Investment Training Module
Topic: Retirement Portfolio Design

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Disclaimer

This presentation is for informational purposes only. It does not constitute nor imply investment advice in any way. Investing involves risk, including the risk of losing principle. An investor should consider their own investment objectives and risk tolerance before choosing any investment product.

Recap: Why Invest?

Investment Goal: Maximize the odds of meeting/exceeding your financial requirements

- What we are trying to accomplish:
  - Reasonably predictable growth
  - Higher return than the "risk-free" rate
  - Meet or exceed goals with minimal risk
- Every investor is different, but most optimized portfolios have common themes

Objective of financial planning is to reduce or eliminate financial stress

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Tools in Our Toolbox

Tool	Risk	Return Potential	Predictability
Buy stocks/stock funds	HIGH	EXCELLENT	POOR
Buy bonds/bond funds	MEDIUM	FAIR	GOOD
Fixed Index Annuity	LOW	FAIR	EXCELLENT
Sector-based stock strategy	MEDIUM-HIGH	EXCELLENT	FAIR
Equipment Leasing	MEDIUM	VERY GOOD	VERY GOOD
Mortgage Notes	MEDIUM-LOW	MEDIUM	EXCELLENT
Managed Futures	MEDIUM	VERY GOOD	GOOD
Energy MLPs	MEDIUM-HIGH	EXCELLENT	FAIR
Real Estate	HIGH	EXCELLENT+	POOR

NOTE: Ranking is the opinion of Jerry Verseput and is highly subjective.

The market is a complex environment and requires a sophisticated set of tools

A Retirement Portfolio is an Endowment

Goal and Purpose of an Endowment: Create enough income and growth to fund scholarships year after year

Goal and Purpose of a Retirement Portfolio: Create enough income and growth to fund living expenses year after year

Can we learn something from the way prominent endowments are constructed?

What are these (>50%)?

Major Endowments

<table>
<tr><th></th><th>US Stock</th><th>Foreign Stock</th><th>Emerging Mkts</th><th>Private Equity</th><th>Absolute Return</th><th>Commodities/ Real Estate</th><th>Fixed Income</th></tr>
<tr><td>Harvard</td><td>11%</td><td>11%</td><td>11%</td><td>16%</td><td>15%</td><td>25%</td><td>11%</td></tr>
<tr><td>Yale</td><td>6%</td><td colspan="2">8%</td><td>35%</td><td>15%</td><td>30%</td><td>6%</td></tr>
<tr><td>Stanford</td><td colspan="3">25%</td><td>23%</td><td>22%</td><td>20%</td><td>10%</td></tr>
</table>

"The heavy allocation to nontraditional asset classes stems from their return potential and diversifying power." – Yale Endowment IPS

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Risk-Focused Portfolio Construction

Note: "Risk-focused" translates to "low volatility"

Income-based foundation keeps the portfolio moving forward without reliance on the stock market.

Absolute Return/Fixed Income	Private Equity
Fixed Index Annuity	**Secured Income (liquidity tradeoff)**

1. Establish low-volatility, steady base that takes care of most of your income needs

NOTE: Fixed Index Annuities can be used as part of the base; however, VFM is not licensed to sell or recommend annuities

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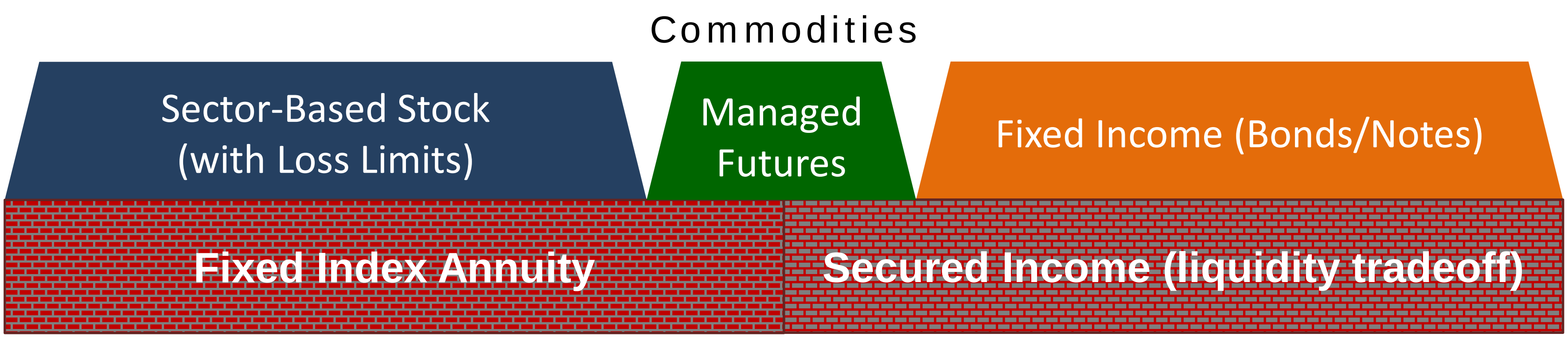
Risk-Focused Portfolio Construction

I prefer a sector-based stock strategy, balanced with Managed Futures, but there is no claim that this is the “best” strategy.



1. Establish low-volatility, steady base that takes care of most of your income needs
2. Add risk-based assets, starting with a core stock and bond strategy

NOTE: Fixed Index Annuities can be used as part of the base; however, VFM is not licensed to sell or recommend annuities

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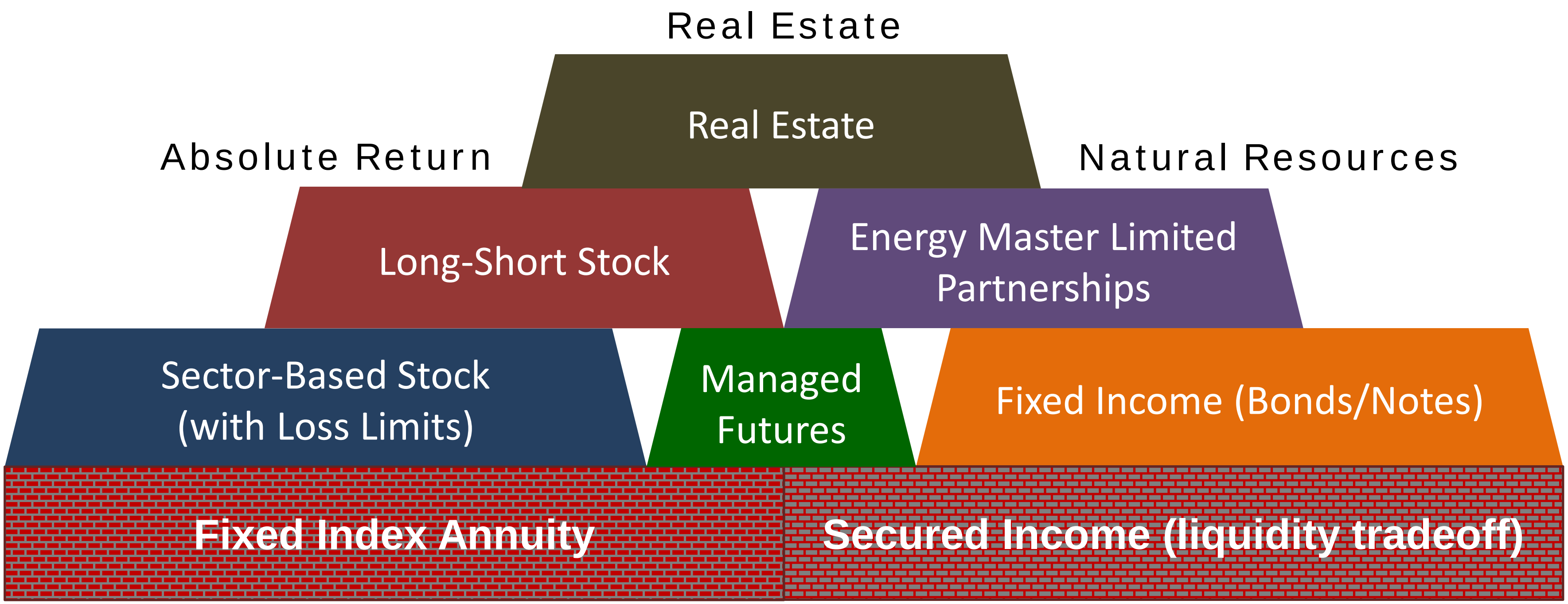
Risk-Focused Portfolio Construction

*Diversification requires investments that **DO** different things.*



1. Establish low-volatility, steady base that takes care of most of your income needs
2. Add risk-based assets, starting with a core stock and bond strategy
3. Continue to add asset classes that increase diversification (Energy MLPs, Real Estate)
4. Monitor and adjust as market conditions change and new opportunities arise

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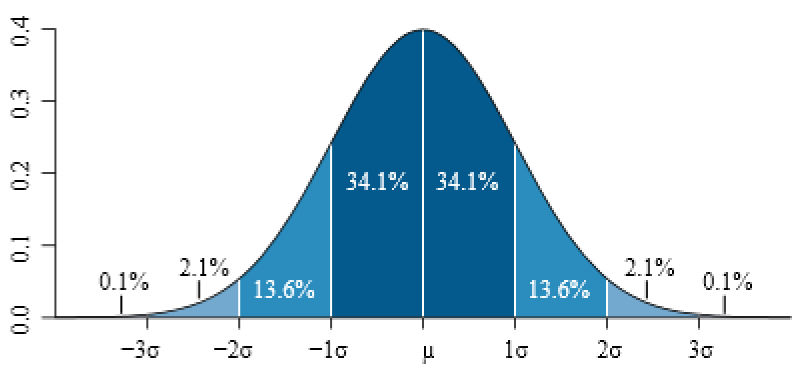
Why Does Risk Need To Be Addressed?

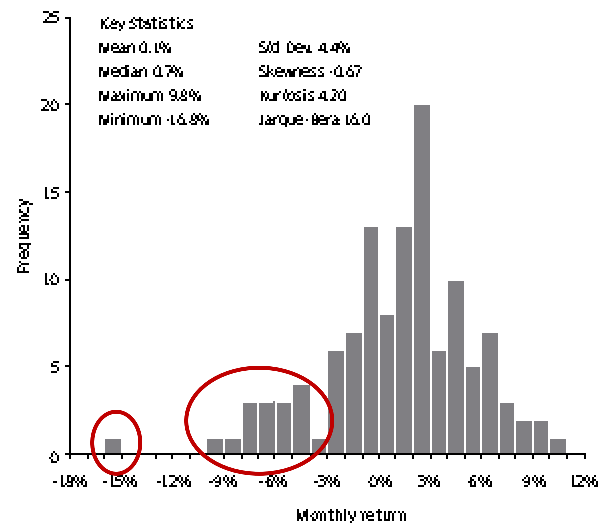
- Common assumption: Risk can be controlled by owning a wide variety of stocks
- Reality: Majority of risk assumptions are based on a "normal" distribution of stock returns, which is wrong

What returns are *supposed* to look like.



What returns *actually* look like.

EXHIBIT 4: HISTOGRAM OF U.S. EQUITY RETURNS—TEN YEARS ENDING OCTOBER 2008



Source: J.P. Morgan Asset Management. For illustrative purposes only.

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A Sample Of Outcomes Based on Modern Financial Analysis

Situation	Predicted Outcome	Actual
Dow move of more than 3.4% (1916-2003)	58 days	1001 days
Dow move of more than 4.5%	6 days	366 days
Dow move of more than 7%	Once every 300,000 yrs	48 days (1900-2000)

- In August 1998, there were 3 trading days where the Dow dropped 3.5%, 4.4% and 6.8%
  - Odds of these 3 drops in one month: 1 in 500 billion
- On October 19, 1987 the Dow fell 29%
  - Odds: 1 in 10^{50} (a number outside the scale of nature)

Conclusion: Most of what we hear from “experts” is wrong, and the math used for most financial software is based on faulty assumptions

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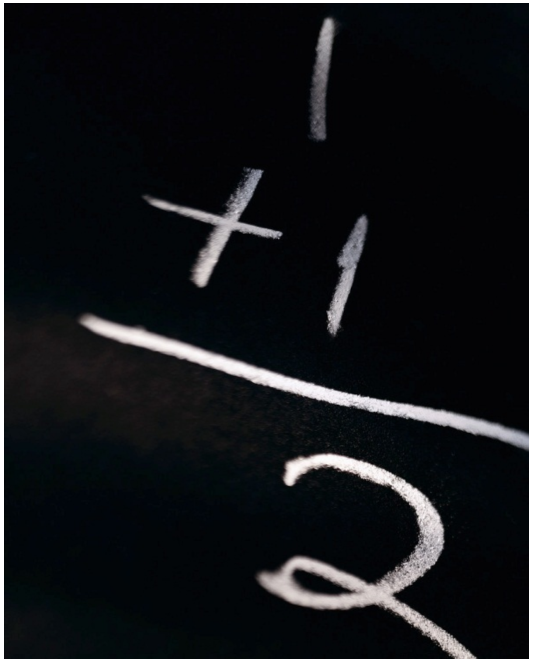
Portfolio Design/Financial Training Key Takeaways

1. Diversification is extremely important
2. Diversification is only achieved by investments that DO different things
3. The stock market is risky, but offers a great opportunity for growing wealth
4. Stock market risk needs to be reduced through systematic risk management
5. A well-designed portfolio is one that allows you to stop thinking about the market



Good luck, and feel free to contact me with questions, comments, gripes, or information on where to send bonus checks

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