Wells Fargo's Turn

A Quest Opportunity Fund (QOF) member that is becoming a HCM client asked us to analyze their Wells Fargo positions. Once again, names have been removed for privacy.

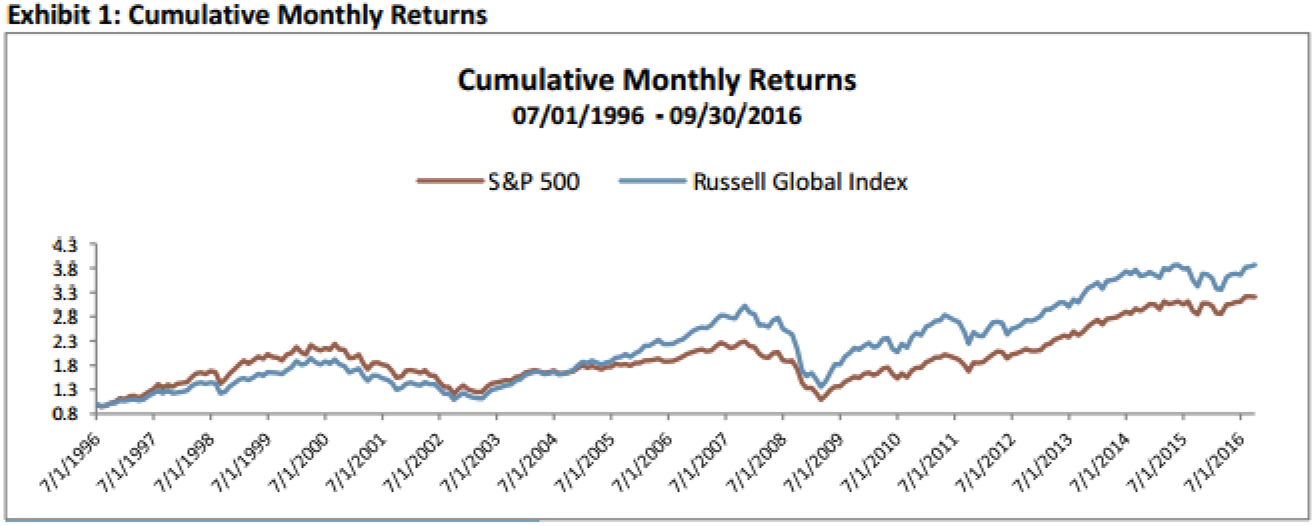
December 7, 2016

Dear P and D,

%	Symbol	Type	Description	Risk (1)
60.0			US Stocks	1.0
11.7			CDs	0
7.7	CSIEX	OEF	US Large Growth	0.8
4.7	NUM	CEF	MI Muni	1.2
4.4	TEMWX	OEF	World Stock-Large Value	1.4
3.0			Cash	0
2.9	IGM	ETF	US Technology-Large Growth	1.1
2.1	IWR	ETF	US Mid-Cap Blend	1.3
1.3	IWM	ETF	US Small Blend	1.6
1.2	HYG	ETF	US High Yield Bonds	1.0
0.8	ODVCX	OEF	Diversified EM-Large Growth	1.6
0.4	FDSTX	OEF	US Large Value	1.1
			Weighted Average:	**0.9**
Notes				
1	Ratio of average historical Maximum Drawdowns to S&P 500 declines greater than 10%			

We have combined the positions in your Wells Fargo accounts into a single portfolio for analysis. Our primary concern is its extreme lack of diversification. As investing legend John Templeton once observed, **"The only investors who shouldn't diversify are those who are right 100% of the time."** The minimum allocation to International stocks that HCM recommends is 40%. International stocks constitute nearly half of the most widely followed global benchmark, the Morgan Stanley Capital International All Country World Index (MSCI ACWI), and two thirds of the world's total market capitalization. Your allocation to International stocks: 3.4%. Academics term this error **Home Bias**, which is defined by Investopedia as "the tendency for investors to invest in a large amount of domestic equities, despite the purported benefits of diversifying into foreign equities." The following quote from Grandeur Peak is taken from our Worth Sharing post **International Diversification - 11/5/2016**: "... when we talk about "the market" we are referring to the global equity market (as might be measured by the Russell Global Index or the MSCI All Country World Index, the All Cap version of which is HCM's benchmark). Instead of measuring the 500 largest companies in 1 country, the Russell Global Index (RGI) contains 10,000 companies across 47 countries; and this is still 20,000+ companies short of the global equity universe from

Exhibit 1: Cumulative Monthly Returns



source: FTSE Russell; Bloomberg (data from 07/01/1996 – 09/30/2016 which we select the Grandeur Peak portfolio holdings.

We think the larger opportunity set and added diversification is important. From the RGI's inception on July 1, 1996 through September 30, 2016, it has delivered an annualized return of 6.9% vs. 5.9% for the S&P 500 (as shown in Exhibit 1)."

The S&P 500, the index from which your 30 individual stocks, all Large and Mega (>$100 Billion) Caps, are drawn from is a subset of the S&P 1500, which is also comprised of the S&P MidCap 400 and S&P SmallCap 600. The S&P 1500 covers approximately 90% of the U.S. market capitalization. Your allocation to Mid-Caps (IWR) is 2.1%, with only 1.3% of your portfolio in Small-Caps (IWM).

Name	Symbol	Mkt Cap	EV/ EBITDA	Decile	Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Health Care	Financials	Technology	Real Estate	Telecom. Services	Utilities
Aflac	AFL	27.9									0.8%				
Alphabet	GOOGL	521.7	15.4	7								3.0%			
Apple	AAPL	586.0	6.2	2								6.0%			
AT&T	T	237.1	6.6	2										2.5%	
Boeing	BA	94.0	14.2	7			2.6%								
CISCO Systems	CSCO	146.8	7.5	2								3.3%			
CVS Health	CVS	82.8	8.6	3						2.4%					
Disney Walt	DIS	156.8	10.5	5				2.3%							
Dow Chemical	DOW	62.1	10.6	5		1.7%									
Exelon	EXC	30.4	8.0	3											1.5%
FedEx	FDX	51.2	10.5	5			1.5%								
General Electric	GE	277.2	36.7	10			1.3%								
Gilead	GILD	95.4	4.5	1						1.7%					
INTC	INTC	161.9	8.0	3								2.2%			
Johnson & Johnson	JNJ	304.6	12.7	6						3.5%					
JPMorgan Chase	JPM	292.0									0.9%				
McDonalds	MCD	98.2	13.3	6				2.8%							
Merck	MRK	168.5	13.2	6						1.9%					
Microsoft	MSFT	460.7	15.0	7								2.6%			
Nextera Energy	NEE	54.8	10.9	5											0.9%
Pepsico	PEP	144.3	13.7	7					2.0%						
Procter & Gamble	PG	220.5	14.5	7					0.6%						
Qualcomm	QCOM	97.2	9.7	4								1.1%			
Starbucks	SBUX	83.3	16.3	8				2.5%							
Scania	SCG	10.1	11.3	5											0.6%
Stryker	SYK	42.0	17.2	8						1.8%					
Target	TGT	43.8	6.9	2					2.5%						
Verison Comm	VZ	203.1	6.8	2										1.0%	
Whole Foods Market	WFM	9.8	7.5	2					0.9%						
3M	MMM	103.7	13.3	6				0.8%							
Total Stocks:					**0.0%**	**1.7%**	**5.5%**	**8.4%**	**6.1%**	**11.3%**	**1.7%**	**18.2%**	**0.0%**	**3.5%**	**3.0%**
S&P 500					7.3%	3.1%	11.6%	11.8%	8.8%	13.3%	15.8%	18.1%	3.3%	3.9%	3.0%

While Wells Fargo's almost exclusive focus on the largest US stocks won't be counterproductive relative to your HCM portfolio, it has historically been very counterproductive to returns. As we note on our website under Factors: "Size is one of the three original factors when Fama and French published their three-factor model in 1992 to explain stock returns. Over the long run, small capitalization stocks tend to beat their large counterparts." This is clearly demonstrated by the relative performance of the S&P 600 and 400 to that of the S&P 500 when using the best ETFs. Small (IJR, blue line) beats Mid (IJH, orange line), and both clobber Large (S&P 500, green line):

From the December 3rd WSJ:

The Reasons to Appreciate Small Stocks Now

By **JASON ZWEIG**
Dec 2, 2016

When markets go way up, your enthusiasm should go down.

But there may still be at least a little opportunity in small stocks, which remain less expensive than their bigger brethren. In today’s market, with stocks teetering near all-time records, being a little less overpriced than the rest is about as good as it gets.

Small stocks had a huge move in November, rising more than 11% in a month when large stocks went up less than 4%. Nearly all that gain came between the election and Thanksgiving, as investors bet that small companies, which tend to be less reliant on exports than big global firms, would benefit disproportionately from Donald Trump’s policies. ...

According to Nili Gilbert and Stuart Kaye, portfolio managers at Matarin Capital Management in Stamford, Conn., small stocks are trading at 10.8 times the cash that their underlying businesses generate from operations, or slightly above their average since 1994. Big companies are valued even more richly, at 11.7 times their operating cash flow, also higher than their average over the past two decades.

The gap between those ratios is barely wider than normal, suggesting that small stocks remain relatively cheap even after their explosive rise in November, say Ms. Gilbert and Mr. Kaye.

That still won't make them easy to own. Small stocks have long tended to fluctuate more sharply than larger companies' shares. They also are more sensitive to many of the Trump policy proposals, so their recently heightened volatility could turn out to be only a foretaste of what is to come.

Last month's big gap in returns between stocks of different size wasn't unusual by historical standards. On average, since 1979, the monthly returns of small and large stocks have differed by at least five percentage points roughly once a year, says Marlena Lee, a vice president for research at Dimensional Fund Advisors of Austin, Texas, which manages approximately $445 billion.

But, as always, hot performance attracts hot money. At iShares, the largest manager of exchange-traded funds, $10 billion of new money came into U.S.-listed ETFs specializing in small stocks during November alone, says Dorothy Lariviere, an analyst and product consultant at the firm. ...

But the long-term case for holding smaller stocks is probably still strong.

"The market is saying that there's been a change to the way government and policymakers are likely to interact with the real economy," says Henry Ellenbogen, portfolio manager of the $16.3 billion T. Rowe Price New Horizons Fund.

"So investors need to revisit what they're doing," he says, "and change their assumptions on what's going to drive returns."

It's rare for small stocks to do well at the end, rather than the beginning, of an economic expansion — which has been underway for more than seven years at this point.

But smaller companies should benefit even more than large ones, argues Mr. Ellenbogen, as the Trump administration tries to achieve faster economic growth, higher inflation, lower corporate tax rates, a strong dollar and greater emphasis on domestic production.

Furthermore, small stocks badly lagged their larger brethren in 2014 and 2015. So, even after their torrid performance in November, the returns on both the Russell 2000 and the S&P SmallCap 600 indexes still trail the giants of the S&P 500 over the past three years.

What if the market as a whole rethinks its euphoria over the election? Small stocks would suffer, too.

From late 2008 through early 2009, in the depths of the financial crisis, the Russell 2000 and the S&P SmallCap 600 indexes each dropped 30% as the S&P 500 fell 27%, according to iShares. During the 2001 recession, the same benchmarks outperformed the S&P 500 by five to nine percentage points. ...

Our Recommendations:

US Stocks - If you decide to keep your accounts commission based (assuming you even have the option of Fee based), **reduce exposure from 60% to 40% and Equal Weight.** Numerous academic studies, two of which we detail on our website, have shown that EV/EBITDA is the best valuation metric. We have provided this metric for all but 2 of your stocks and the resulting decile. The Valuation component of our IVE Stock Selection System requires that we buy stocks in the lowest decile ("1"), and sell them when they become fully valued ("5"). Small beats Large even within the S&P 500, which is a Market Cap weighted index. From 1/1/63 to 12/31/15 the S&P 500 had a CAGR (Compound Annual Growth Rate) of 10.2%, while Equal Weighting the same stocks resulted in a 12.7% annual return. Apple (AAPL) is 6% of your portfolio, while Scania (SCG) is only .6%.

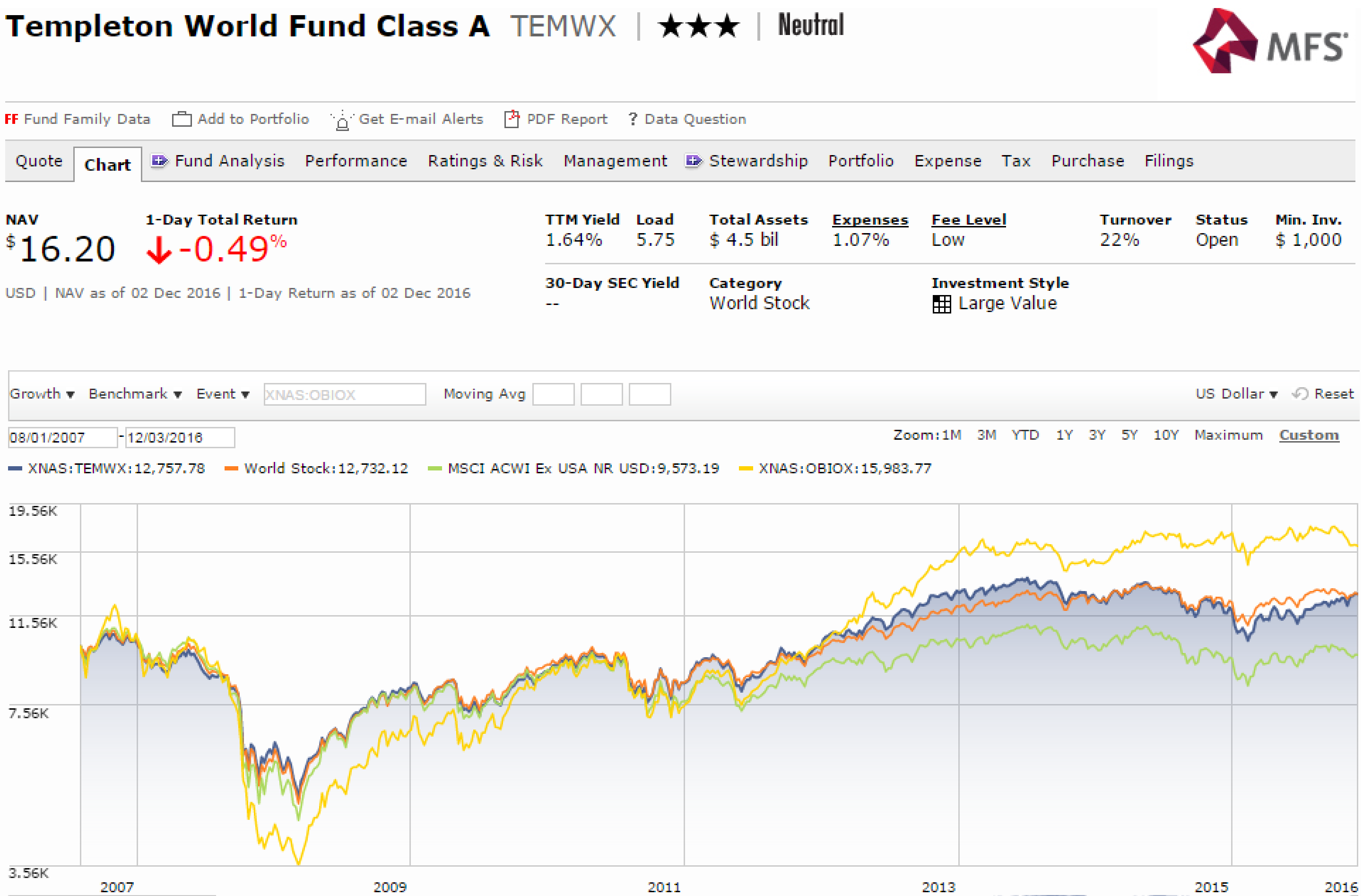
CDs & Cash - Having 14.7% of your portfolio being Dead Money reduces Risk, but it is still Dead Money. SPDR DoubleLine Total Return Tactical ETF (TOTL) yields 3.1% with minimal risk. Bloomberg's ETF expert Eric Balchunas, considers Jeffrey "Bond King" Gundlach's TOTL the "ETF equivalent of a no-hitter."

CSIEX - Sell. This Large Cap Open End Fund (OEF) is rated 3 stars (Morningstar's ratings, with 5 being the highest, are based on 3, 5 and 10 year performance) and has a **4.75% Load.** You clearly don't need any more Large Cap stocks and the Growth aspect of its Investment Style would be counterproductive to your HCM portfolio. As we detail on our website under Factors, Value beats Growth over the long run. "Popularized by Benjamin Graham, Value Investing is the principal of buying stocks that are cheap relative to their Intrinsic Value (what the stock should really be worth)."

CSIEX replaced its management team on 6/16/15. Its results, relative to the S&P 500 (green line) haven't improved, and it still barely beats its Peers (orange line).

NUM - Sell, despite its 4* rating. This Michigan Municipal Bond CEF (Closed-End Fund) is riskier than the S&P 500 due in part to its 39.6% leverage. It has already dropped 15.8% in its latest downturn which began on July 18th. As noted in the WSJ's **Bond Market Slide Intensifies** on December 2nd, "U.S. municipal bond prices also have declined amid concerns that tax cuts could erode the value of the debt's tax breaks."

TEMWX - Replace with OBIOX, and increase to 10% of your portfolio. Templeton World Fund (blue line) is a 3* Neutral (Morningstar's analysts rate OEFs under coverage Gold, Silver, Bronze or Neutral on their future prospects), with an Investment Style of Large Value and a **5.75% Load.** There is a Load Waived (.lw) version. The 5* rated Oberweis International Opportunities (OBIOX, yellow line) is a Foreign Small/Mid Growth OEF that we use for all clients with IRA accounts. We are very familiar with their Quantitative process having spoken to the fund's manager and subscribed to The Oberweis Report for over a decade prior to HCM's founding.



IGM - Replace with ICWIX. IGM is a Technology Sector bet, despite the fact that you already have 18.2% exposure from your 30 individual stocks, compared to 18.1% in the S&P 500. Our Sector analysis shows no Energy or Real Estate exposure. We consider Real Estate to be a separate Asset Class and are recommending a 10% allocation in your HCM portfolio. However, we have not compensated for the under weighting of Energy in your Wells Fargo portfolio. Hence our recommendation of this top rated Energy OEF (Fact Sheet: http://www.integrityvikingfunds.com/PortalIntegrityFunds/DesktopModules/ViewDocument.aspx?DocumentID=59). Since the "A" shares have a sales charge (Load) of 5%, make sure you get the "I" shares, which also have the lowest Expenses, at .95%, of the 3 share classes.

IWR - Replace with IJH, and augment. The 5* rated iShares Core S&P Mid-Cap (IJH, orange line) is the superior ETF for this exposure.

Morningstar's Ben Johnson, CFA from 11/1/2016:

... A low fee and a soundly constructed and reasonably representative benchmark leave this exchange-traded fund well-positioned to continue its long streak of producing superior risk-adjusted returns relative to its peers over the long haul and underpin its Morningstar Analyst Rating of Gold.

During the 10-year period ended Sept. 30, 2016, IJH returned 8.99% per year, outstripping the U.S. mid-blend Morningstar Category average by 2.2 percentage points per year. Much of this relative outperformance can be attributed to the fund’s sizable fee advantage. At 0.07%, IJH’s annual levy is a tiny fraction of the 0.97% median fee charged by its category peers. ...

Low turnover is another key advantage of a fund tied to a market-cap-weighted benchmark. Lower turnover equates to lower transaction costs and a lesser likelihood of taxable capital gains distributions. IJH’s median annual turnover was 14% during the trailing 10 years. This compares to a median figure of 77.3% for its category peers. ...

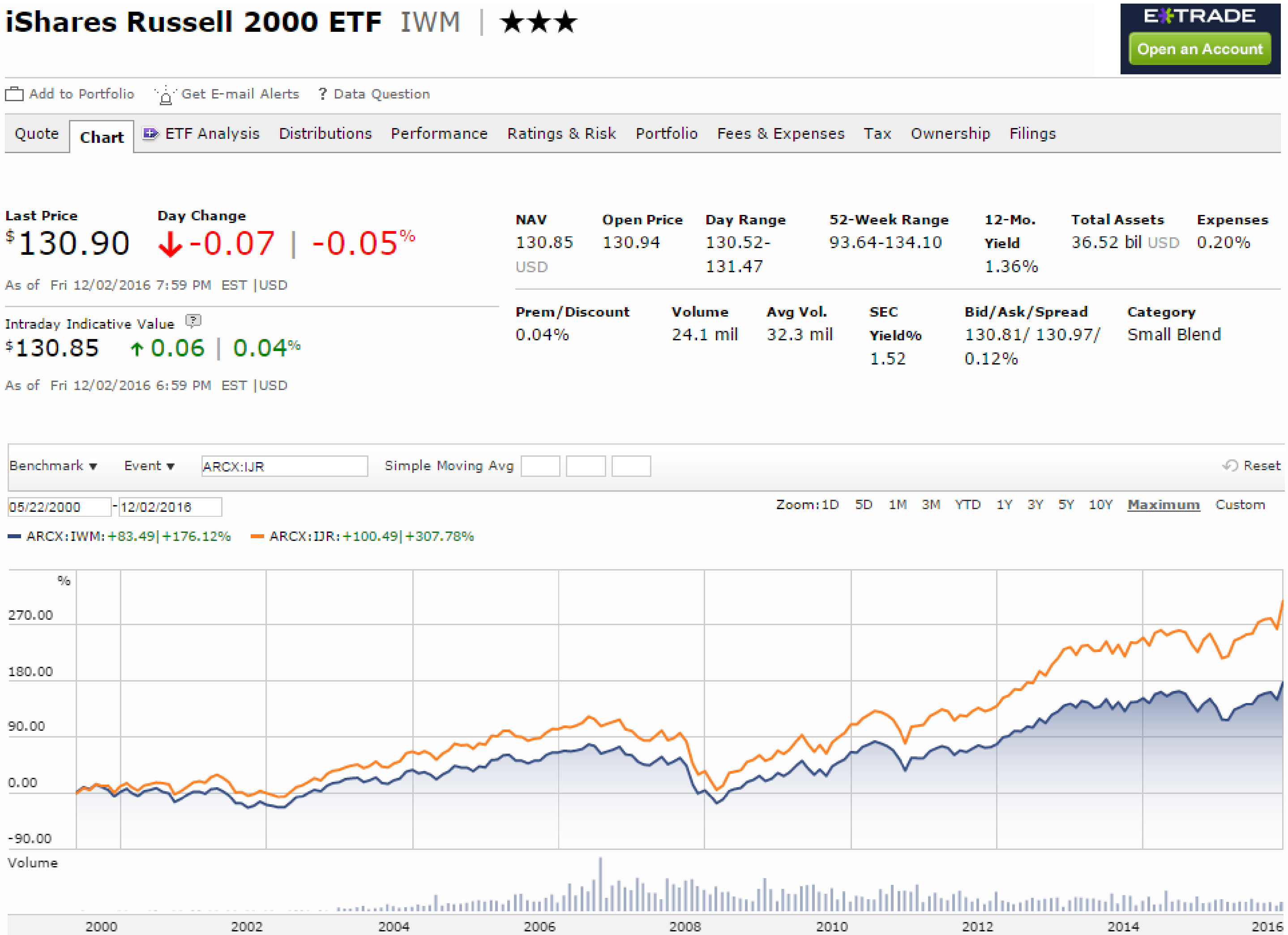
Mid-cap stocks have been in the sweet spot of risk-adjusted performance since 1926. Although they have historically had a higher return than large caps, they have also had a ... more procyclical movement with the market. But the higher return has compensated investors for the increased risk. While small caps had even higher returns, mid-caps have had a slightly better ratio of return to risk. ...

The outperformance of mid-cap stocks during the past 15 years has caused them to look expensive relative to large-cap stocks. As of October 2016, this fund's mid-cap stocks were trading at a price/prospective earnings ratio of 20.2 while the less-volatile large caps in the S&P 500 were trading at a more reasonable 19.0. The dividend yield on stocks on mid-caps is about 1.8% versus about 2.3% for the S&P 500.

The valuation premium of mid-cap stocks could be justified in part based on analyst expectations for faster earnings growth. According to consensus analyst estimates, earnings for the stocks in the fund are expected to grow at 10.2% during the next three to five years, compared with 8.5% for stocks in the Russell 1000. An investment in mid-cap stocks may give investors access to a faster-growing segment of the market without as much volatility as small caps. ...

IShares Core S&P Mid-Cap seeks to match the holdings and returns of the S&P MidCap 400, which gives it a broadly diversified portfolio of mid-cap stocks across industries and the value-growth spectrum. This index effectively diversifies risk, promotes low turnover, and accurately represents its target market segment, supporting a Positive Process Pillar rating. This fund has a smaller average market cap ($4.4 billion) than the mid-blend category average ($6.6 billion) and the S&P 500 ($73.8 billion). The index covers approximately 7% of the market, whereas the large-cap S&P 500 covers approximately the largest 75%. The committee that selects the constituents for the S&P indexes has some discretion to exclude companies based on quality factors, so unlike some other indexes, size is not the sole determinant of inclusion. (As we detail on our website, adding the Quality Factor to the Size Factor enhances returns.)

IWM - Replace with IJR, and augment. The 5* rated iShares Core S&P Small-Cap (IJR, orange line) is the superior ETF for this exposure.



Morningstar's Adam McCullough, CFA from 11/1/2016:

An efficiently managed small-cap fund with less junk.

... A low fee and a well-diversified portfolio with a modest profitability tilt give the fund an edge over its peers, underpinning its Morningstar Analyst Rating of Gold.

The fund tracks the S&P SmallCap 600 Index and offers well-diversified exposure to small-cap U.S. stocks. Its top 10 holdings represent only 5% of assets, compared with the small-blend Morningstar Category average of 22%. The fund reaches further down the market-cap spectrum than most of its category peers. At $1.5 billion, its average market cap is half of the category average. And micro-cap stocks represent more than a third of its holdings compared with less than 5% for the category average.

Heavy trading can impact smaller, less-liquid stocks' prices. The fund has several advantages that lower its reconstitution costs. First, it tracks a less popular index than peers so there's less demand for liquidity when stocks are added or removed from the index. Second, the index requires that at least 50% of a stock's shares trade in the market, which removes less-liquid names. Finally, stocks in the fund must meet a trading volume threshold to be included in the index. These liquidity hurdles help lower the fund's transaction costs and turnover. Its average five-year turnover of 15% is a fourth of the small-blend category average.

Small-cap stocks tend to be riskier than large-cap stocks but can offer higher potential returns. The fund screens out unprofitable stocks and recent IPOs, which tilts holdings toward more-profitable companies. Despite its lower average market cap, the fund has a higher return on equity than peer market-cap-weighted funds. The profitability tilt also affects the fund’s holdings. Compared with index peers, it has greater telecom and industrial sector weightings.

The fund's efficient index construction and profitability tilt have paid off. For the trailing 10 years through September 2016, it bested the category average by 1.8% per year with slightly less volatility. More-favorable stock exposure in the consumer cyclical and healthcare sectors contributed the most to this outperformance.

Small-cap stocks tend to be riskier and less profitable than mid- and large-cap stocks because they have less-established competitive advantages and they’re more sensitive to the business cycle. But small-cap stocks may compensate investors with higher return potential. Over the very long term, small-cap stocks have, in fact, generated higher returns than their larger counterparts, but they can experience decade-long stretches of underperformance. ...

A profitability screen may improve the size premium’s efficacy. In a paper titled “Size Matters, If You Control Your Junk,” AQR’s research team found that removing less-profitable small-cap stocks produced a more stable and significant size premium. (this paper is discussed on our website under Factors - Size +) The fund doesn’t add unprofitable stocks or recent IPOs, but it can hold stocks that have become unprofitable. The fund’s initial profitability screen shifts sector weightings away from the category average. It has less exposure to the utilities and real estate sectors. Its healthcare sector weighting is similar to peer market-cap-weighted funds’, but its composition differs. Not surprisingly, the fund holds barely any biotech stocks. Instead, healthcare provider and equipment stocks make up most of its healthcare exposure. The profitability tilt supports dividend-paying stocks. Indeed, the fund’s dividend yield has typically been 10% higher than the category average. ...

The index is also more flexible when it removes stocks. Stocks must have a market capitalization of at least $400 million when they are added to the index but aren’t sold immediately if they fall below that threshold. The fund’s stake in micro-cap stocks had increased to 34% in September 2016 from 13% in March 2006, but the category average’s share has remained less than 5% during the same time period. The fund’s average market cap is half the category average.

Market-cap weighting skews the portfolio toward the larger stocks in the small-cap segment and allows market prices to determine the portfolio’s sector weightings. ... It has more than 600 stocks, and its top 10 holdings represent less than 5% of the portfolio.

HYG - Sell. Your investment in this Junk Bond Fund needs to find a new home (see above). Our negative view on Bonds, both cyclical and secular, can be found under Asset Allocation on the HCM website. **"Over long periods of time, the returns on equities not only surpassed those on all other financial assets, but were far safer and more predictable than bond returns when inflation was taken into account."** – Princeton professor Jeremy Siegel from the 2014 preface to his classic book, Stocks for the Long Run

iShares iBoxx $ High Yield Corporate Bond ETF HYG | ★★★

Add to Portfolio · Get E-mail Alerts · ? Data Question

Quote | **Chart** | ETF Analysis | Distributions | Performance | Ratings & Risk | Portfolio | Fees & Expenses | Tax | Ownership | Filings

Last Price $85.38 **Day Change** ↑0.51 | 0.60%
As of Fri 12/02/2016 7:59 PM EST |USD

Intraday Indicative Value $85.12 ↑0.06 | 0.07%
As of Fri 12/02/2016 6:59 PM EST |USD

NAV	Open Price	Day Range	52-Week Range	12-Mo. Yield	Total Assets	Expenses
85.01 USD	85.07	84.98-85.39	75.09-87.56	5.52%	16.41 bil USD	0.50%

Prem/Discount	Volume	Avg Vol.	SEC Yield%	Bid/Ask/Spread	Category
0.31%	9.4 mil	14.1 mil	5.88	84.78/ 86.95/ 2.53%	High Yield Bond

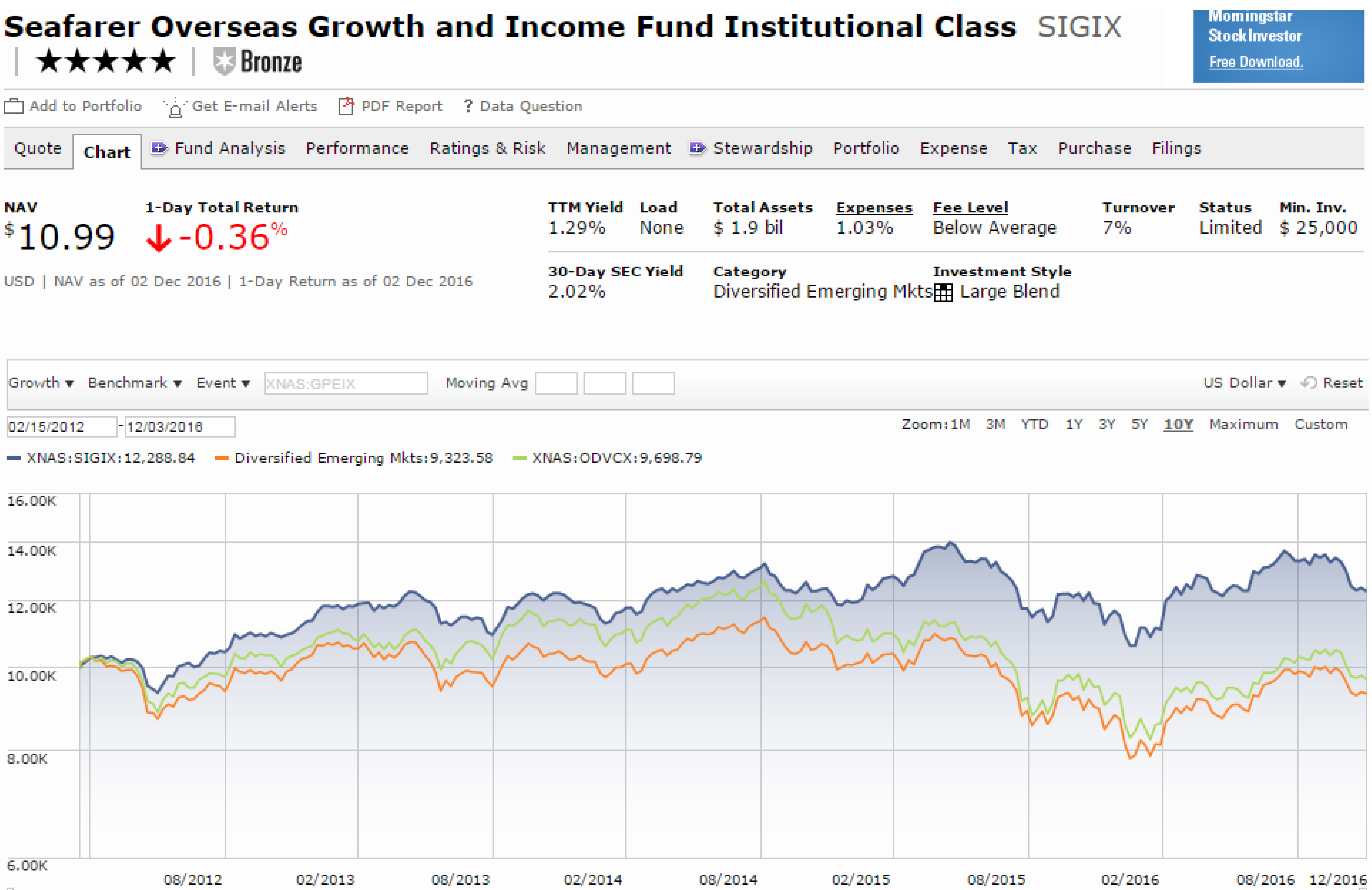
Morningstar's Sumit Desai, CFA from 11/1/2016:

... the largest exchange-traded fund in the high-yield bond ETF Morningstar Category and its low price tag is a positive. That said, the high-yield bond market remains an area where experienced active managers can add value over passive vehicles. For that reason, this ETF earns a Morningstar Analyst Rating of Neutral.

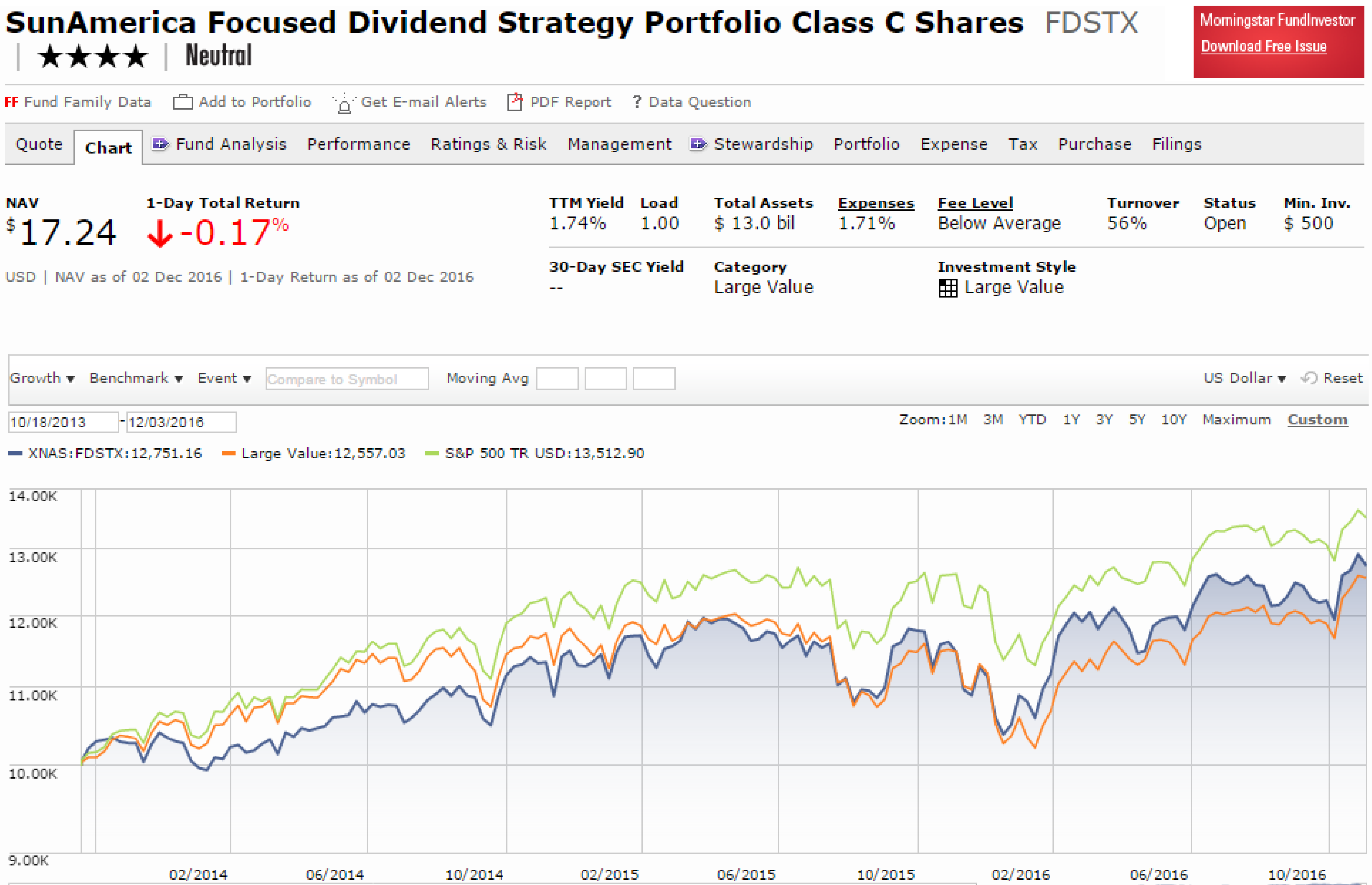
High-yield bonds sit at the intersection of high-quality bonds and equities and typically offer mid- to high-single-digit yields. However, investors must also keep in mind that these higher yields are associated with higher levels of risk. High-yield bonds (defined as those rated BB or below by a major ratings agency) are issued by highly leveraged firms, including some that are going through financial distress or have taken on significant debt because of mergers and acquisitions, share buybacks, or other needs. This ETF tracks the Markit iBoxx USD Liquid High Yield Capped index which measures the performance of the most-liquid U.S.-dollar-denominated non-investment-grade corporate bonds issued by corporations located in developed economies. Eligible bonds must have a minimum outstanding of $400 million, a minimum maturity of 1.5 years, and a maximum of 15 years. The size restriction helps to manage liquidity risk by avoiding smaller and thus typically less-liquid bonds, but it means that investors also forego the higher yields those smaller bonds typically provide.

Further, this ETF and other similar passive vehicles have yet to prove an edge over experienced actively managed high-yield bond funds. Active managers can tactically use smaller bonds to generate extra yield and can also add value over standard benchmarks by adjusting sector and individual bond positioning based on expected changes to the underlying issuer's fundamentals. Over the trailing five years ending Sept. 30, 2016, this fund's 7.1% annualized return made it the top-performing high-yield bond ETF but landed it only near the middle of the combined universe of high-yield bond ETFs and actively managed open-end funds.

ODVCX - We track a handful of the top Emerging Market OEFs, including your Oppenheimer Developing Markets (green line). ODVCX is 4* Silver rated, with a Large Growth Investment Style and 2.07% Expenses. It has a **1% Load**, but has Share Classes without a Sales Charge. We prefer **SIGIX** (blue line), but the central question to be answered is whether you want a set allocation to this segment of the Equity Markets. We shared our concerns in **Another DIYer - 11/28/16**: "While we would avoid an allocation to Emerging Markets for any client at this time, that is especially true for someone transitioning to Capital Preservation. Interest rates are climbing, with the U.S. 10-year Treasury yielding over 2.4% today. As a result, the dollar is gaining. In a webcast on the 17th, BCA Research's Chief Strategist Caroline Miller pointed out that, "**EM risk assets have never escaped a rising dollar**."



FDSTX - Sell, although with only a 0.4% allocation this is primarily a house cleaning recommendation for a **1% Load** OEF that we wouldn't add funds to.



Morningstar's Kevin McDevitt, CFA from 8/12/2016:

There are doubts about this fund's continued success.

SunAmerica Focused Dividend Strategy has one of its category's best 10-year records, but concerns over its team, expenses, and performance attribution have pulled its Morningstar Analyst Rating to Neutral from Bronze.

... the person largely responsible for creating the model is no longer on the fund. ... This current team is unproven and, although it's still early days, the fund lagged the FTSE Index by 2.2 percentage points since the new team took over through July.

The fund's fees are particularly disappointing. Assets have grown by nearly $5 billion since 2013, yet the expense ratio has risen 8 basis points. The expense ratio was even lower at 0.94% in 2009 when assets were less than $200 million. Arguably, SunAmerica hasn't shared economies of scale with fundholders. ...

HCM Portfolio

Diversification is often referred to as **"the only free lunch on Wall Street."** Our website has a section devoted to Asset Allocation, from which these quotes are taken unless otherwise noted.

Bonds - "Here is what Warren Buffett wrote about fixed-income investing in his 2012 annual letter to Berkshire Hathaway, Inc., shareholders: 'They are among the most dangerous of assets. Over the past century these instruments have destroyed the purchasing power of investors in many countries, even as these holders continued to receive timely payments of interest and principal… Right now, bonds should come with a warning label.'"

Cash - "Equities have historically returned 10% a year. Move the decimal point 2 places to the left and you have what cash is currently yielding. That is an opportunity cost of 9.9% annually."

Commodities - "Many investment advisors recommend a significant allocation to commodities for returns uncorrelated with the rest of the market. And while the returns from this asset class are indeed uncorrelated, for the past few decades the roll yield on many commodity futures contracts have been negative, meaning investing in these contracts has been a losing game." ***Everything* is correlated to the stock market now because *everything* is traded on the same exchanges by the same people with the same borrowed money. Diversification is dead.** - Charles Sizemore, CFA 4/26/12

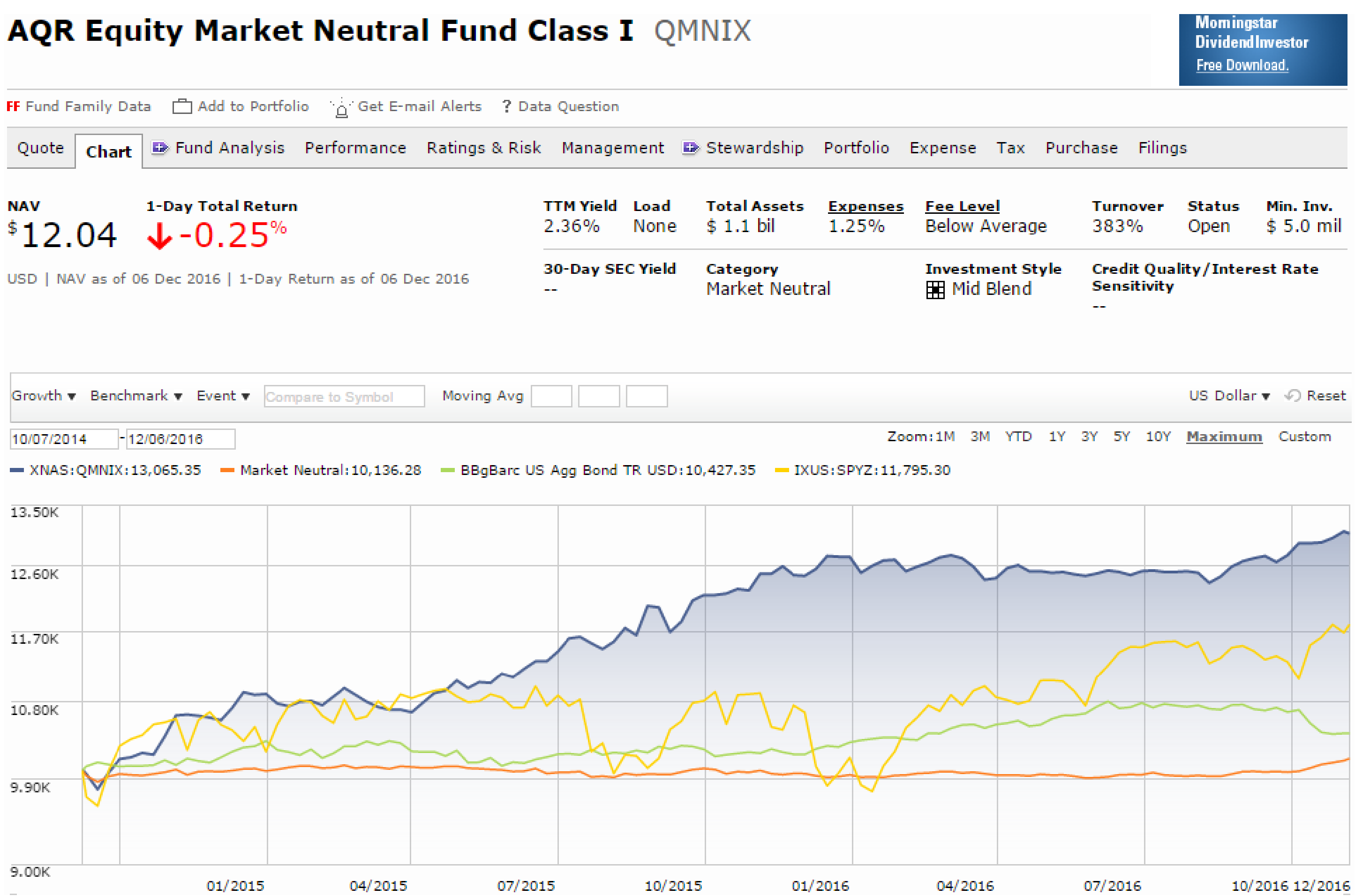
Real Estate - We recommend a slice due to its historically higher return than Equities. Its advocates will also point to its relatively low correlation to Equities. However, when the SHTF the Maximum Drawdowns, our preferred **Risk** metric, tend to be higher than Equities.

Equities - While portfolio diversification beyond Equities and Real Estate is likely to be hazardous to one's financial health, there is greater opportunity today for proper diversification within Equities than ever before. From 2016's *Your Complete Guide To Factor-Based Investing*: "Support for such factor-based investing strategies is provided by Antti Ilmanen and Jared Kizer in their 2012 paper 'The Death of Diversification Has Been Greatly Exaggerated.' Their work, which won the prestigious Bernstein Fabozzi/Jacobs Levy Award for the best paper of the year, made the case that factor diversification is more effective at reducing portfolio volatility and market directionality than asset class diversification."

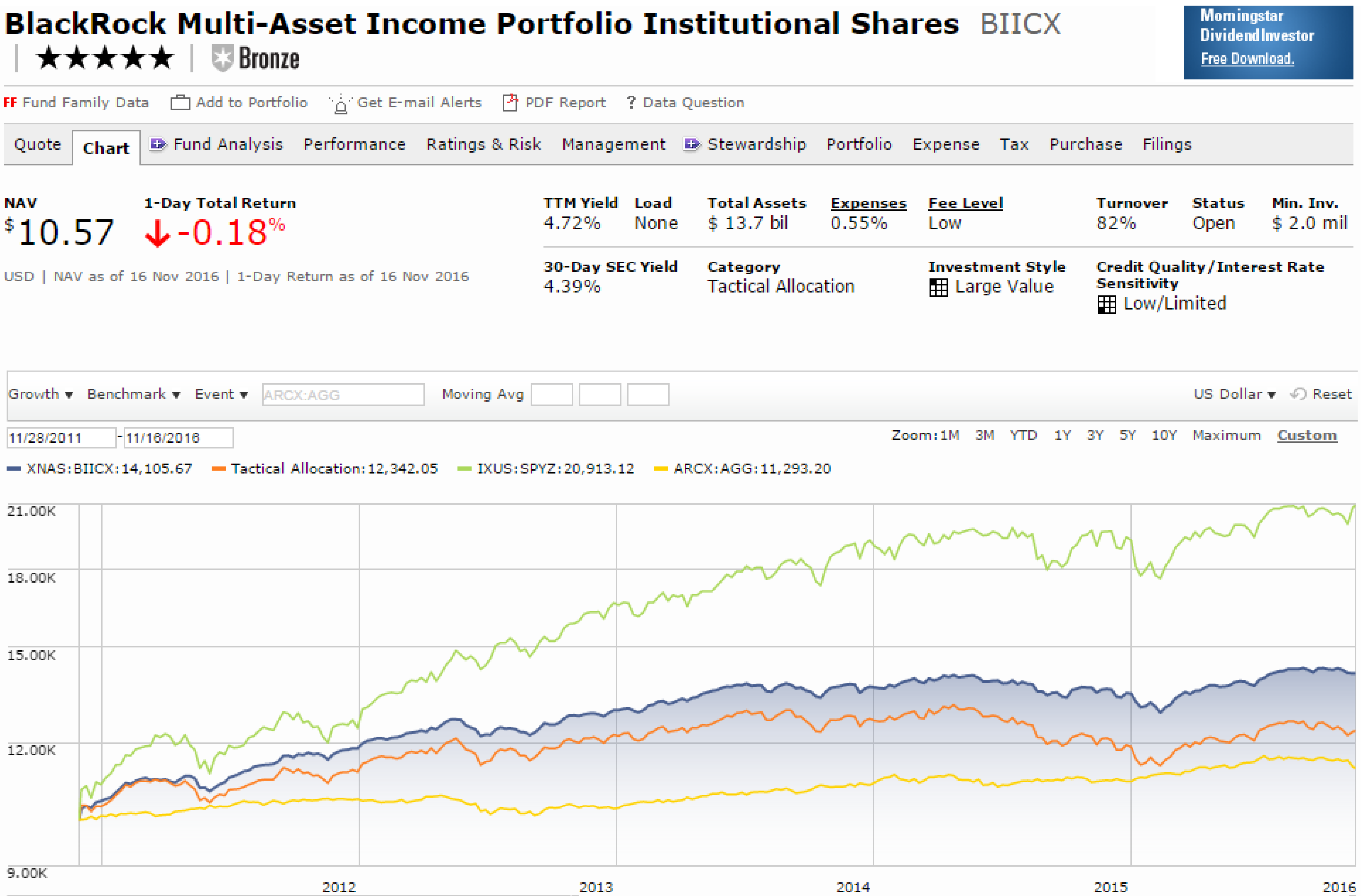
At this point in time, we would recommend the following portfolio, which has the same **0.9 Risk** ratio as your Wells Fargo holdings and a **2.5%** annual **Distribution**, compared to 2.1% for your Wells Fargo accounts.

%	Symbol	Type	Description	Factors (1)	Dist.	(2)	Risk (3)
20	QMNIX	OEF	Global Long/Short Equity-Large Blend	V, M, Q	2.4%	A	0
20	BIICX	OEF	Global Tactical Allocation		4.7%	M	0.6
10	GFMRX	OEF	Global Real Estate		2.4%	Q	1.1
11			QOF	I, V, E			1.8
9	MTUM	ETF	US Large Growth	M	1.2%	Q	1.0
10	KNOW	ETF	Domestic Mid Blend	I, E, V	1.4%	Q	1.0
5	IVAL	ETF	Foreign Large Value	V, Q	1.4%	Q	1.3
5	IMOM	ETF	Foreign Large Blend	M, Q	0.9%	S	1.2
10	GPIIX	OEF	Foreign Small/Mid Growth	S, V, Q	4.7%	A	1.7
			Weighted Average:		**2.5%**		**0.9**
			Notes				
1	V=Value, M=Momentum, Q=Quality, I=Insiders, E=Earnings, S=Size						
2	Distribution Frequency: A=Annual, S=Semi-annual, Q=Quarterly, M=Monthly						
3	Ratio of average historical Max. Drawdowns to S&P 500 declines greater than 10%						

QMNIX - We have added the S&P 500 (yellow line) to its Morningstar chart. Note that with a "5.0 mil Min. Inv." this OEF is effectively only open to Registered Investment Advisor clients.



BIICX - Our favorite Income Fund, with a **Risk** ratio of **0.6**. Note that with a "2.0 mil Min. Inv." this OEF is effectively only open to Registered Investment Advisor clients. We have added the S&P 500 (green line) and AGG (yellow line) to Morningstar's chart for comparison. AGG (iShares Core US Aggregate Bond Fund) "is among the cheapest ways to anchor a portfolio with core fixed-income exposure. Its bogy, the Barclays U.S. Aggregate Bond Index, is the industry standard" and the benchmark we use.



Morningstar's Jeff Holt, CFA from 5/25/2016:

An income-oriented allocation strategy that keeps a close eye on risk.

2015 proved to be BlackRock Multi-Asset Income's most difficult year since it morphed into its current income-oriented approach in November 2011; the fund fell 3.3% in 2015's third quarter and lost 1.4% for the year. Still, those relatively modest declines in a turbulent market environment reflect positively on the fund's risk-conscious approach, supporting its Morningstar Analyst Rating of Bronze.

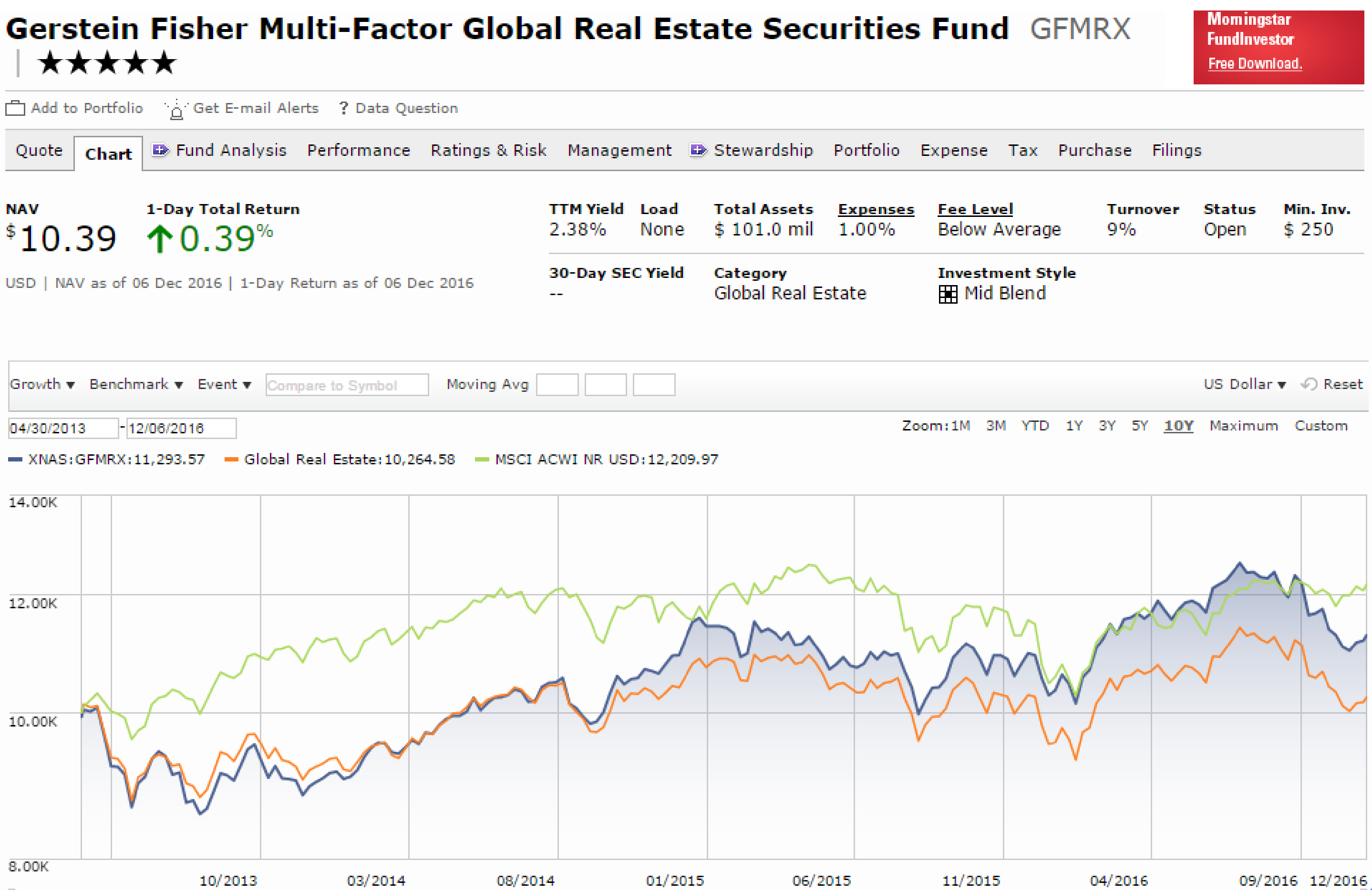
Lead manager Michael Fredericks and his two comanagers aim to keep volatility below that of a 50% MSCI World Index /50% Barclays U.S. Aggregate Bond Index blended benchmark; they've successfully done so thus far. Since Fredericks took the helm through April 2016, the fund's 5.2% annualized standard deviation comes in below the blended benchmark's 5.9%. The fund's volatility also appears lower than most income-oriented allocation peers over that same period.

The portfolio consists of an ever-changing mix of dividend-paying equities, fixed-income securities, and alternative income sources. Most recently, management has taken a relatively defensive stance because of its low-growth economic outlook, cutting exposure to U.S. dividend-paying stocks. Conversely, high-yield bonds and bank loans combine to a 30% stake as of March 2016, and management finds bank loans' yields and higher position on the capital structure particularly attractive. Covered calls, which produce income by writing options on individual stocks, remain one of the fund's distinguishing sources of income and represented roughly 15% of the portfolio as of March 2016.

The fund has delivered for income seekers in its short history. Its income return has ranged between 4.8 and 5.4 percentage points each calendar year under Fredericks' oversight, and the fund boasts a total 7.2% annualized gain since Fredericks took over through April 2016.

The fund's low cost gives it an additional edge, helping make it an overall strong choice for income-oriented investors.

GFMRX - A Quantitative, unleveraged OEF with a Risk ratio relative to the S&P 500 of 1.1, which is low for Real Estate Funds.



MTUM - In an interview, Eugene Fama (the father of the Efficient Market Hypothesis) admitted that "…the one thing that causes lots of trouble is the evidence that there's some short-term momentum in returns…. in my view that's the biggest challenge to market efficiency."

iShares Edge MSCI USA Momentum Factor ETF MTUM | ★★★★★

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Quote | **Chart** | ETF Analysis | Distributions | Performance | Ratings & Risk | Portfolio | Fees & Expenses | Tax | Ownership | Filings

Last Price $76.16   **Day Change** ↑0.98 | 1.30%

As of Wed 12/07/2016 4:00 PM EST |USD

Intraday Indicative Value $76.22 ↑1.01 | 1.35%

As of Wed 12/07/2016 4:41 PM EST |USD

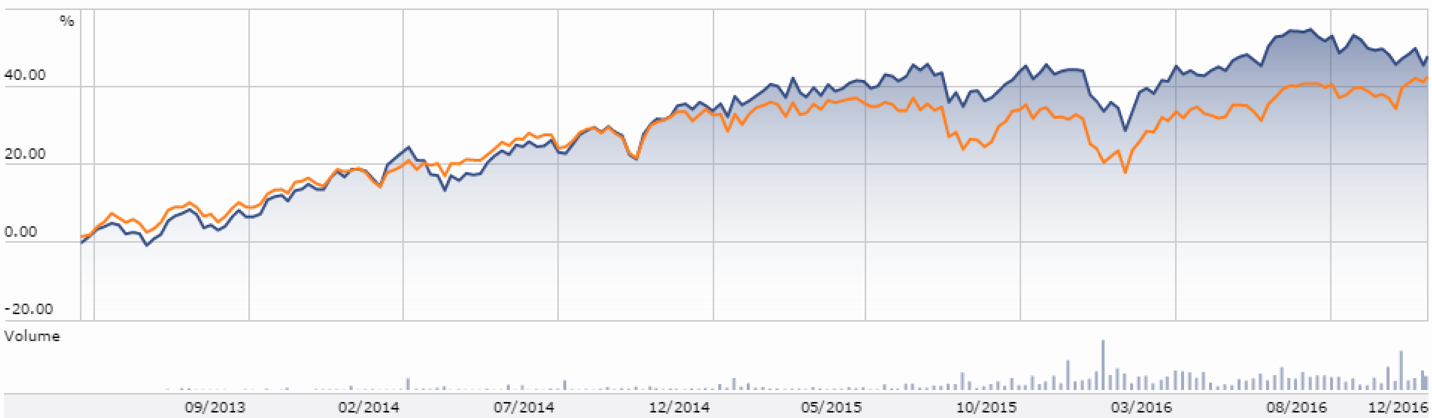
NAV	Open Price	Day Range	52-Week Range	12-Mo. Yield	Total Assets	Expenses
75.21 USD	75.15	75.07-76.22	63.92-78.78	1.19%	1.80 bil USD	0.15%

Prem/Discount	Volume	Avg Vol.	SEC Yield%	Bid/Ask/Spread	Category
-0.08%	133342	261,561	1.06	73.06/ 78.08/ 6.64%	Large Growth

Benchmark ▾   Event ▾   Compare to Symbol   Simple Moving Avg   Reset

04/16/2013 - 12/06/2016   Zoom: 1D 5D 1M 3M YTD 1Y 3Y 5Y 10Y **Maximum** Custom

ARCX:MTUM: +24.26|+47.64%   IXUS:SPX: +659.87|+42.51%



Morningstar's Alex Bryan, CFA from 11/1/2016:

A cost-efficient momentum strategy.

... MTUM offers low-cost exposure to stocks with strong recent performance. It is based on the observation that recent relative performance tends to persist in the short term. This efficient momentum strategy should offer attractive performance against its large-growth Morningstar Category peers over the long run, supporting the Morningstar Analyst Rating of Silver.

The fund targets large- and mid-cap stocks with strong risk-adjusted price performance over the past seven and 13 months, excluding the most recent one. This focus on risk-adjusted performance may help moderate the fund’s volatility. It also may give a better signal of directional price movements. The fund weights its holdings according to both their market capitalization and risk-adjusted momentum to strengthen its momentum orientation, while tilting toward the largest names. This can lead to some large positions in individual names, but the fund caps these weightings at 5%. The resulting portfolio lands squarely in large-growth territory. It should effectively complement value-oriented holdings because momentum tends to work well when value doesn't, and vice versa.

To mitigate turnover, the fund only reconstitutes twice a year and applies a wide buffer around the stocks it targets. These adjustments reduce the fund’s style purity, since momentum can shift from month to month. But they also improve cost efficiency. The fund can still experience high turnover. In the fund's most recent fiscal year, turnover was 106%. However, it has not yet distributed a capital gain. The exchange-traded fund structure allows the managers to transfer holdings out of the portfolio through a nontaxable in-kind transaction with the fund's authorized participants.

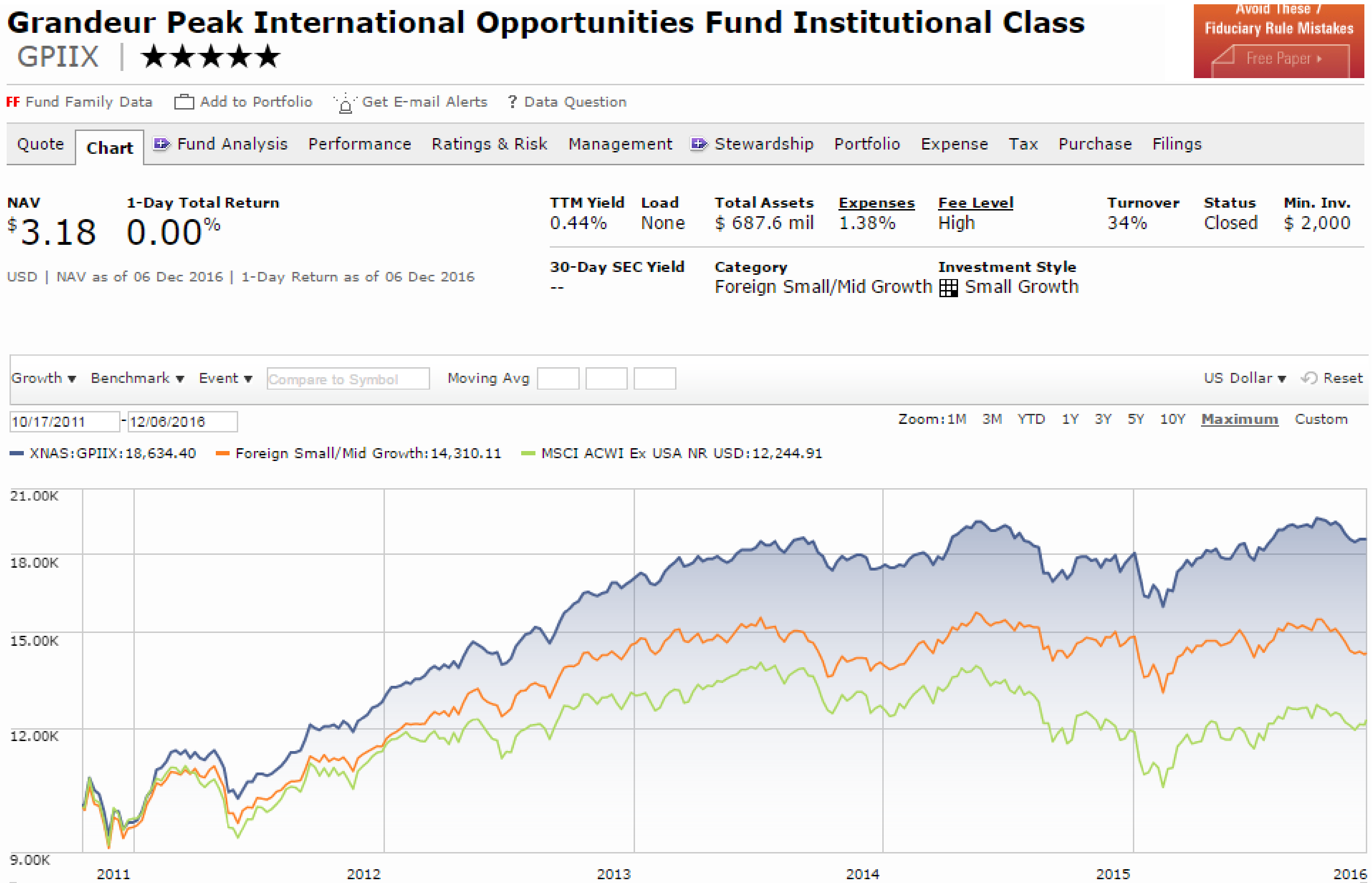
While the fund has a limited record, its approach has worked well so far. From its inception in April 2013 through September 2016, it outpaced the Russell 1000 Growth Index by 1.4 percentage points annually, with comparable volatility. ...

KNOW - Uses the same 3 Factors as our IVE Sock Selection System. "The strategy follows a quantitative rules-based equity approach that allows investors access to stocks that corporate insiders are accumulating. The strategy reviews each of the index constituents on a monthly basis, focusing on strong insider buying and favorable analyst ratings." It also applies an overlay based on the Valuation and Quality Factors.

IVAL - It is important to compare it to an appropriate benchmark, in this case iShares MSCI EAFE Value (EFV, orange line), at $3.3 billion the largest International Value ETF.

IMOM - We have added IVAL (orange line), Alpha Architect's International Value ETF, to Morningstar's chart. As we detail on our website, Value and Momentum are 2 Factors that academic research has found to be synergistic: "As both Value and Momentum have withstood the rigors of academic scrutiny, why not combine the two into a kind of super factor? Alpha Architects has studied this strategy, and found that while both value and momentum belong in a portfolio, they work best separately, not as a single factor. “The evidence suggests that a value and momentum system, which combines both pure value and pure momentum into a single portfolio, may prevent a value-only investor or a momentum-only investor from suffering through extended, long-term stretches of poor performance.”

GPIIX - We use Grandeur Peak's International Opportunities Fund for International Small Cap exposure for clients without an IRA. They (blue line) use a similar Quantitative approach to our own, and outperform their peers (orange line), which, in turn, outperform their benchmark (green line), as shown below. While it is hard Closed to all investors, HCM has been granted a waiver to this 5*, Morningstar's highest performance rating, OEF.



Our thoughts:

When the Obama Administration's DOL proposed that brokers be held to the same fiduciary responsibility for retirement accounts that Registered Investment Advisors (RIA) like HCM are held to for all clients, the howls of protest that emanated from brokers like Wells Fargo weren't over their concerns for their clients' bottom line. From a Dec. 2, 2016 article by Greg Iacurci:

"Wells Fargo Advisors has elected to keep commission retirement accounts intact under a Labor Department regulation governing investment advice ...

The so-called fiduciary rule, which seeks to clamp down on conflicted investment advice in retirement accounts, exposes firms offering commission accounts to additional compliance costs and litigation risk. ...

Merrill Lynch ... and **JPMorgan Chase & Co.** aim to scrap commission retirement accounts once implementation of the rule takes effect in April, a move that would bypass many of what analysts view as the rule's more onerous provisions.

Merrill also has maintained that **only offering retirement accounts** charging a flat fee on assets under management **is the right way** to serve clients' best interests under the rule. ...

One such compliance detail involves a "firm-approved list of available investments for retirement accounts," the memo said.

A person close to the firm's decision-making said nothing has been finalized, and it's too soon to say if the number of available investments will be reduced from those currently offered."

While the obvious self serving that resulted in their Wells Fargo portfolio isn't the most egregious case we've seen, that dubious distinction belonging to an Edward Jones broker, it has come at a significant cost. Perhaps these clients were fully informed as to what was being done to them. If so, was that sufficient justification? Would they have been better served in Fee based accounts? We believe the answer to the first question is "No", and to the last question "Yes", assuming a reasonable fee and competent portfolio manager.

A properly diversified portfolio has more than a 3.4% allocation to International stocks. Again from *Your Complete Guide To Factor-Based Investing*: "In the 2016 Credit Suisse Global Investment Returns Yearbook ... the equity risk premium (ERP) is provided for 21 developed countries, from the perspective of a U.S. investor. From 1900 through 2015, the premium, the average annual return for stocks as measured against one-month U.S. Treasury bills, was positive in every case, ranging from about 3.1 percent in Belgium to 6.3 percent in South Africa. The U.S. market was tied for eighth place with a premium of 5.5 percent. The global ERP was 4.2 percent, the world ex-U.S. premium was 3.5 percent, and in Europe it was 3.4 percent. Over the last 50 years of this period (1966-2015), again all premiums were positive, ranging from 1.4 percent in Austria to 6.6 percent in Sweden. The U.S. premium was 4.4 percent (ninth highest), the global premium was 4.1 percent, the world ex-U.S. was 4.5 percent, and in Europe it was 5.4 percent. ... And you can see that the United States was not the country with the highest returns." As legendary, 71-year-old Wharton finance professor Jeremy Siegel, whose book *Stocks for the Long Run* we highly recommend, is quoted in a December 12th WSJ article "Go world-wide."

A properly diversified portfolio doesn't devote 60% of the portfolio to individual U.S. Large and Mega-Cap stocks. U.S. Large-Cap stocks are the world's most efficient segment of the Equity Markets. While there is some academic evidence that large brokerage firm analysts are marginally superior, there is no evidence that Wells Fargo's are any better than Goldman Sachs', J.P. Morgan's, Morgan Stanley's, Citigroup's, etc. If your broker is claiming otherwise, the following quote from statistician W. Edwards Deming may help: **"In God we trust; all others bring data.**" Churning 30 stocks in this segment of the market only increases costs while lowering performance.

I am very familiar with a Morgan Stanley Group in Arizona that does an excellent job for clients. I'm sure there are others out there, and just as sure that they are all fee-based. I acknowledge that some of us just don't have what it takes to survive cold calling hell in order to join the kettle circling above. Some of us RIAs find it abhorrent that brokers aren't held to the same fiduciary standard we are, for all clients, and wonder how many of them are aware of the fact. So if you too have a commission-based broker managing your investments, never, ever allow him or her to put you in a Load fund. All 4 of the OEFs in this case had Share Classes available without a Sales Charge. Otherwise, choosing from the OEF/ETF/CEF smorgasbord (there are more Funds than stocks) is a matter of analyzing relative Performance, Process, Management Team (for OEFs and CEFs) and Cost. Your broker or RIA should be able and willing to explain in writing the reason for every selection. Morningstar is an excellent resource with which to double check what your broker or RIA is doing for or to you.