The Lubitz Financial Group
PERSONAL FINANCIAL PLANNING & INVESTMENT MANAGEMENT

FREQUENTLY ASKED QUESTIONS
March 2016

What are we doing?

- In the context of the current interest rate environment, the possible rise in interest rates, and also acknowledgment of the increasing complexity of the bond investments now in the market, we have been exploring ways that we can better position your bond portfolio to better deal with the increased volatility in the global bond markets. We are not increasing nor decreasing the bond allocation, merely shifting within the allocation and removing the static allocation to certain types of bonds, such as high yield, to introduce more flexible and dynamic bond strategies.
- At this time, we want to increase the flexibility within our bond portfolios to capture return in more diverse sectors of the market while still preserving the focus in quality and stability. Our proposed bond allocation will contain three main asset class components: US core bonds – which will still represent the majority of your bond allocation – Multisector bonds, and foreign bonds.
- Our recommended changes will introduce the Multisector sub-asset class or bond strategy and will removing the dedicated target exposure to high yield bonds. We will still maintain the majority of your bond allocation in U.S .investment grade bonds and will maintain the small allocation to foreign bonds we have always had. We are not eliminating the exposure to high yield bonds or emerging market bonds, but rather we are delegating the decisions as to how much, when, and how to invest in these markets to the experienced bond managers within the Multisector bond strategies.

Why are we doing this change in Bond allocation/strategy? Why doing it now?

- Our objective for the bond portion of the portfolio is to be the anchor and diversifier to equity markets. Through our research and views on the future of the fixed income markets, we believe that deferring specific fixed income sector exposures (EM, HY, MBS, etc.) to active managers will result in stronger risk-adjusted performance going forward.
- Fixed income markets have entered a new uncharted territory that we haven't been in for decades (or ever before) due to the historically low interest rates, uncertainty of central bank policy decisions, low inflation, and challenges that are increasingly global. We are positioning the bond portfolio to be more flexible in its ability to navigate these challenges and capitalize on opportunities.

Are you changing other things or markets in the portfolio?

- Your fixed income/bond allocation will remain the same and we are only changing the different sectors or allocations within your bond allocation.
- We will not be making changes to the equity/stock allocation of the portfolio at this time.
- We will be making changes to the Alternatives/REIT funds within the portfolio shortly by selecting the appropriate investment strategies that will benefit the portfolio in the long term but we are not changing the total allocation in your portfolio. We are finalizing the research and selection of strategies to implement and expect to notify you next quarter.

Are we doing this because of the recent US FED move to leave rates unchanged (or begin raising rates in 12/2015?

- These changes are not a direct reaction to the FEDs decisions. We have been researching this topic for quite some time (since mid-2015) and the FEDs move only increasingly supports our decision to reposition the fixed income portfolio to better navigate the current environment

Does the risk or return profile of the portfolio change because of this change?

- Briefly, on a high level, we do not expect the projected risk/return characteristics of the portfolio to change. We have completed in depth portfolio analysis and based on historical data we have seen a similar portfolio have slightly higher return and slightly lower risk/standard deviation
- Because we are at historically low interest rate environment, the risk and volatility of bonds rises as interest rates go up. We are trying to position the portfolio the best way possible to minimize that volatility/risk within the bond markets while maintaining a reasonable return and yield.

What are multi sector bond funds?

- Multisector bonds, by nature (and as the name implies) have flexibility to invest in fixed income positions across all global markets and all sectors. Traditional core bond strategies are limited as to how much they can move away from an index or benchmark, which can lead to being over concentrated in areas or sectors that may not be as attractive to invest in given the current environment.
- Multisector bonds can use strategies that are a little different than the traditional broader buy and hold fixed incomes investors. Their flexibility in markets also allows them to make calculated changes to the overall investments at any time.
- If asked about specific sectors that these bonds can invest in, you may say that you can get back to him/her via email with a more detailed breakdown.

What transactions costs will I incur from these changes?

- The total cost will depend on the portfolio and total account value, but the range will be from $150-$450. Part of this change is to implement an investment that does not charge a transaction fee. We have done a great job in placing at least one non-transaction fee fund in every asset class we currently use. We are very fee conscious and always try to minimize fund fees and transactions costs. The overall expenses of the portfolio will also be reduced.

INVESTMENT QUESTIONS

What does each fund do specifically and what are the differences?

Short Term Bonds

- Thornburg Limited Term Income Fund (THIIX) *already used in portfolios* –The fund's fixed income positions are mainly rated A or better and the fund is structured as a 7-year ladder. A bond ladder is a portfolio of bonds with varying maturity dates to minimize interest-rate risk and to increase liquidity. It typically maintains an average maturity of no more than 4 years and average duration of less than 3 years.

Core US Bonds

- Schwab US Aggregate Bond ETF (SCHZ) *already used in portfolios as core bond fund* – This exchange traded fund offers a low-cost option to track the Barclays US Aggregate Bond Index. The Barclays Index accounts for the four major bond sectors in the United States, the US Government, US Credit, US Mortgage Backed, and US Asset Backed.
- Sterling Capital Total Return Fund (BIBTX) *NEW* –Sterling Capital is a private firm back by BB&T Corporation and has been managing institutional fixed income for over 30 years. This fund offers a time-tested approach to being the Core, or anchor, of the fixed income portfolio. They invest mainly in high quality (investment grade) bonds using their experienced team with more than 20 years managing fixed income portfolios.

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Multisector Bonds

- PIMCO Income Fund (PIMIX) *NEW* – PIMCOs globally diversified team has been running this portfolio since before the financial crisis of 2008. They have also recently partnered with Ben Bernanke, ex-chairman of the Federal Reserve, as a guide for future macroeconomic investment decisions. The overall goal of the fund is to generate a consistent level of income in pursuit of long-term capital appreciation. The fund is not constrained to a following a benchmark allocation, which allows them to seek opportunities from multiple sources in the fast changing market environment.
- Performance Trust Strategic Bond Fund (PTIAX) *NEW* – Performance Trust's team specializes in complex and niche fixed income sectors. They seek to achieve the best risk adjusted opportunities through a process that does not rely on interest rate movements or forecasts. We believe their expertise in dissecting investments and nimble size will add a significant amount of value to the Multisector Bond allocation. This team of portfolio managers started working together after the financial crises leveraging their deep specialized expertise in analyzing complex fixed income securities.
- Blackrock Strategic Income Opportunities Fund (BSIIX) *NEW* – Blackrock is a global firm with leading talent, trading abilities, technology, and a culture built on serving clients. Their process for this fund is practical, rigorous, and repeatable, which has allowed them to consistently provide stability from volatile markets. Their seemingly arduous process for selecting which asset classes to invest has helped them repeatedly reduce exposure to volatile markets, an essential goal of the portfolio.

Foreign Bonds

- PIMCO Foreign Bond Fund (USD-Hedged) (PFORX) *already used in portfolios* – This fund is currently in your portfolio. This fund's objective is to invest in high-quality bonds from countries other than the United States. Once the bonds are put in the portfolio, the currency of the foreign country is then converted to US Dollars to eliminate fluctuations in the foreign country's currency.

Are these bond fund strategies liquid, in other words, can I sell them at any time? What level of liquidity do these bond funds provide?

- Because these investments are mutual funds and Exchange Traded funds, we are able to sell the positions at any given day. Each of the bond funds selected is aware of investor liquidity concerns and position the portfolio very purposefully to address this. The US Bond funds (Thornburg, AC, Sterling, and Schwab) each have sufficient allocations to cash to handle any liquidity concerns. The PIMCO Income fund, as an example, has set aside 1-1.5 years' worth of income to maintain their objective for investors.

For taxable accounts, do you plan to get rid/replace municipal bond funds?

- No, for taxable accounts, we will continue to utilize your existing municipal bond funds in addition to adding the newly elected funds. The municipal bond funds will continue to be part of the US Core Bond allocation.

Will the credit quality and duration of my bond portfolio change?

- Historically, our bond allocation had stated target allocations for credit quality and maturity of the bonds with little change over time. One of the goals in utilizing these new active managers is to provide them with the flexibility to adjust credit quality, duration, and maturity of their underlying bond investments based on their research of the global markets combined with the in-depth analysis of the actual bonds.

Why are we removing the high yield allocation? Is it because of the recent negative return the asset class had in 2015?

- We are not removing high yield from the portfolio. We are delegating to the new managers/funds the decision to invest in high yield, how much, what sectors, and when. All these factors play an important role in capturing the right exposure to high yield. We are simply saying we no longer feel high yield should be a static allocation at all times and accepting the fact that these successful bond managers will be better prepared to conduct the necessary research and due diligence to make the decisions as to when to make adjustments to the high yield allocation.

What type of foreign bonds would we have? Would we maintain emerging market bonds? Would we hedge or not hedge currency?

- Our research has shown an allocation to foreign bonds has helped to diversify a portfolio and reduce overall volatility over a long time horizon. Because of this, it is our policy decision to maintain a minimum allocation to foreign bonds in your investment allocation.
- Further research completed concluded that exposure to the currency fluctuations when investing in these foreign bonds added additional risk. For that reason, our foreign bond allocation will be 100% converted back to USD (hedged) to avoid these currency movements that add volatility.
- Emerging markets bonds will still be in your portfolio. However, due to the complex nature of these developing markets, we chose to have active managers do the research and diligence on these bonds. The new Multisector funds in the portfolio have the flexibility and expertise to make investments in these Emerging markets bonds if they see fit, and generally they have maintained exposure to these markets over time.

What are the expense ratios of these new bond funds?

- Thornburg Limited Term Income Fund – 0.52
- PIMCO Foreign Bond Fund (USD-Hedged) – 0.52
- Schwab US Aggregate Bond ETF - 0.05
- Sterling Capital Total Return Fund – 0.46
- PIMCO Income Fund - 0.45
- Performance Trust Strategic Bond Fund – 0.89
- Blackrock Strategic Income Opportunities Fund – 0.64

- ***Current Fixed Income Portfolio Average Expenses 0.49
- ***New Fixed Income Portfolio Average Expenses 0.47

How did we determine that these fund managers and bond strategies are the correct ones?

- We start with screening mutual funds and Exchange Traded Funds (ETFs) that meet the minimum investment criteria defined in your Investment Policy Statement. We then drill down the remaining funds by looking at various risk measures, performance return, and other technical data compared against the average peers in that asset class. Surprisingly, this narrows the field quite a bit. We then identify funds that have an investment objective that coincides with our long-term approach to investing, grounded on research and historical modern portfolio theories. Next, we begin reaching out to each of the fund companies to gather information on the management structure, bond/security selection methodology, and overall philosophy of the firm. This in depth process involves at times long conversations with the portfolio management team to really understand their thought process and methodology. After we have poked and prodded the fund managers, we meet internally to discuss the findings and make a decision with an implementation strategy.

What Morningstar Star rating, stewardship, and other MorningStar commentary are there about them?

Name	Morningstar Category	Morningstar Rating Overall	Morningstar Stewardship Grade
Summary		★★★★	
Benchmark:Morningstar US Market TR USD			
BlackRock Strategic Income Opps Instl	US OE Nontraditional Bond	★★★★	C
Performance Trust Strategic Bond	US OE Multisector Bond	★★★★★	
PIMCO Foreign Bond (USD-Hedged) I	US OE World Bond	★★★★★	C
PIMCO Income Instl	US OE Multisector Bond	★★★★★	C
Schwab US Aggregate Bond ETF™	US ETF Intermediate-Term Bond	★★★★	
Sterling Capital Total Return Bond I	US OE Intermediate-Term Bond	★★★★	
Thornburg Limited Term Income Instl	US OE Short-Term Bond	★★★★★	

- Blackrock Strategic Income - This fund has delivered consistent results since its management team has stabilized
- PIMCO Foreign - This fund saw a management change in 2014, but it retains many of the same strengths
- PIMCO Income - Still running strong
- Schwab ETF - The cheapest ETF available for passive exposure to the domestic investment-grade bond market
- We do not make investment security selections based on Morningstar Rating because it is biased towards recent performance of the fund compared to a benchmark, which may or not be appropriate. We can provide you with research piece as to why it is not a great idea is relying on these ratings for your fund selection process.

How did these funds do against the benchmark?

Name	Morningstar Category	Total Ret 1 Yr	Total Ret Annlzd 3 Yr	Total Ret Annlzd 5 Yr	Total Ret Annlzd 10 Yr	Total Ret Annlzd 15 Yr
Thornburg Limited Term Income Instl	Short-Term Bond	1.02	1.75	3.58	4.81	4.80
US OE Short-Term Bond	Short-Term Bond	-0.18	0.52	1.40	2.83	3.18
Schwab US Aggregate Bond ETF™	Intermediate-Term Bond	1.48	2.17			
Sterling Capital Total Return Bond I	Intermediate-Term Bond	0.67	2.21	3.72	5.17	5.17
US OE Intermediate-Term Bond	Intermediate-Term Bond	-0.32	1.51	3.28	4.27	4.56
BlackRock Strategic Income Opps Instl	Nontraditional Bond	-2.79	1.53	2.70		
US OE Nontraditional Bond	Nontraditional Bond	-4.05	-0.56	1.19	2.95	4.41
Performance Trust Strategic Bond	Multisector Bond	3.13	3.83	6.16		
PIMCO Income Instl	Multisector Bond	1.14	3.96	7.68		
US OE Multisector Bond	Multisector Bond	-4.50	0.63	3.22	4.83	5.81
PIMCO Foreign Bond (USD-Hedged) I	World Bond	0.11	4.32	6.25	6.28	6.22
US OE World Bond	World Bond	-3.34	-0.92	1.33	3.92	5.06

MY PORTFOLIO and MY PLAN

Do we need to make changes to our investment return assumptions used in the plan or IPS?

- These changes will not materially impact the return/risk expectations we have been using in your IPS and your financial plan. Although our research suggests that portfolio return may improve while risk/standard deviation stay the same or even be lower, our true goal for this change is to position the bond portfolio better for the current environment we are facing

Based on the current market returns and where you see the market going, am I still invested the way I should or do you recommend any other changes?

- We are not recommending changes to the total allocation to bonds in your portfolio but just revising slightly the specific strategies we will be using within the bond markets
- The financial planning projections we have completed with you in the past have suggested the type of portfolio and investment returns you needed to meet your goals. Unless your current circumstances, personally and/or financially, have changed since then, we still believe you have the right investment allocation and policy.

How would you implement these changes across my accounts?

- We will be reviewing all your accounts and determining how to implement these changes in the most cost effective manner. We will review your taxable accounts (if any) for possible capital gain tax consequences. We will review any outside accounts (if any) such as 401ks, 403bs, variable annuities, etc. and evaluate the investment funds available within those accounts that better represent the changes we are proposing.

Are there going to be any tax consequences with these changes?

- We will be evaluating taxable accounts on a client by client basis to make sure there are no unintended tax consequences. It is our goal, as always, to minimize any potential taxes due because of our trading, but it is possible that some trades will result in a taxable event.