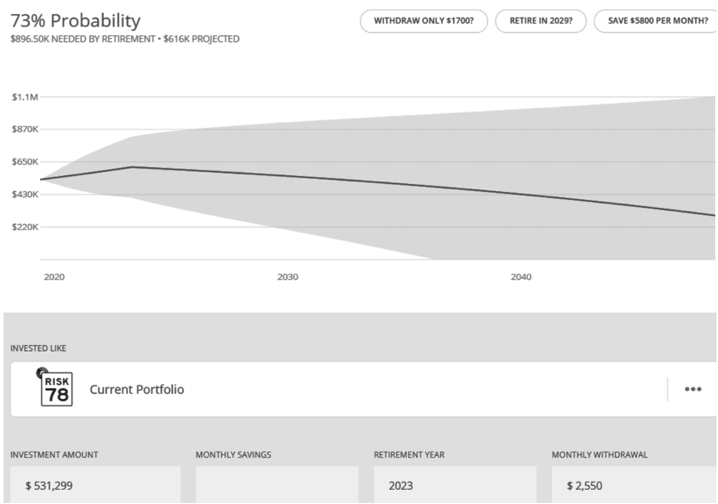
Source: Riskalyze

Take a look at what their retirement map shows with their current portfolio (see the following chart). First off, they only have a 73% probability that they can withdraw the same amount of $2,250 per month when they retire. That means that they have a 27% probability (bottom edge of the retirement map) of running out of money in 2036 when they are 78! I don't like those odds and they struck out a lot, but there are a few things they can do to bring this portfolio up to a 95% probability. They can:

1. Reduce their monthly withdrawal from $2,250 to $1,700.
   Everyone wants more to live on in retirement.

2. Work for 6 more years after 2023.
   No one wants to work longer than they must.

3. Save an extra $5,800 per month from now until they retire in 2023.
   Who wants to save more when you don't have to?



Source: Riskalyze

Stress Tests

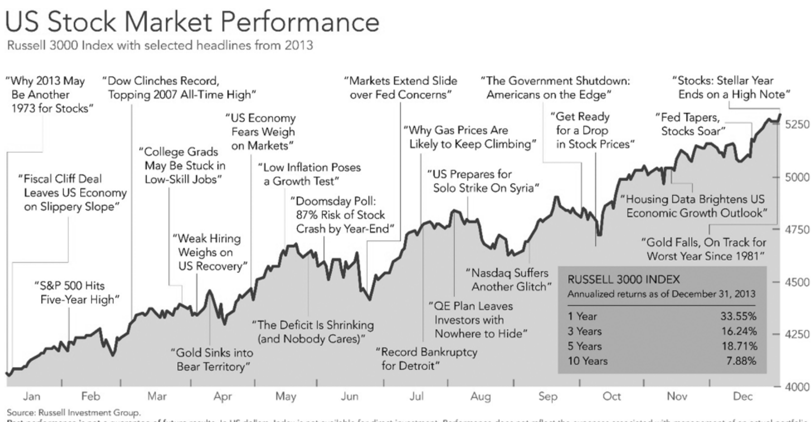
This is probably one of the most important things to consider when looking into the future. Many lived through the good times and the bad times of the market. Instead of guessing how your portfolio would behave in different market cycles, let's get a better determination so we know what to expect when these cycles kick into gear. The technology exists today to simulate how these portfolios would have performed in several different market cycles.

2013 Bull Market – Good Times

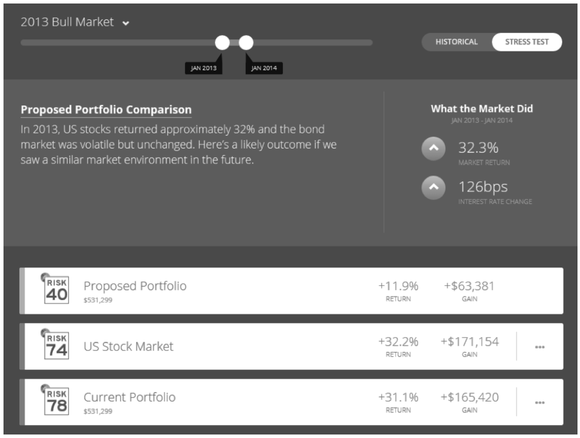
During 2013, stocks rose steadily all year, the S&P 500 had its best year since 1997 when it rose more than 32%, and the broader Russell 3000 Index (which includes both large and small company stocks) gained 33.55%.

Two retailers, namely Best Buy (BBY) and Netflix (NFLX) surged 270% in 2013. Best Buy bounced back from steep losses in 2012 because their sales turned around and after being hit hard in 2011 Netflix was near an all-time high because of strong subscriber gains and its new, original content.

Yet it wasn't all rosy in 2013. The following chart shows there was a steady chorus of worrying media headlines throughout the year. The U.S. entered the final three months of 2013 with the government closed and the economy threatened by a mandatory sequester.



As stated in the following chart from 2013, U.S. stocks returned approximately 32%, the bond market was volatile but unchanged, and interest rates increased by 1.26% over the year



Source: Riskalyze.

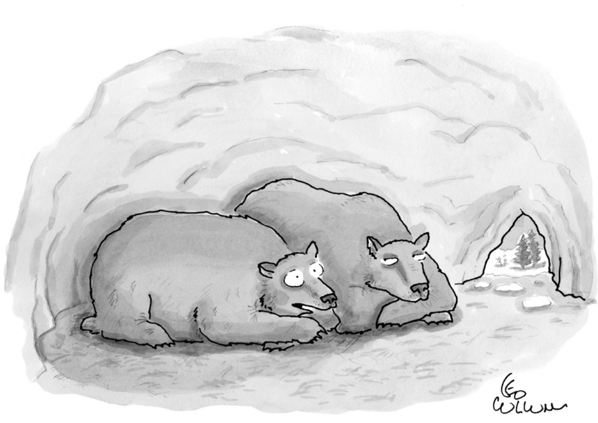
US stock market is modeled using the S&P 500 Index. Interest rate change is modeled using the 10-year treasury rate. Dollar values for model portfolios shown above represent the hypothetical performance of a $10,000 investment in that model portfolio.

The proposed portfolio with a low risk number of 40 would have returned 11.9%, while the S&P 500 returned 32.2% and their existing portfolio would have performed close to the U.S. stock market with a return of 31.1%. These returns make total sense given that their current portfolio is constructed to behave like the S&P 500. The proposed portfolio should have returned less because it has half of the risk.

2008 Bear Market – Bad Times

We all remember this period when we couldn't sleep at night and we never opened our 401(k) statements. People referred to their 401(k) plans as their 201(k) plans because it lost half of its value. Only time will tell the full story of the stock market crash of 2008, but on Monday October 6, the stock market would start a week-long decline in which the Dow would fall 1,874 points or 18.1%. While the exact cause of this crash may differ from that of 1929 or 1987, they share one common element: they all began in October. On October 9, 2007, the Dow hit its pre-recession high and closed at 14,164.43. By March 5, 2009, it had dropped more than 50% to 6,594.44.

While the stock market's 90% fall during the Great Depression took 4 years, the 2008 crash only took 18 months!



"If I knew what our 401k was doing maybe I could sleep."

During the years preceding the credit market collapse, the sub-prime mortgage industry thrived. Individuals with poor credit were given access to loans they really couldn't afford, but as long as home prices were on the rise, these poor lending practices were simply ignored. Lenders could afford to write bad loans as long as the homeowner's equity outpaced their desire for new debt. If borrowers failed to pay back their loans, lenders could always foreclose on the home, since it was an asset with ever-increasing value.

The credit market's problems began when housing prices started to fall in 2007. Homeowners frequently found that themselves with underwater loans, where they owed lenders more than their home was worth. Understanding this reality, homeowners no longer feared the threat of foreclosure and simply abandoned their homes, choosing to start a new life elsewhere rather than pay off their debt.

As mortgage defaults started to rise, the national economy started to falter, and fear crept into the credit markets. Despite the efforts of the Federal Reserve, the destabilization of the credit market quickly spread to the national financial system as lenders began to fear borrowers could no longer repay their loans. Sure enough, investment banks starting falling victim to this fear, with Bear Stearns being the first one. Investors, as well as other financial institutions, began to worry that money borrowed by Bear Stearns would not be repaid, and they began pulling money back from them. On March 13, 2008, Bear Stearns advised the Federal Reserve that its liquidity position had deteriorated, and that it would file for bankruptcy unless alternative sources of funds were made available. Two days later, Bear Stearns agreed to merge with JP Morgan Chase in a deal that wiped out 90% of Bear Stearns' market value.

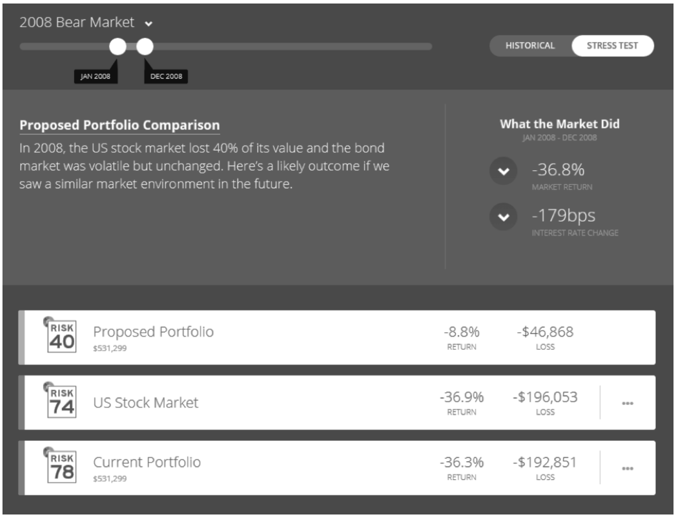
By the year 2008, the Federal National Mortgage Association ("FNMA" or "Fannie Mae") and the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac") either owned or guaranteed nearly $6 trillion in mortgage loans. With a mortgage crisis in the United States, these two corporations quickly began showing signs of financial distress. On September 7, 2008, the governing authority over these two agencies, the Federal Housing Finance Agency, or FHFA, placed both Fannie Mae and Freddie Mac under their conservatorship. In addition, the U.S. Treasury Department began supplying funds to help stabilize these companies, raising the national debt ceiling by $800 billion in the process.

On September 14, 2008, Bank of America agreed to acquire Merrill Lynch for $50 billion as a second wave of volatility began in the financial community. On September 15, 2008, concerns over the ability of financial institutions to cover their exposure in both the sub-prime loan market as well as credit default swaps led to further market instability. That same day, Lehman Brothers would be forced to file for Chapter 11 bankruptcy protection. On September 16, 2008, American International Group ("AIG") would fall victim to a liquidity crisis, as AIG's shares lost 95% of their value and the company reported a $13.2 billion loss in just the first six months of the year. By September 22, 2008, AIG was removed from the Dow and was replaced by Kraft Foods.

Although the market arguably started its crash back on October 1, 2008, the "Black Week" began on October 6th and lasted five trading sessions. During that week, the Dow would fall 1,874 points or 18.1%. In that same week, the S&P 500 would fall more than 20%. After a brief uptick in mid-October, the market would begin a second decline later in that same month. On October 24th, the Dow would fall 312.30 points to 8,378.95. This was its lowest level since April 25, 2003. The S&P 500 would fall 31.24 to 876.77, its lowest level since April 11, 2003. Finally, the Nasdaq Composite would fall 51.88 points to 1,552.03, its lowest level since May 23, 2003.

Many market theorists believe that stock market crashes feed on themselves. Once destabilization of the stock market occurs, this incident may be followed by a series of events that trigger an even larger decline in the market. One of these events has to do with investor fear (which we covered earlier in the book), and the other has to do with stop losses. Investors may reach a "loss threshold" where they are unwilling to continue to risk additional losses. Unfortunately, selling stocks well into a bear market is a good way to lock in losses, and this type of panic selling often backfires as an effective strategy to combat such losses in a down market. Additionally, investors can place stop loss orders in advance with brokers. These orders programmatically sell a security when it reaches a certain price. The intention of a stop loss order is to limit the potential decline of a security's value. During the onset of a market crash, stop loss orders can lead to a sell-off of stocks, and an even further decline in stock prices. As the market gets flooded with sell orders (from stop loss orders), the prices of the underlying stocks begin to drop rapidly as the supply of stocks overwhelms their demand.

As indicated in the following graphic, in 2008 the U.S. stock market lost almost 37% of its value and the bond market was volatile but unchanged. Interest rates decreased by 1.79% for the time period.



Source: Riskalyze.

US stock market is modeled using the S&P 500 Index. Interest rate change is modeled using the 10-year treasury rate. Dollar values for model portfolios shown above represent the hypothetical performance of a $10,000 investment in that model portfolio.

In this scenario, the proposed portfolio with a low risk number of 40 had a negative return of just -8.8%, compared to the S&P 500's loss of -36.93%. The proposed portfolio performed close to the U.S. Stock market with a loss of -36.3%. However, if you are close to retirement or in retirement, you don't have that kind of time to recoup your losses. Your lifestyle will take a significant hit under this scenario and you'd better off hitting to get on base and focusing on singles and doubles.

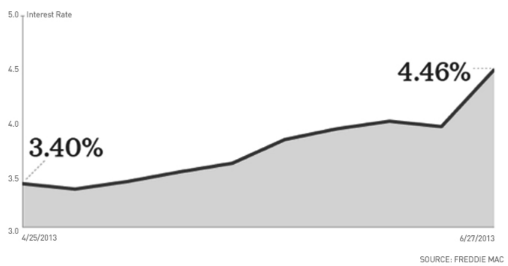
2013 Interest Rate Hike – Uncertain Times

When interest rates increase too quickly, it can cause a chain reaction that affects the domestic economy as well as the global economy. It can even create a recession in some cases, prompting the government to backtrack the increase. However, that is not a quick fix and the economy may take some time to recover from the dip.

Adjusting interest rates is one way that the Federal Reserve ("Fed") can encourage employment and keep prices stable in an economy. Interest rates have an impact on everything from home mortgage prices to the ability of a business to expand through financing. If interest rates go too high or are pushed higher than what people and companies can readily afford, spending could stop. In this sense, higher interest rates could mean that a person may not be able to get a loan to purchase a house on favorable terms, or that a company will lay workers off instead of financing payroll during a downturn.

When the Fed raises the federal funds rate, the cost of borrowing goes up too, and this increase starts a series of cascading effects. Consequently, banks raise their interest rates for consumers and businesses, and it costs more to buy a home or finance a company. In turn, the economy slows down as people spend less.

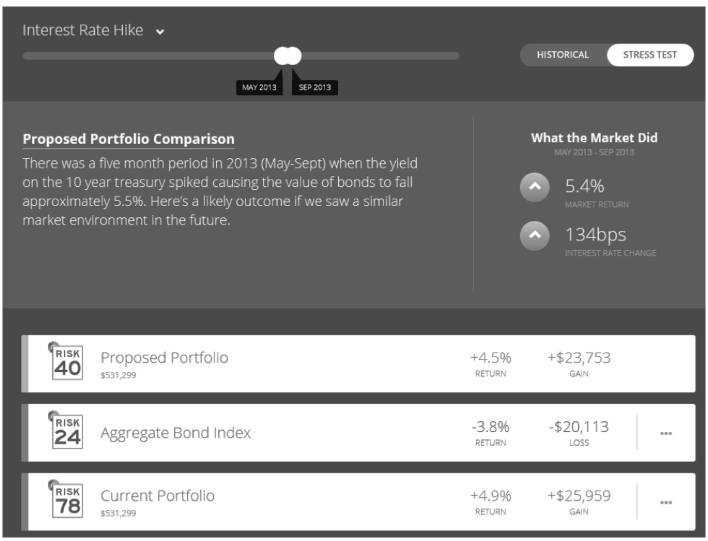
The 30 year loan, which stood at 3.35% in early May, was at its highest level since July 2011. Rates for 15 year loans, popular with homeowners refinancing their mortgages, jumped 0.46% to 3.5%. Rates on 30 year, fixed-rate home loans spiked 0.53% to an average of 4.46% in one week in late June 2013, which was the largest weekly increase in more than 26 years, as was reported by mortgage giant Freddie Mac.



An extra percentage in home loan rates cost homeowners with a 30 year fixed-rate mortgage $56 more a month for every $100,000 they borrowed. The sudden jump in rates was driven by uncertainty over whether the Federal Reserve's economic stimulus program, called quantitative easing ("QE"), would continue.

The consensus thinking back in 2013 was that the only direction for interest rates to move was up. The big jumps in interest rates were largely driven by the housing market's strong recovery, which led the Fed to talk about scaling back its monthly purchases of Treasury on mortgage bonds sooner than expected. The Fed launched the bond-purchasing program during the worst of the financial crisis in 2008 to help lower long-term interest rates and stimulate economic activity.

As stated below, there was a five-month period in 2013 (May – September) when the yield on the 10 year treasury spiked causing the value of bonds to fall approximately 5.5%. Interest rates increased by 1.34% for the time period.



Source: Riskalyze.

US stock market is modeled using the S&P 500 Index. Interest rate change is modeled using the 10-year treasury rate. Dollar values for model portfolios shown above represent the hypothetical performance of a $10,000 investment in that model portfolio.

It is worth noting that both portfolios did well in a rising interest rate environment because the driving force behind them is that they were both well diversified across equities and bonds. While the bond allocation had a negative return, the equity portion had a positive return and more than made up for the loss in bonds.

The Results

2013 Bull Market – Good Times (Hitting Home Runs)

Before we get to the results, let's look at the home run hitters in baseball to draw a comparison. In Major League Baseball ("MLB"), the "50 home run club" is the group of batters who have hit 50 or more home runs in a single season. Babe Ruth was the first to achieve this, doing so in 1920. Ruth subsequently became the first player to reach the 50 home run club on four occasions, repeating the achievement in 1921, 1927 and 1928. He remained the only player to accomplish this until Mark McGwire and Sammy Sosa matched his feat in 1999 and 2001, thus becoming the only players to achieve four consecutive 50 home run seasons. Barry Bonds hit the most home runs to join the club, collecting 73 in 2001. In total, 30 players have reached the 50 home run club in MLB history and nine have done so more than once.

The 2013 Bull Market can be compared to the 50 home run club in that anything invested in did well. In other words, we were on that top 5% top edge of the retirement map when everything was going right and we were hitting countless home runs. However, we all know that only a few hitters in baseball ever made it to the 50 home run club as it′s an unsustainable and short-lived goal for most. Similar to this elite club within the MLB, the bull market in our economy is also unsustainable and short-lived.

2008 Bear Market – Bad Times (Striking Out)

On the surface, the mechanics of hitting a baseball seem straightforward: keep your eyes on the ball and swing. However, when you investigate the physics behind what is happening when a batter gets a hit, you find that it's a bit more complicated — and quite impressive. For instance, consider the act of hitting an MLB-level fastball when the ball is traveling in excess of 90 mph and spinning around 20 times per second.

The distance between the pitcher and the batter is 60 feet and 6 inches. The average MLB fastball covers that distance in between .30 and .50 of a second, which is about the same time to snap your fingers. That's how much time a hitter must assess the pitch and decide whether to swing. As an added frame of reference, it takes .30 of a second to blink. On top of that, the hitter is trying to hit a round ball with a round bat, squarely. Exceptional eyesight, concentration, experience, and quick reflexes are needed to hit a baseball at the MLB level. The average hitter needs about 50 milliseconds to instinctively hit the baseball, 7 milliseconds too early or 7 milliseconds too late and it's likely a foul ball.

Knowing that, it is no wonder why it is so hard to become an MLB player and not strike out a lot. This is a lot like the 2008 bear market. Nothing was going right, and every investment went down. It represents the bottom-edge of the retirement map when everything is going wrong.

2013 Interest Rate Hike – Uncertain Times (Getting on Base)

Baseball fans are probably familiar with the story about the Oakland A's General Manager Billy Beane[41], upon which the film *Moneyball*[42] was based. Beane placed the emphasis on the body of the athlete or the physical tools that the athlete possessed. His theory illustrated the simplicity of baseball by asking two questions: Can the player hit, and does he get on base? Beane decided to base his drafting of position players/hitters on very specific statistics: on-base percentage ("OBP") and slugging percentage. These two stats combined to form a new statistic called on-base plus slugging ("OPS"). Another unique aspect in Beane's approach was his lack of emphasis on power as he believed that power could be developed, whereas patience at the plate and the ability to get on base could not.

Billy Beane believed that when putting together a lineup, managers must decide the best order in which the team has the best chance of winning and to win the game you must score more runs than the opposing team. This philosophy then begged the question why then was such great importance placed on batting average rather than on runs scored? He believed that a hitter's job was not to compile a high batting average, but to maintain a high on-base percentage. Beane believed that the job of a hitter was to create runs.

When new ownership eventually took over the A's, they ordered the team to slash payroll. To field a competitive roster on a limited budget, Beane began employing his philosophy and focused on obtaining undervalued players. He molded the A's into one of the most cost-effective teams in baseball. For example, in the 2006 MLB season, the Athletics ranked 24th. of 30 major league teams in player salaries but had the 5th best regular-season record. The Athletics reached the playoffs in four consecutive years from 2000 through 2003 and they became the first team in the 100+ years of American League baseball to win 20 consecutive games. Consequently, they won their first playoff series under Beane in 2006 when they swept the Minnesota Twins in the American League Division Series.

The point of that baseball example is that it represents the median case of the retirement map and it's more important to get on base, hitting singles and doubles, than swinging for the fences. When there is uncertainty in the market, it is better to focus on defensive measures than taking on a lot of risk. You don't know which way the market is going to turn, so it's better to protect the downside with smart strategies and look for incremental gains wherever you can.

The Better Financial Outcome

Stress Test	Current Portfolio	Proposed Portfolio	Market
2013 Bull Market	$165,420	$63,381	$171,154
2008 Bear Market	-$192,851	-$46,868	-$196,053
Interest Rate Hike	$25,959	$23,753	-$20,113
Total	-$1,472	$40,266	-$45,012

Source: Redhawk Wealth Advisors, Inc.

Let's tally up how the current and proposed portfolio did during these times frames, which are extreme conditions and reflect the best and worst of markets. The bottom line is that the proposed portfolio endured the best return with the lowest risk number. As we've already discussed in this book, just because a portfolio has more risk doesn't mean that it will outperform a portfolio with a lower risk.

Scorecard

For those of you that want to dig deeper and look at more data, let's look at the following scorecard which shows a side-by-side comparison of the current and proposed portfolio. It also includes information on the S&P 500 as a reference point. The starred boxes are the better numbers between the two portfolios.

Client Assumptions		
Maximum Monthly Withdrawal at Retirement	$2,550	
Retirement Year	2023	
Monthly Savings Until Retirement	$0	
Client Risk Score	45	
Investable Assets	$531,299	
95% Probability of a Loss Over the Next 6 Months	-8.00%	($42,504)
95% Probability of a Gain Over the Next 6 Months	13.00%	$69,069

Portfolio Comparison	Current	Redhawk		S&P 500
Portfolio Risk Score	78	* 40		75
95% Probability of a Loss Over the Next 6 Months (%)	-17.60%	-6.80%		-16.82%
95% Probability of a Loss Over the Next 6 Months ($)	($93,560)	($35,984)		($89,364)
95% Probability of a Gain Over the Next 6 Months (%)	23.30%	13.00%		24.08%
95% Probability of a Gain Over the Next 6 Months ($)	$123,834	$68,978		$127,937
Stocks Allocation	90%	28%		100%
Bonds Allocation	3%	57%		0%
Cash Allocation	6%	4%		0%
Other Allocation	1%	11%		0%
Bubble Score	65.56	* 92.94		85.26
Funds Average Expense Ratio	0.84%	* 0.27%		N/A
Potential Annual Return	5.70%	* 6.21%		7.26%
3-Year Upside Capture Ratio	* 99.41%	75.17%		99.47%
3-Year Downside Capture Ratio	93.45%	* 35.65%		99.84%
Annual Dividend	1.16%	* 3.56%		1.85%
3-Year Alpha	0.06%	* 1.94%		-0.07%
3-Year Sharpe Ratio	* 0.77%	0.67%		1.21%
Assets Needed at Retirement Date	$896,500	* $601,400		
Legacy Assets	$290,000	* $440,000		
Retirement Probability	73%	* 95%		

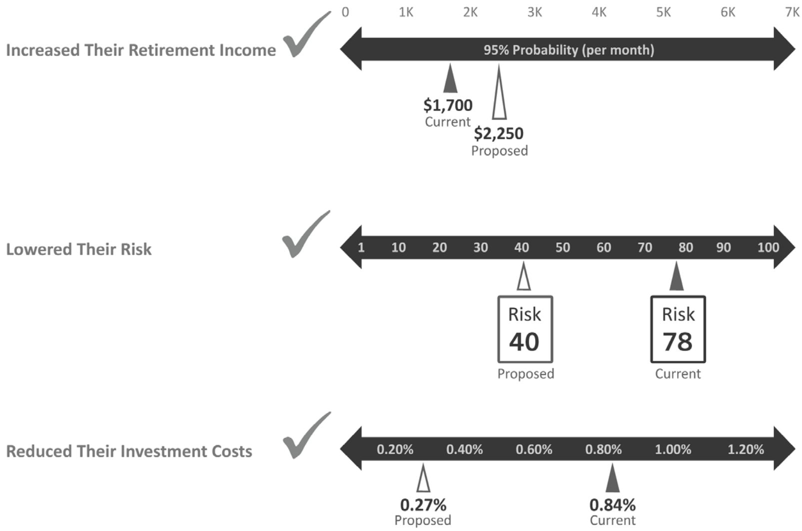
Investment returns represent past performance and do not guarantee future results. The performance results represent percentage changes in net asset value assuming the reinvestment of capital gains and dividends. The performance results do not include front-end sales charges, rear-end sales charges, advisory fees, or the effects of taxation. Investment returns for periods equaling 1-year or longer are annualized. Ongoing deposits and/or transfers are not calculated in the performance history.

Investment returns and principal fluctuate with changes in interest rates and other market conditions. Your account value may be worth more or less than the total deposits at the time of liquidation. Carefully consider the investment's objectives, risks, charges, and expenses before investing. Prospectuses containing information about each fund can be obtained by contacting your financial adviser. You should read the prospectus carefully prior to investing to be certain the investment is suitable for your goals and tolerance standards.

Performance history is based on current holdings and current allocations as of the date of this report. This report represents the weighted performance of all investments based on a proportional allocation of each investment's performance relative to its percentage of the total assets.

Source: Redhawk Wealth Advisors, Inc. with information provided by Riskalyze and The Evaluator.

By reviewing this case study, you can see how the FiduciaryShield process works and provides better financial outcomes. Let's see how we did:



In short, we were able to accomplish all three of the "Better Financial Outcome" objectives. As Billy Beane taught us, it's always better to get on base than to swing for home runs.

CHAPTER 9

Taking Action.

At this point, you're probably eager to put this guide in place to create your own better financial outcome. Taking action is certainly not an easy step and it will come with many trials and tribulations. The key to success is to just get started.

Implementing a plan is the step where the rubber meets the road. During the implementation don't lose momentum, as it can be very tempting to let things slide. I can't stress enough how important it is to find the right financial advisor first — they will keep your financial outcome front and center while keeping you focused.

Your financial advisor will go over their planning process, ensure that your vision is considered, and modify their implementation process to fit your needs. I personally find it much easier to break down what is needed into manageable chunks. The key is to buckle down and get it done in the way that works best for you.

This chapter is a summary that ties together most of what's already been covered in this book. At Redhawk we believe the following three steps are the most efficient ways to get the fastest results for our clients:

Step 1. Find a Financial Advisor Who is a Fiduciary.

This is the most important step because following it will make everything else in the process easier. You want to make sure the advisor is a good fit as this will create an ongoing relationship and help your advisor to help maintain your financial goals throughout the partnership. Keep in mind that it is critical the financial advisor acts in a fiduciary capacity and has your best interest in mind, not their own. Find a financial advisor near you by visiting www.redhawkwa.com and click on "Find an Advisor." It's simple and easy and all our financial advisors are committed to following the FiduciaryShield promise.

Step 2: Develop a Comprehensive Financial Plan.

Using your goals, financial situation, and financial data, your chosen advisor will create a personalized and comprehensive plan. They will also help you implement this plan using applications and financial planning tools.

This plan will also include your investment policy statement, investment philosophy, and investments that will give you the best opportunity to achieve your goals. During this step, if you need estate planning, your financial advisor will coordinate with your attorney to make sure it gets done. If you need insurance, they will make sure you get it. Your financial advisor will ensure you have a solid investment portfolio that is diversified and professionally managed. This is your road map to a better financial outcome.

Step 3: Monitor and Adjust

All that being said, the very best financial plan is worthless if it isn't monitored correctly. As time goes by, circumstances change — and so should your plan. Today's goal may not be the same as tomorrow's dream. This is why it is important to review your goals and objectives on a regular basis with planning reviews and ongoing monitoring. As your life unfolds, new things become more important to you.

Remember to be reasonable with yourself and don't try and tackle the whole thing in one go. This is a process that you will follow for your lifetime.

With time, effort, and the right financial advisor, you can reach your goals more quickly and develop peace of mind. While it's easy to get bogged down in the process, stay focused on your end goals — the *why* of what you're doing. The right financial advisor will keep those goals front and center to make this process work for you.

If you have any questions or want help, please call Redhawk Wealth Advisors, Inc. at (952) 835-4295 or email info@redhawkwa.com.

EPILOGUE

The Pandemic That Changed Everything.

It's been said that when you buy electronics you are purchasing something that is already outdated. I finally finished writing this book and it was in the process of being published — then the coronavirus pandemic hit. The book on which I have spent so much time and effort researching and writing was in danger of being outdated. Therefore, I have provided updated facts and relevant perspectives on how the coronavirus has, and will continue to have, an impact on your investment decisions and retirement plans.

Prior to writing this epilogue, no one knew for certain what the world would look like in the aftermath of the pandemic that has upended, and ended, so many lives. One thing is certain: it has forever impacted the way people work, live, and assess their finances. As a company founded in the wake of the 2008 financial crisis, Redhawk knows market turbulence is an inevitable part of a long-term investment strategy. We also understand that the emotional wear and tear of rocky markets can make it even more challenging to stomach.

Impact on Investors

The coronavirus posed (and still poses at this writing) a threat not only to people's health and financial well-being, but to derail your future retirement security as well. The dilemma that we are facing is that the entire world is looking for balance between implementing public health measures, offering fiscal and monetary stimulus, and closing and opening economies. Pre-coronavirus, everyone struggled to save for retirement because many were juggling high housing costs, student loan payments, and credit card debt. Add in a global pandemic, record unemployment, and an economic lock down, and a retirement crisis was quickly born.

Many Americans were already underprepared for retirement, not having saved enough for their futures by the time they were ready to leave the workforce. The global pandemic will most likely make it even harder for many to afford retirement now. At the mid-June 2020 point of the outbreak 38.6 million U.S. workers had filed for unemployment benefits[1]. That is roughly one out of every four people who were working before the pandemic hit. The official unemployment rate was 14.7% in April, which was the highest since the tail end of the Great Depression.

In just a few short months, coronavirus wreaked havoc on retirement financial security:

- Non-essential businesses were forced to shut down and employees were either furloughed, laid-off, or worked from home.
- People that were unemployed could not contribute to their workplace retirement plan or receive company matching contributions.
- People that lived from paycheck to paycheck did not have any extra money put away to weather the storm.
- People had to take distributions or loans from their retirement plans, which lowered their potential returns in the long run.
- Assets significantly declined in personal and retirement plan accounts.

- Many large employers decided to suspend matching contributions to retirement plans including Amtrak, Marriott, Macy's, La-Z-Boy, Expedia, Hilton, and Best-Buy. As of late April 2020, 12% of 816 companies representing 12 million workers had suspended matching contributions, according to a Willis Towers Watson survey. An additional 23% said they will or may halt them later in the year.
- Some workers were forced into retirement and started claiming Social Security benefits earlier than anticipated. When people claim before their "Full Retirement Age," they receive less in payments than if they had waited.

It is not all doom and gloom, however. Yes, the coronavirus hit the entire country and retirement savers hard, but I believe many will bounce back, just as investors have after past recessions. It is important to look where people stand today versus previous years.

Current retirees age 70 and older have 62% more in retirement savings than the same demographic did in 2007, the year prior to the Great Recession[2]. People between ages 55 and 69 have 19% more saved than the same age group did in 2007. The youngest group, those under 40, have 34% more in savings. The only group that is not faring as well are those between ages 40 and 54, who see only a 1% increase in retirement savings.

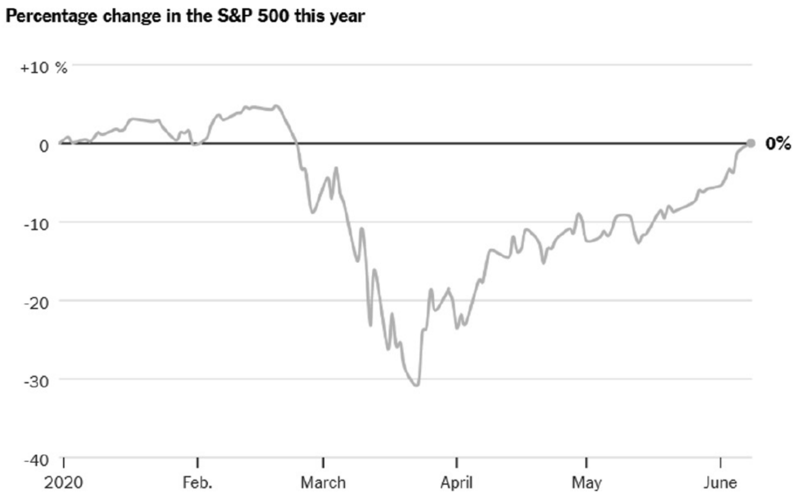
If you were planning on retiring in the midst of the pandemic, you could continue to do so as long as you've been planning for this retirement date and kept to your financial plans. If you are not quite ready to retire but are suffering from consequences of the coronavirus crisis, you should organize your finances, assess how much you will need in cash flow during retirement, create short-term plans for finding new jobs, and review your portfolio asset allocation.

Impact on the U.S. Financial Markets

Between March 4 and March 11, 2020, the S&P 500 index dropped by 12%, landing in bear market territory. On March 12, 2020, the S&P 500 plunged 9.5%, its steepest one-day fall since 1987. Stock markets have plunged in the wake of the coronavirus pandemic, with investors fearing that its spread will destroy economic growth. Supported by figures that suggested cases were leveling off in China, investors were initially optimistic about the virus being contained. However, confidence in the market started to wane as the number of cases increased worldwide. Investors have been deterred from buying stocks, and this was reflected in the initial downward spiral of the markets.

A bear market occurs when the value of a stock market suffers a prolonged decline of more than 20% over a period of at least two months. Concerns over the impact of the coronavirus pandemic has led to the current downward market trend. The S&P 500 achieved a record closing high of 3,386 on February 19, 2020. However, just over three weeks later the S&P 500 closed at 2,480, which represented a decline of around 26% in only 16 sessions.

Fast forward three months from that February and we are back to where we started (see the following chart). On June 8, 2020, the S&P 500 climbed back above where it began the year before the pandemic brought the United States economy to a standstill. After an initial few weeks of volatility when the market dropped 34%, it seems to have become resistant to bad news. On April 29, 2020 when the Commerce Department announced that the economy shrank at a nearly 5% annual rate (its fastest drop since the 2008 recession) stocks rose 2.7%. When the Bureau of Labor Statistics published what was essentially the worst employment report on record which showed that more than 20 million jobs were lost in April 2020 driving unemployment to 14.7% (the highest since the Great Depression) — stocks rose 1.7%.



Source: Refinitiv • Year-to-date change from close of trading on Dec 31. 2019

So, why did the markets snap back so quickly?

1. Mostly due to the swift actions of the federal government. Early on, the Federal Reserve flexed its financial muscle by providing liquidity into the markets and used its emergency lending powers to buy assets from municipal and corporate debt. The Fed also began purchasing government-backed bonds through a newly unlimited buying campaign, which had the effect of keeping bond prices up and yields low, which move in the opposite direction of prices. These actions convinced investors to look for better returns and they continued to invest in the stock market.

2. The renewed positive outlook, bordering on euphoria, for the economy as the states re-opened and activities started to return to a sense of normalcy. Many of the companies that were hit hardest by the pandemic, such as the leisure and travel industries, came roaring back and outperformed several of the growth orientated technology companies.

March 23, 2020 was the low point in the markets since the coronavirus began, yet the Dow Jones industrial average has soared 48%. The Nasdaq composite index, which is heavily weighted toward technology, is up 45% and closed at a record high on June 8, 2020 as investors felt that Amazon and Microsoft were well positioned to benefit from stay-at-home orders around the country. In addition, the S&P 500 is also up nearly 45% as of this writing.

There still looms a vast amount of uncertainty in the market that must be played out before we may be out of the woods:

1. Since the Fed first took steps to stabilize the markets in March, it has created roughly $2.9 trillion in stimulus, the vast majority of which has gone into financial markets. Additionally, the federal government borrowed a record-breaking $3 trillion from April 2020 to June 2020, much of which was channeled to businesses and consumers to keep them afloat during the shutdown. An over-arching concern is how the Fed will reduce this enormous amount of debt? Will it lead to runaway inflation?

2. Wall Street analysts do not expect that corporate profits for S&P 500 companies will return to 2019 levels until 2021. But the market rally has effectively already priced in all those gains (some say in part) because of the government's actions. Even after accounting for the government's support, there are significant risks facing investors that could stop S&P 500 companies from generating the profits they did before the virus.

3. Economic and political tensions between the United States and China, also remain high after the two economic superpowers engaged in a disruptive on-again-off-again trade war for the last two years. A renewed flurry of tariffs could further complicate the recovery for large American corporations as well as the global economy. Such tensions may also be more likely to re-emerge ahead of what could be a contentious presidential election in November 2020.

4. It is anticipated that there will be many enterprises that go out of business. This will prolong the high unemployment until those workers are reemployed in new jobs.

5. Then, there is the prospect of a second wave of the pandemic in September of 2020. This could set back the economy yet again.

How did our risk management algorithms behave?

My mom always used to say that the proof is in the pudding. What does that really mean? According to the Cambridge Dictionary the English adage, "The proof of the pudding is in the eating" or (like we Americans know it), "The proof is in the pudding", means that you can only judge the quality of something after you have tried, used, or experienced it. So, in relating this saying back to our investment process, how did it work?

Earlier in this book, I went over our three levels of algorithms that are used when managing portfolios:

Level 1: Macro Algorithms based on the VIX.

This is the most important algorithm because it signals when to get out of the market and go on the defensive. There are three modes at this level:

1. Risk On – when the portfolios are fully invested in the market.

2. Risk Watch – when the market is experiencing volatility and the risk off signal has tripped, but not enough to go into full risk off mode.

3. Risk Off – when the portfolios move into defensive mode and invest in non-correlated asset classes such as treasuries, consumer staples, utilities, gold, and healthcare.

Level 2: Asset Class Algorithms based on Momentum.

When the macro algorithm is "risk on," the portfolios are fully invested in equities and in the best performing asset classes. In other words, those asset classes that are experiencing the greatest positive momentum. When the macro algorithm is "risk off" the portfolios are invested in the non-correlated asset classes that have the most positive momentum.

Level 3: Fund Algorithms based on Performance.

Once the asset classes with the most positive momentum have been determined, the portfolios are invested in the best performing funds that are in that asset class.

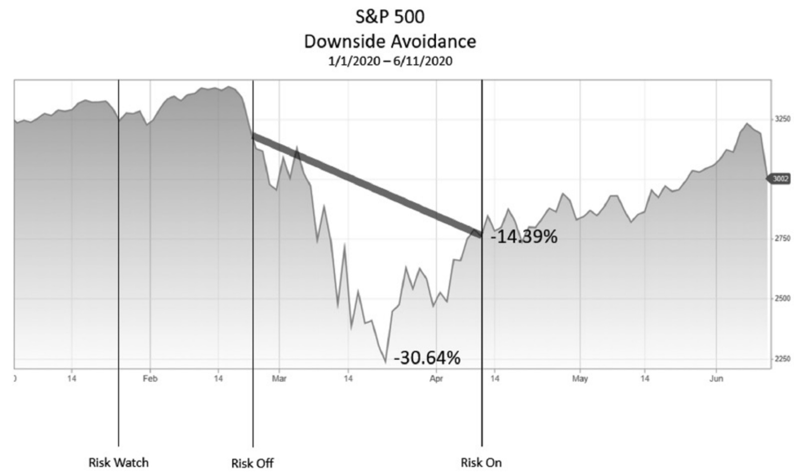
Let's see how the risk management algorithms behaved.

Date	Risk Management Mode	VIX Close	S&P 500 Close	S&P 500 Downside Avoidance	Comments
1/27/2020	**Risk Watch**	18.23	3,243.63		
2/19/2020	Risk Watch	14.38	3,386.15		S&P 500 reached its all-time high.
2/24/2020	**Risk Off**	25.03	3,225.89		
3/16/2020	Risk Off	82.69	2,386.13		VIX reached its all-time high.
3/23/2020	Risk Off	61.59	2,237.40	-30.64%	S&P 500 closed at its lowest level during the pandemic.
4/13/2020	**Risk On**	41.17	2,761.63	-14.39%	

Source: S&P 500 and VIX data from Yahoo Finance. • Note: S&P 500 Downside Avoidance represents the downside the S&P 500 incurred during the "risk off" period starting on 2/24/2020.

Note the markets were very volatile during this period with the VIX ranging from 25.03 to 82.69. The VIX reached its highest level on 3/16/2020 when it hit 82.69. This was the highest reading for the VIX since 11/20/2008 when it closed at 80.86, which was at its highest during the financial crisis.

As you can see in the following diagram, the S&P 500 reached its all-time high on 2/19/2020. Then on 3/23/2020, the S&P 500 reached its lowest point during the pandemic. The "risk off" algorithm tripped on 2/24/2020 and the S&P 500 had a 30.64% downside when the S&P 500 was at its lowest during the pandemic and a 14.39% downside when the algorithms tripped back to "risk on."



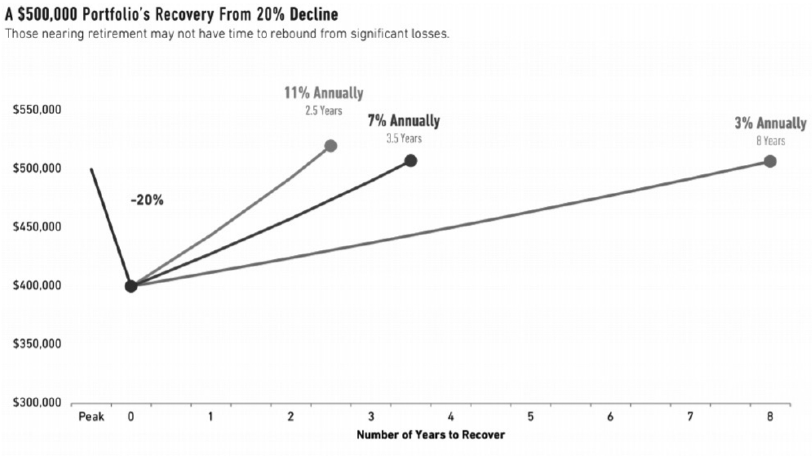
Source: CNBC.com

The markets are always forward-looking, and discounts or rewards are based on anticipated headwinds and tailwinds. The markets become extremely volatile when uncertainty exists and is difficult to measure. During the pandemic stocks swung wildly often suggesting a disconnect with the terrible economic and public health news of the moment. A steady hand is necessary to navigate troubled markets, and we will continue to monitor the market and err on the side of caution and downside risk management.

Why am I so focused on downside risk management?

Basic math. You may retire after a lifetime of hard work just as the market falls. An investment portfolio subject to market returns would therefore be negatively impacted, and the potential effect could come as a shock.

For example: a loss of 10% requires an 11% gain to recover, which is quite manageable. However, as the loss grows, the size of the return needed to recover increases at a faster pace. Indeed, a 50% loss requires a 100% gain to recover and an 80% loss requires a 400% percent gain just to get back to even (see the following chart) [3].



Source: 361 Capital

It would be bad luck that as you begin retirement and start withdrawing assets for day-to-day living expenses the value of your portfolio decreases. Too many investors fail to realize that it is not only about the loss of your investments, but also the loss of time in which to make them back. What the cold-hearted math of stock market losses makes painfully clear is that you need to protect your investments against big losses.

Acknowledgements

1. Scott Horsley, NPR, "38.6 Million Have Filed for Unemployment Since March," May 21, 2020.https://www.npr.org/sections/coronavirus-live-updates/2020/05/21/859836248/38-6-million-have-filed-for-unemployment-since-march.

2. Alessandra Malito, MarketWatch, "here Comes the Retirement Crisis, coronavirus-style," April 18, 2020. https://www.marketwatch.com/story/will-covid-19-deepen-the-retirement-crisis-yes-and-no-heres-how-2020-04-17.

3. "Returns Needed to Recover a Stock Market Loss," Zacks.com

APPENDIX

Fiduciary Process: Favorable Opinion Letter

Though I've written in detail about Redhawk's process throughout this book, I understand that an objective, third party opinion can often be more helpful when analyzing and reviewing a company's procedures. Therefore, I included a favorable opinion letter Redhawk received from The Wagner Law Group[43] in 2017, who reviewed our fiduciary process and summarized their findings.

The Wagner Law Group is a nationally recognized practice in the areas of ERISA and employee benefits, which includes the distinct areas of Fiduciary Compliance, Retirement Plans, ESOPs, Executive Compensation & Non-qualified Plans, Welfare Benefit Plans and PBGC, as well as Employment, Labor & Human Resources, Investment Management, Trusts & Estates, Litigation, Family, Corporate & Commercial and Real Estate Law. Established in 1996 by Marcia S. Wagner, The Wagner Law Group is dedicated to the highest standards of integrity, excellence and thought leadership and is amongst the nation's premier ERISA and employee benefits law firms.

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June 14, 2017

By E-mail: Rick@RedhawkWA.com
and U.S. Mail

Mr. Rick Keast
President
Redhawk Wealth Advisors, Inc.
7700 France Avenue, Suite 430
Minneapolis, MN 55435

Re: Opinion for Redhawk Wealth Advisors, Inc.

Ladies and Gentlemen:

Redhawk Wealth Advisors, Inc. ("Redhawk") is a full-service registered investment advisory firm formed in 2008 and headquartered in Minneapolis, MN. Redhawk works with over 500 financial advisors in 47 states who offer wealth advisory and retirement plan services. While the Redhawk is not a broker-dealer firm, it has established many broker-dealer partnerships.

Redhawk has developed its own custom proprietary multi-step fiduciary services process (the "Fiduciary Process") which is currently utilized by its individual advisor representatives ("IARs") as well as the registered representatives of the broker-dealer firms with which Redhawk has formed partnerships ("Reps"). The IARs and Reps use the Fiduciary Process when they act as fiduciaries to retirement plans covered by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Redhawk is making the Fiduciary Process available to IARs and Reps when they provide investment advice services to individuals with one or more individual retirement accounts ("IRAs"). The IARs and the Reps intend to charge a levelized fee for such services to IRAs.

On April 8, 2016, the U.S. Department of Labor (the "DOL") issued new regulatory guidance (the "Fiduciary Rule") under ERISA with the goal of broadening the scope of advisors who will be deemed fiduciaries when advising retirement clients, including IRA owners, with

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respect to their retirement accounts. The Fiduciary Rule had a delayed applicability date that was to go into effect on April 10, 2017. The President, by Memorandum to the Secretary of Labor dated February 3, 2017, directed the DOL to examine the Fiduciary Rule. On March 2, 2017, the DOL published a notice seeking public comments on, among other things, the proposal to adopt a 60-day delay to the applicability date of the Fiduciary Rule. This culminated in the April 7, 2017 publication of a final rule ("Delay Rule"), which formally extended the applicability date of the Fiduciary Rule and the related exemptions, including the Best Interest Contract Exemption ("BICE"), to June 9, 2017. Beginning on June 9, 2017, virtually all financial institutions offering investment-related services to retirement clients through their advisors will be deemed to be fiduciary investment advisors under the Fiduciary Rule. The BICE and related exemptions will have limited applicability during the new and shortened transition period from June 9, 2017 to January 1, 2018 with full implementation thereafter.

The Fiduciary Process is currently being used by Redhawk's IARs and Reps when providing fiduciary services to ERISA-covered retirement plans. You have asked for our views as to whether the Fiduciary Process, when used by IARs and Reps in advising IRA owners, will protect the IARs, the Reps, and Redhawk against fiduciary risk and any related fiduciary liability arising as a result of the application of the Fiduciary Rule or the BICE.

I. EXECUTIVE SUMMARY OF ANALYSIS AND CONCLUSIONS

- ***Impact of Fiduciary Rule on Firms and Their Advisors***. Virtually all broker-dealers and their registered representatives, registered investment advisers and their individual adviser representatives, and insurance companies and their agents (collectively, "Firms" at the institutional level or "Advisors" at the individual representative level) who provide investment-related services to retirement clients will be deemed fiduciary advisors as a result of the application of the Fiduciary Rule, which is applicable on June 9, 2017. As fiduciary advisors, Firms and their Advisors will be prohibited from earning commissions or other forms of variable compensation, when giving advice subject to ERISA, unless they qualify for a DOL exemption, such as Prohibited Transaction Exemption 2016-01 ("PTE 2016-01"), which is also called the BICE.

- ***Best Interest Standard of Care***. As required under the BICE, any fiduciary investment advice, where exemptive relief under the BICE is needed, that is provided by a Firm's Advisor to a retirement client, must meet the "Best Interest Standard of Care." This means that such advice must be provided: (i) with the care, skill, prudence and diligence that a prudent person who is familiar with such matters would use, (ii) based on the investment objectives, risk tolerance, financial circumstances, and needs of the client, and (iii) without regard to the interests of the Firm or the Advisor. Additionally, the Advisor must give appropriate consideration to the client's needs and objectives, and to whether or not the recommended investment is reasonably designed to meet these needs and objectives.

- ***Uncertainty of Fiduciary Rule and Related Exemptions.*** Despite the uncertainty around the Fiduciary Rule and the exemptions and regardless of whether they are repealed or modified, the policy discussions on this topic in recent years have raised the profile of best

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interest investment advice. Heightened fiduciary standards with respect to retirement investing are now squarely in the public arena. In our view, the BICE's "Best Interest Standard of Care," or a standard substantially similar to it, will continue to be relevant to Firms and their Advisors after the dust settles.

- ***Using Redhawk's Fiduciary Process to Meet Best Interest Standard of Care***. The BICE does not expressly approve of any particular type of questionnaire or process to follow in order to meet the Best Interest Standard of Care. **However, a process that gathers information as to the IRA owner's risk tolerance, financial goals, and retirement horizon and quantifies the risk tolerance while matching it to an appropriate investment strategy that is consistent with the IRA owner's wishes as to risk and retirement goals, would assist the IAR or Rep in satisfying its duty to act with the care, skill, prudence, and diligence of a prudent expert under the BICE's Best Interest Standard of Care.** By responding to a number of questions in the risk questionnaire about the IRA owner's retirement goals and risk tolerance, and then applying technology such as Riskalyze to quantify both the IRA owner's preferred risk level and that of the targeted portfolio, the Fiduciary Process would help IARs and Reps elicit key information in accordance with their fiduciary duty of prudence, enabling the IAR or Rep to give appropriate consideration to the retirement client's needs and objectives. The objectively determined investment lineup created by E-Valuator, which scores the performance of investments based on their benchmark and takes into account the client's responses, would also enable the IAR and Rep to give investment recommendations reasonably designed to meet the IRA owner's needs and objectives.

II. FACTUAL OVERVIEW OF REDHAWK'S FIDUCIARY PROCESS

The first step in the Fiduciary Process is to determine the investor client's "risk number." The client completes a risk questionnaire, the purpose of which is to help determine his or her risk tolerance, investment goals, and retirement horizon. Based on the answers provided in the questionnaire, the IAR or Rep uses an advanced quantitative risk technology called Riskalyze to identify the investor's "risk number." The risk number is a number that falls within a range of 1 to 99 and measures the client's "six month comfort zone" – that is, his or her comfort level relating to potential losses and potential gains over a six-month period. A higher number indicates that the client has a greater comfort with higher risk, while a lower number indicates that the client is more conservative. For example, a risk number of 53 for a client with a portfolio of $750,000, indicates that the client is comfortable risking a loss of -10% or -$74,827, in exchange for the chance of making a gain of +16% or $117,793. This represents the hypothetical target that the client would prefer to keep his or her investments within. With this information, the IAR or Rep can build a customized investment strategy and portfolio that contains just the appropriate level of risk for the investor.

The second step involves comparing the investor client's risk number to his or her existing investment portfolio. The IAR or Rep employs Riskalyze in this step as well to assign a risk number from 1 to 99 to the client's existing portfolio of investments. By comparing the client's

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risk number to the risk number of the existing portfolio, the IAR or Rep can identify any discrepancy between the client's risk level in the current portfolio versus the risk level that the client prefers. To continue the example from the above paragraph, a risk discrepancy exists when the client's risk number is 53 and the risk number of his or her existing portfolio is 78. In this case, the client's current investments are riskier than the client has indicated he or she prefers.

The third step in the Fiduciary Process involves reviewing the performance of the client's existing portfolio. Here, the IAR or Rep will not automatically assume that a new portfolio needs to be built from scratch. Rather, the IAR or Rep will use Redhawk's proprietary E-Valuator to review and score the client's existing portfolio to determine which investments, if any, should be kept as well as investments that need to be replaced. E-Valuator scores the existing investment funds based on how they perform against their respective benchmarks, and also takes into account the client's risk tolerance as represented by his or her risk number. It also generates a report that identifies the assets residing in the "Keep Zone, the "Above Average Watch Zone," the "Below Average Watch Zone," and the "Replace Zone." The report also depicts the results in a "bubble chart," where the size of the bubble represents the percentage of assets an investment has of the total assets in a zone. In other words, a larger bubble represents an investment with more assets in that zone, and a smaller bubble represents an investment in fewer assets in that zone.

The fourth step is to build a proposed portfolio for the client that is close to his or her risk score. The IAR or Rep analyzes all of the major asset categories to determine the top performing sub-categories to include in the portfolio, taking into account the performance of the funds in the client's existing portfolio, the needs and circumstances of the client, and his or her retirement goals as described in the risk questionnaire. Riskalyze is used in this step as well to ensure that the proposed portfolio aligns with the client's risk score. The result is a proposed portfolio of investments resulting from unbiased investment selection that is consistent with the best interests of the client.

The fifth step occurs when the IAR or Rep generates an individualized Investment Policy Statement ("IPS") for the investor client. The IPS establishes a clear understanding between the client and the IAR or Rep as to the client's investment goals, summarizes the investment philosophy that the IAR or Rep will pursue on behalf of the client, and the applicable policies.

The sixth step is a recurring one that involves proactive and frequent communication on the part of the IAR or Rep to the investor client. The IAR or Rep will provide the client with a Weekly Wrap Up, a weekly email with market commentary and investment signals on the portfolios. The IAR or Rep also emails a Monthly Monitoring Report that includes a "bubble report" with scores that show how the underlying investments in the portfolio are performing. A Quarterly Performance Report is also available, which contains transaction, performance and other information pertaining to the client's account.

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III. LEGAL ANALYSIS AND CONCLUSIONS

A. IMPACT OF NEW DOL RULE ON FIRMS AND THEIR ADVISORS

Title I of ERISA requires fiduciaries of employer-sponsored retirement plans ("ERISA Plans") to act in accordance with a "Prudent Man Standard of Care."[1] The duty of prudence requires an Advisor to provide advice based on the investment objectives, risk tolerance, financial circumstances and needs of the retirement client, which in turn requires the Advisor to obtain this information before providing such investment advice. Additionally, the duty of prudence requires the Advisor to obtain such information in the same manner that a prudent person would.

Longstanding DOL regulations provide that a fiduciary is deemed to comply with the duty of prudence if the fiduciary gives "appropriate consideration" to the facts and circumstances that the fiduciary knows or should know are relevant with respect to an investment action.[2] Therefore, it is generally understood that a fiduciary advisor must give appropriate consideration to the needs and objectives of the retirement client prior to making any investment recommendations. The DOL regulations further provide that giving "appropriate consideration" includes making a determination that the investment action is reasonably designed to further the purposes of the retirement client. Accordingly, in addition to giving appropriate consideration to the client's needs and objectives, the fiduciary advisor must also give appropriate consideration to whether the recommended investment is reasonably designed to meet these needs and objectives and continues to meet them over time.

Title I also includes a related set of "Prohibited Transaction Rules"[3] that prohibit ERISA Plan fiduciaries from engaging in certain types of activities. Among other restrictions, the Prohibited Transaction Rules generally prohibit a fiduciary from engaging in any self-dealing or other transactions that involve conflicts of interest. A violation of the fiduciary requirements of Title I of ERISA may result in personal liability for the breaching fiduciary, giving the client the rights of rescission, restitution for any losses, and disgorgement of profits.[4] In addition, the DOL may impose punitive civil penalties as well as other equitable remedies.[5]

Title II of ERISA includes a set of punitive excise tax rules that mirror the Prohibited Transaction Rules under Title I. These excise tax provisions are reflected in Section 4975 of the Internal Revenue Code of 1986, as amended (the "Code"), which was added to the Code by Title II of ERISA. ERISA plan fiduciaries are subject to the restrictions under both Titles I and II of ERISA. Conversely, fiduciaries to retirement clients that are not subject to Title I of ERISA are subject to the requirements of Title II of ERISA only (*i.e.*, the excise tax rules under Code Section 4975). Retirement clients that are not subject to Title I of ERISA generally include IRAs and sole proprietor plans such as solo 401(k) plans. Thus, fiduciaries to IRAs are not subject to

[1] ERISA Section 404.
[2] Section 2550.404a-1(b) of DOL Regulations.
[3] ERISA Section 406.
[4] ERISA Section 409.
[5] ERISA Section 502(l).

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Title I of ERISA, but are subject to the requirements of the excise tax rules under Code Section 4975. While not subject to ERISA, IRAs are subject to the general fiduciary standards and prohibited transaction rules. In our view, providing advice to IRA owners consistent with ERISA's prudent man standard of care would likely satisfy fiduciary obligations to act in the best interest of the retirement client.

Many Firms offering investment-related services to retirement clients in the past have taken the position that neither they nor their respective Advisors are acting in a fiduciary capacity. In other words, they have typically asserted that the investment recommendations made by their Advisors to retirement clients are non-fiduciary in nature, and do not include any fiduciary "investment advice" within the meaning of Title I or Title II of ERISA. However, virtually all Firms and their Advisors providing investment-related services to retirement plans, including IRA owners, will be deemed fiduciary advisors as a result of the application of the Fiduciary Rule on June 9, 2017. The Fiduciary Rule is specifically designed to broaden the scope of advisors who will be deemed to be fiduciaries with respect to any retirement clients, and many Firms and their Advisors will be deemed to be offering fiduciary investment advice for the first time on June 9, 2017, as a result of the Fiduciary Rule.

B. "BEST INTEREST STANDARD OF CARE" UNDER BICE

Under the Prohibited Transaction Rules,[6] fiduciary investment advisors generally cannot earn any "variable compensation" that varies with the particular investment(s) that are selected in connection with the investment advice furnished to a retirement client.[7] An impermissible conflict of interest arises to the extent that a fiduciary advisor has a financial incentive to recommend a particular investment that results in a higher level of compensation for such advisor. Accordingly, when financial institutions and their representatives are deemed to be fiduciary investment advisors as a result of the application of the Fiduciary Rule, they will be prohibited from earning commissions, revenue sharing, 12b-1 fees, third-party payments, or other forms of variable compensation in connection with the investment advice they provide to their retirement clients, unless they qualify for an exemption from the Prohibited Transaction Rules. As part of the Fiduciary Rule, the DOL has also issued a new prohibited transaction class exemption, the BICE. In sum, the BICE would give Firms and their Advisors the ability to earn variable compensation, such as the commission-based compensation described above, as long as the numerous conditions imposed under the BICE are satisfied.

Among the BICE's conditions, any fiduciary investment advice provided by a Firm's Advisor to a retirement client must meet the new "Best Interest Standard of Care,"[8] Accordingly, the investment advice must be provided (i) with the care, skill, prudence, and

[6] For purposes of this letter, all references to the Prohibited Transaction Rules under ERISA Title I should be interpreted as also referencing the mirror excise tax provisions under ERISA Title II, except as the context otherwise clearly requires.
[7] Variable compensation is generally prohibited under the Prohibited Transaction Rules and the mirror excise tax rules. See ERISA Section 406(b) and Code Section 4975, respectively. See, also, the preamble to the BICE (April 8, 2016).
[8] Section VIII(d) of the BICE.

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diligence that a prudent person who is familiar with such matters would use; (ii) based on the investment objectives, risk tolerance, financial circumstances and needs of the client; and (iii) without regard to the interests of the Firm or the Advisor. The exemptive relief under the BICE is potentially available with respect to all types of retirement clients advised by the fiduciary investment advisor. Thus, the BICE's Best Interest Standard of Care may apply to an individual client with an ERISA plan account (such as a 401(k) plan participant), an IRA account owner or a sole proprietor with a non-ERISA plan account (such as a solo 401(k) account). It should also be noted that in the case of an individual client with an ERISA plan account, the fiduciary investment advice provided by the Firm through its Rep would also be subject to the Prudent Man Standard of Care under Title I of ERISA, which is generally imposed under the ERISA statute in addition to the Best Interest Standard of Care imposed under the BICE.

As noted by the DOL, the Best Interest Standard of Care is intended to be given the same meaning as the Prudent Man Standard of Care. Both fiduciary standards reflect a duty of prudence, which is generally viewed as incorporating objective standards of care, as well as a duty of undivided loyalty to the client. In support of the foregoing, the DOL noted the following in its preamble to the BICE:

> The Best Interest standard, as set forth in the exemption, is intended to effectively incorporate **the objective standards of care and undivided loyalty that have been applied under ERISA for more than forty years**. Under these objective standards, the Adviser must adhere to a professional standard of care in making investment recommendations that are in the Retirement Investor's Best Interest. **The Adviser may not base his or her recommendations on the Adviser's own financial interest in the transaction**. Nor may the Adviser recommend the investment, unless it meets the objective prudent person standard of care. Additionally, the duties of loyalty and prudence embodied in ERISA are objective obligations that do not require proof of fraud or misrepresentation, and full disclosure is not a defense to making an imprudent recommendation or favoring one's own interests at the Retirement Investor's expense. **(Emphasis added.)**

C. UNCERTAINTY OF FIDUCIARY RULE AND RELATED EXEMPTIONS

The applicability date of the Fiduciary Rule and the related exemptions have been delayed until June 9, 2017. The BICE and related exemptions will have limited applicability during the new and shortened transition period from June 9, 2017 to January 1, 2018 with full implementation thereafter. The Fiduciary Rule is currently under examination by the DOL and it is unclear, as of this writing, whether it and the related exemptions will survive intact. However, despite this uncertainty and regardless of whether the Fiduciary Rule and the exemptions are repealed, the policy discussions on this topic in recent years have raised the profile of best interest investment advice. Heightened fiduciary standards with respect to retirement investing are now squarely in the public view. Consequently, investor clients will likely demand that Firms comply with stricter fiduciary standards regardless of whether Firms and their Advisors receive levelized compensation. Prior to the Delay Rule, many Firms devoted significant

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resources to comply with the Fiduciary Rule and the related exemptions by April 10, 2010. Some of these Firms have decided to move ahead with the changes to their compensation arrangements, fee structures and the higher level of fiduciary care despite the 60-day delay, perhaps as a means of differentiating themselves from their competitors. In our view, the BICE's "Best Interest Standard of Care," or a standard substantially similar to it, will continue to be relevant to Firms and their Advisors after the dust settles.

D. USING REDHAWK'S FIDUCIARY PROCESS TO MEET THE BEST INTEREST STANDARD OF CARE

As a result of the application of the Fiduciary Rule, virtually all Firms and their Advisors will be deemed to be fiduciary investment advisors when advising retirement clients. Because of the fiduciary investment advice liability to which they will be subject as a result of the Fiduciary Rule, many Firms and their Advisors may cease advising IRA owners. The use of Redhawk's Fiduciary Process may enable IARs and Reps to provide investment advice to IRA owners without exposing the IARs, Reps and Redhawk to significant fiduciary risk.

The BICE does not expressly approve of any particular type of questionnaire or process to follow in order to meet the Best Interest Standard of Care. **However, a process that gathers information as to the IRA owner's risk tolerance, final goals, and retirement horizon and quantifies the risk tolerance while matching it to an appropriate investment strategy that is consistent with the IRA owner's wishes as to risk and retirement goals, would assist the IAR or Rep in satisfying its duty to act with the care, skill, prudence, and diligence of a prudent expert under the BICE's Best Interest Standard of Care.** By responding to a number of questions in the risk questionnaire about the IRA owner's retirement goals and risk tolerance and then applying technology such as Riskalyze to quantify the IRA owner's preferred risk level and that of the targeted portfolio, the Fiduciary Process will help IARs and Reps elicit key information in accordance with their fiduciary duty of prudence, enabling the IAR or Rep to give appropriate consideration to the retirement client's needs and objectives.

The objectively determined investment lineup created by E-Valuator, which scores the performance of investments based on their benchmarks and takes into account the client's responses, will also enable the IAR and Rep to give investment recommendations reasonably designed to meet the IRA owner's needs and objectives. As discussed above, the investment lineup for the IRA owner is constructed based on investment performance and the needs of the client. The investment portfolio is based on an objective financial analysis that considers all relevant information provided by the IRA owner, and it can guide the IAR's or Rep's recommendations and confirm for the IRA owner that these recommendations are in his or her "Best Interest."

As a result of our comprehensive review, it is our opinion that the use of the Fiduciary Process by the IAR or Rep will assist in protecting against fiduciary risk and related fiduciary liability by aiding the IAR or Rep to meet the Best Interest Standard under the BICE.

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The opinions and views included in this letter represent our view of the outcome in a court of law if a challenge were to be made to the conclusions set out above and do not represent a guarantee as to the outcome. The legal analysis included herein is based on the facts presented and the existing laws and regulations in effect as of the date of this letter. The addition of facts other than those described above and any material changes in the law or regulatory guidance may affect the legal analysis and conclusions set forth herein. Our opinions and views expressed in this letter are furnished to you solely for your benefit. Although we understand that you may wish to provide copies of this letter to third parties for their information only, to which we provide our consent, the opinions and views expressed in this letter may not be relied upon by any person other than you without our prior consent.

Sincerely,

Wagner Law Group

The Wagner Law Group

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Definitions

Asset Category is a grouping of investments that exhibit similar characteristics and are subject to the same laws and regulations. The main asset categories include equities (stocks), Fixed Income (bonds), Cash and cash equivalents (CDs), and Real Estate and Commodities.

Asset Class is a further breakdown of the investments that are in an asset category. For example, equities can be further segmented into U.S. equities, foreign equities, and emerging markets equities. U.S equities can be further grouped by market capitalization, such as small-cap growth, small-cap blend, and small-cap value. It's used to help investors make meaningful comparisons between funds.

Bank of Japan ("BoJ") is the central bank of Japan and is responsible for the yen currency.

Basis Point ("bps") is one one-hundredth (1/100 or 0.01) of 1%.

Behavioral Finance is the study of the influence of psychology on the behavior of investors or financial analysts. It also includes the subsequent effects on the markets. It focuses on the fact that investors are not always rational, have limits to their self-control, and are influenced by their own biases.

Beta measures the sensitivity of an investment to the movement of its benchmark. A beta higher than 1.0 indicates the investment has been more volatile than the benchmark and a beta of less than 1.0 indicates that the investment has been less volatile than the benchmark.

Bloomberg Barclays U.S. Aggregate Bond Index is an unmanaged index that measures the performance of the investment grade universe of bonds issued in the United States. The index includes institutionally traded U.S. Treasury, government sponsored, mortgage and corporate securities.

Broker is a professional who executes buy and sell orders for stocks and other securities on behalf of clients. A broker may also be known as a registered representative. A broker is usually associated with a broker-dealer and handle transactions for retail and institutional customers alike. A broker often receives commissions for their services.

Broker-dealer is a firm in the business of buying and selling securities for its own account or on behalf of its customers. A broker-dealer is a buyer and seller of securities, as well as distributors of other investment products. As the name implies, they perform a dual role in carrying out their responsibilities. As a dealer, they act on behalf of the brokerage firm, initiating transactions for the firm's own account. As a broker, they handle transactions, buying and selling securities on behalf of their clients.

Chartered Financial Analyst ("CFA") is considered the most exclusive and difficult title to achieve. The CFA designation requires multiple monitored exams, working as an investment professional for a minimum of four years, and committing to a code of ethics and standards of professional conduct. This title is bestowed by the CFA Institute, founded in 1959. However, it is unlikely that an individual investor would deal with a CFA. CFAs are generally research analysts employed by investment banks, mutual fund companies, and securities firms. They typically specialize in an industry and the companies operating within that industry.

Certified Financial Planner ("CFP") is a designation conferred by the Certified Financial Planner Board of Standards, Inc. It has become increasingly popular in recent years, particularly by those who provide fee-based advisory services to individuals or sell financial products which are frequently coordinated with other components of personal finance.

Certification is rigorous and involves a lengthy education requirement that follows the successful passage of multiple exams completed over a two-day period dealing with personal finance subjects, including investments, insurance, and estate planning. Candidates are required to possess a bachelor's degree and three years of relevant experience and must adhere to a code of ethics.

Chicago Board Options Exchange ("CBOE") Volatility Index ("VIX") is a measure of market expectations of near-term volatility as conveyed by S&P 500 stock index option prices.

Correlation is a statistical measure of the relationship between two sets of data. When asset prices move together, they are described as positively correlated; when they move opposite to each other, the correlation is described as negative or inverse. If price movements have no relationship to each other, they are described as uncorrelated.

Cyclically Adjusted Price-to-Earnings Ratio ("CAPE") is defined as price divided by the average of ten years of earnings, adjusted for inflation.

European Central Bank ("ECB") is responsible for the monetary system of the European Union ("EU") and the euro currency.

Federal Funds Rate (fed funds rate, fed funds target rate, or intended federal funds rate) is a target interest rate that is set by the FOMC for implementing U.S. monetary policies. It is the interest rate that banks with excess reserves at a U.S. Federal Reserve district bank charge other banks that need overnight loans. The Federal Reserve's dot plot shows the projections of the 12 members of the Federal Open Market Committee ("FOMC") on where they think the fed funds rate should be at the end of the various calendar years shown, as well as in the long run—the peak for the fed funds rate after the Fed has finished tightening or "normalizing" policy from its current levels. The dot plot is published after each Fed meeting.

Federal Open Market Committee ("FOMC") is a policy-making body of the Federal Reserve System responsible for the formulation of a policy designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments. The Fed's neutral rate is the rate that is consistent with the economy maintaining full employment, capacity utilization and stable prices. It is also called the terminal rate or neutral interest rate.

Federal Reserve Board ("Fed") is responsible for the formulation of U.S. policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.

Fiduciary is a person who holds a legal or ethical relationship of trust with their client while prudently taking care of their money or assets. A fiduciary may be a financial advisor, a corporate trust company, or the trust department of a bank. When a financial advisor has a fiduciary duty to their client, they must act in a way that will financially benefit them. The financial advisor who has a fiduciary duty is called the fiduciary, and the client to whom the duty is owed is called the principal or the beneficiary.

Fiduciary Standard refers to a standard that an investment advisor representative ("IAR") is bound to and is regulated by the Securities and Exchange Commission ("SEC") or state securities regulators, both of which hold advisors to a fiduciary standard that requires them to put their client's interests above their own. The act is specific in defining what a fiduciary means, stipulating that it consists of a duty of loyalty and that an IAR must place their interests below that of their clients.

Financial Industry Regulatory Authority ("FINRA") is an independent regulator securities firms doing business in the United States. Securities are financial instruments, such as stocks or bonds, that can be traded freely on the open market.

Group of Twenty (also known as the "G-20" or "G20") is an international forum for the governments and central bank governors from 20 major economies. The members include 19 individual countries—Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States—along with the European Union ("EU"). The EU is represented by the European Commission and by the European Central Bank.

Gross Domestic Product ("GDP") is an economic statistic which measures the market value of all final goods and services produced within a country in a given period.

Inverted Yield Curve refers to a market condition when yields for longer maturity bonds have yields which are lower than shorter-maturity issues.

Investment Policy Statement ("IPS") is a document drafted between a financial advisor and their client that outlines general rules for the investments manager. This statement provides the general investment goals and objectives of a client and describes the strategies that the manager should employ to meet these objectives. Specific information on matters such as asset allocation, risk tolerance, and liquidity requirements may be included.

Investment Advisor Representative ("IAR") is a financial professional who works for an investment advisory company and whose primary responsibility is to provide investment-related advice. According to regulations, IARs can only offer advice on topics on which they have passed the appropriate examinations. An IAR must register with a Registered Investment Advisor ("RIA") firm. IARs receive compensation by charging fees.

Market Capitalization ("Market Cap") is the total dollar market value of all company's outstanding shares. It is calculated by multiplying a company's shares outstanding by the current market price of one share.

MSCI Emerging Markets ("EM") Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.

MSCI World Index is an unmanaged index of common stocks of company's which are representative of the market structure of 22 developed market countries in North America, Europe, and the Asia/Pacific Region. The index is calculated without dividends, with net or with gross dividends reinvested, in both U.S. dollars and local currencies.

Price-to-Book ("P/B") Ratio is a stock's price divided by the stock's per share book value.

Price-to-Earnings ("P/E") Ratio is a stock's price divided by its earnings per share.

Quantitative Easing ("QE") refers to a monetary policy implemented by a central bank in which it increases the excess reserves of the banking system through the direct purchase of debt securities.

Real GDP is a nation's total output of goods and services in constant dollar, or inflation-adjusted terms.

Real Yields are calculated by adjusting stated yields to compensate for inflation expectations over the time period during which the yields are expected to be paid.

Registered Investment Advisor ("RIA") is a firm who advises high-net-worth individuals on investments and manages their portfolios.

RIAs have a fiduciary duty to their clients, which means they have a fundamental obligation to provide investment advice that always acts in their clients' best interests. As the first word of their title indicates, RIAs are required to register either with the Securities and Exchange Commission ("SEC") or state securities administrators.

Return on Equity ("ROE") is the amount of net income returned as a percentage of shareholders' equity. Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested. ROE is expressed as a percentage and calculated as: Return on Equity = Net Income/ Shareholders' Equity.

Robo-Advisor is a digital platform that provides automated, algorithm-driven financial planning services with little to no human supervision. A typical robo-advisor collects information from clients about their financial situation and future goals through an online survey and then uses the data to offer advice and automatically invest client assets.

S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S.

Securities and Exchange Commission ("SEC") is a U.S. Government agency, with the purpose of protecting investors from dangerous or illegal financial practices or fraud, by requiring full and accurate financial disclosure from companies offering stocks, bonds, mutual funds, and other securities to the public.

Suitability Standard refers to an obligation that broker-dealers must fulfill which is defined as making recommendations that are consistent with the best interests of underlying customers. The suitability standard requires only that broker-dealers must reasonably believe that any recommendations made are suitable for clients, in terms of their financial needs, objectives, and unique circumstances. A key distinction in terms of loyalty also is important, in that brokers serve the broker-dealers they work for and not necessarily their clients.

Yield Curve is the graphical depiction of the relationship between the yield on bonds of the same credit quality but different maturities.

Acknowledgements

1. Since 1994, DALBAR's Quantitative Analysis of Investor Behavior ("QAIB") has measured the effects of investor decisions to buy, sell and switch into and out of mutual funds over short and long-term time frames. These effects are measured from the perspective of the investor and do not represent the performance of the investments themselves. The results consistently show that the average investor earns less – in many cases, much less – than mutual fund performance reports would suggest. The 25th Annual QAIB examines real investor returns in nearly 30 different categories of investors. The analysis covers the 20-year period to December 31, 2018, which encompasses the aftermath of the crash of 1987, the drop at the turn of the millennium, the crash of 2008, plus recovery periods leading up to the most recent bull market. https://www.dalbar.com/

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37. The National Association of Personal Financial Advisors ("NAPFA") is the country's leading professional association of Fee-Only financial advisors - highly trained professionals who are committed to working in the best interests of those they serve. Our rich history began in 1983 when a group of advisors simply wanted to serve their clients without muddling the relationship with commissions. Since then we have developed high standards in the field and each advisor must sign and renew a Fiduciary Oath yearly and subscribe to our Code of Ethics. It's all a part of the mission of NAPFA. The association provides support and education for over 3,000 practitioners all over the country and is governed by the NAPFA Board of Directors and supported by our four Region Boards. https://www.napfa.org/

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40. The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC strives to promote a market environment that is worthy of the public's trust. https://www.sec.gov/

41. William Lamar Beane III (born March 29, 1962) is a former American professional baseball player and current front office executive. He is the executive vice president of baseball operations and minority owner of the Oakland Athletics of Major League Baseball (MLB); he is also minority owner of Barnsley FC of EFL Championship. From 1984 to 1989 he played in MLB as an outfielder for the New York Mets, Minnesota Twins, Detroit Tigers, and Oakland Athletics. He joined the Athletics' front office as a scout in 1990, was named general manager after the 1997 season, and was promoted to executive vice president after the 2015 season.

42. "Moneyball" is a 2011 American sports film directed by Bennett Miller and written by Steven Zaillian and Aaron Sorkin. The film is based on Michael Lewis's 2003 nonfiction book of the same name, an account of the Oakland Athletics baseball team's 2002 season and their general manager Billy Beane's attempts to assemble a competitive team.

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