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ADVANCE CAPITAL MANAGEMENT

FINANCIAL LIVING

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A QUARTERLY NEWSLETTER FOR THE CLIENTS AND FRIENDS OF ADVANCE CAPITAL MANAGEMENT

Training the Investor Brain

An Interview with Behavioral Expert Bob Schmidt

Behavioral economics, or finance, studies the effects of psychology in the economic decision-making processes of individuals. Based on research in this field, it turns out people aren't as rational as they think when making decisions. Certain mental biases cause people to make financial decisions that might not be in their best interests. That includes everything from how people shop to how they save – or don't – for retirement.

The good news is that knowing our limitations helps us create systems to make better decisions and ensure better financial outcomes. We spoke with Bob Schmidt, who oversees project research and analysis for the Brandes Institute, which examines market behavior and portfolio management. He talks about the impact emotions can have on investors.

What made you interested in this subject?
I was a financial adviser in the early '90s and saw firsthand the consequences of poor decision-making. In my role now, I enjoy sharing insights and tools designed to help investors limit the damage emotions can cause. This is still a relatively young field for research, and new tactics and discoveries continue to be developed.

Behavioral finance was generally founded on the work of Daniel Kahneman and Amos Tversky, which introduced the concepts of prospect theory and the two-system theory of thinking. Could you explain the two-systems?

Actually, I'd go back much further to the work of Benjamin Graham. In his book, "The Intelligent Investor," he shares a wonderful parable called "Mr. Market." Graham personified the stock market's ups and downs with this fictional character and made a great point: investors could use market irrationality to their advantage. How? By constantly focusing on the relationship between price and value. Asset values don't tend to change very quickly, but prices (often driven by emotion) can.

Tying these concepts to Kahneman and Tversky, System 1 thinking could be our emotional response to the market; this could be represented by prices. System 2 thinking is more rational. To me, this is focusing on assessing what an asset is worth and comparing that value to the price. I think it helps investors greatly if they can identify which system they are using in their decisions.

Why do losses hurt humans so much? Is this true for just a few of us, or is it broadly true?
Each person is different, but I think losses hurt a lot more than comparable gains feel good for most people. Forget about investing for a moment. I often joke that Prospect Theory helps explain why it's so hard to forgive someone. The hurt someone causes you tends to outweigh the nice things they do. This dynamic is similar when investing. I think it's just part of human nature.

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Market Insights: Q3 2018

Although the United States economy and foreign economies around the world are experiencing a somewhat synchronized and multidimensional pickup in growth, there are ample signs of potential change in the wind for investors.

With central banks tightening their belts, global trade tensions and an aging U.S. expansion, there exists the potential for higher interest rates, higher market volatility and additional economic uncertainty around the world.

U.S. ECONOMY GROWS AT FASTEST PACE SINCE 2014

In the second quarter, the U.S. economy grew 4.2%, which is the fastest pace in four years. Passage of the Tax Cuts and Jobs Act of 2017 has put more cash in companies' coffers and ramped up business spending at the fastest pace in years.

For instance, capital expenditures, such as spending on factories, equipment and other capital goods, totaled about $167 billion in the first quarter for S&P 500 companies. That is the fastest pace in seven years and a record for a first quarter. Add in a solid job market, rising corporate profits and healthy industrial production, all signs point to the U.S. economy growing throughout this year and into next.

GLOBAL TRADE TENSIONS CREATE UNCERTAINTY

As the domestic economy produces solid growth numbers, global trade tensions between the U.S. and its major trade partners have festered and could potentially derail this sanguine economic environment.

The U.S. has reached agreements with Mexico and Canada to revamp the North American Free Trade Agreement (NAFTA). In late July, the U.S. and European Union also agreed to work toward lower tariffs and trade barriers, and the Europeans agreed to buy billions of dollars' worth of soybeans and natural gas.

Yet an agreement with China, one of our largest trade partners, is still elusive and complicated. In short, the president has threatened to impose tariffs on virtually all $505 billion that the U.S. imports from China. These threatened and imposed tariffs are viewed as punishment for China's policies that have resulted in intellectual property theft or mandated technology transfers on U.S. companies doing business there. So far, China has responded in kind to our tariffs, mostly in the agricultural sector. It is still unclear what the long-term outcome will be of this trade war. A quick resolution should benefit domestic growth and employment, while a prolong and severe trade war will serve to hurt U.S. farmers, families and businesses.

CENTRAL BANKS CHANGE COURSE

Several central banks around the world have started the arduous process of reversing their decade-long accommodative monetary policy agendas. The Federal Reserve began raising interest rates in 2015 and then began selling assets in 2017. The benchmark interest rate has moved from about 0.25 percent to 2.0 percent over the past three years. Further, the European Central Bank and Bank of Japan are reining in asset purchases, although neither has begun raising rates or reducing balance sheet assets. The Bank of England, meanwhile, hiked interest rates for the first time in a decade last November.

The accommodative monetary policies of the last decade have provided significant tailwind for asset prices. Now that those policies are tightening, the global economy is in uncharted territory. How much of a headwind will financial markets face in this new environment? The answer to this question will likely influence markets for years to come.

BONDS EXPECTED TO FALL, STOCKS TO CONTINUE MODEST GAINS

Looking ahead to the remainder of this year and into 2019, the economy appears poised for modest growth, sustained employment gains and an increase in corporate activity and earnings. However, amidst these positives are expected higher interest rates by the Federal Reserve and elevated trade tensions between our trading partners, which could disrupt world economies if not contained.

As these events play out, we expect capital markets to respond accordingly. Core fixed-income securities will likely suffer as interest rates continue to trend higher. Domestic equities should produce solid, albeit more modest, gains moving forward, while we expect many of the international markets to bounce back from their slump of the past six months.

As always, investing in the capital markets comes with some risk and uncertainty. We thank you for your continued support of our investment process as we work hard to deliver positive risk-adjusted portfolio returns to our clients. Should you have any questions, please do not hesitate to reach out to your financial adviser. ■

It is not possible to invest directly into an index. The indices mentioned in this article are unmanaged and are not affiliated with Advance Capital Companies.

Higher Interest Rates Mean Lower AT&T Lump Sums

One way to think about interest rates and AT&T lump-sum pension payouts is like a playground seesaw. When interest rates fall, lump-sum payouts rise, and vice versa. Currently, interest rates are on the upswing, which means lower AT&T lump-sum values.

The chart below shows the projected impact of these higher rates.

As you can see, when you retire can be the difference of tens of thousands of dollars for retirement.

Therefore, if you're planning to retire in late 2018 or early 2019, it's critical that you understand how to exactly time your retirement to maximize your lump-sum benefit. And, if you're considering retirement in the next several years, this is a good opportunity to discuss the impact a lower lump sum has on your financial plan.

Your Advance Capital adviser will gladly answer any of your questions. Also, if you have any current or former co-workers who might find this information useful, please refer them to us. An adviser would be happy to assist them as well.

2018 Corporate Composite Rate	2019 *Projected* Corporate Composite Rate	Potential Change in Lump Sum Value	Potential Impact for a $500,000 Lump Sum
3.34%	3.9 - 4.1%	-5% TO -8%	-$25,000 to -$40,000

Training the Investor Brain *(Continued from page 1.)*

Why do you think it's so important for the average, mom-and-pop investor to understand how the mind can play tricks on us?
I believe once investors are aware of some of the more common and potentially dangerous biases, they can guard against them more effectively. Understanding how our minds sometimes play tricks on us can help us see the same behaviors in others and, hopefully, take advantage of it. Warren Buffett famously said we should be greedy when others are fearful and fearful when others are greedy. I think that's good advice.

What do you think are some of the most important traits of successful investors?
To me, the best investors have a solid philosophy and consistent process. They make decisions based on principles that have endured for decades. Of course, I'm biased toward value investing, but it has worked over the long term and it makes sense. In all facets of our lives, we likely are seeking attractive value for a low price. That idea has benefits whether you're buying something in the supermarket or the stock market.

What behavioral bias do you think investors most commonly fall victim to?
It depends on the investor, but among the more popular biases I've seen are extrapolation and some aspect of Prospect Theory. In short, investors tend to project what's happening now into the future and, as a result, can often allow fear or greed in the short term to derail a solid, long-term plan. Of course, I think investors should create a plan and put some thought into how they will invest and why, too.

Why is it that long-term investing seems so right in theory but so very hard in practice?
Emotions. It's like dieting. Both investing and dieting generally are pretty simple. With dieting, it's eat less and exercise more. With investing, it's spend less and invest more. But, just because it's simple doesn't mean it's easy. And it's hard for people because success demands discipline and patience. Often, we're not good at exhibiting those latter traits consistently.

At the same time, I think we can improve on these traits and become better investors with conscious effort and time. Partnering with a financial professional also can be a big help for some investors. Most people would benefit from the guidance of an objective professional. There's nothing wrong with asking for help—especially given the biases we tend to exhibit.

What insights can you give us into how to better judge risk? Are there ways for us to become aware of our biases, either by setting up checklists or learning how to frame things better?
With respect to risk, it's vital for investors to define it. That may sound odd, but there are different types of risk—fluctuation in asset prices, permanent loss of capital or not meeting long-term goals, for example. Once investors define it for themselves, they are better able to manage it. As for learning about our biases, this can be really tough. It can be hard for us to be objective about ourselves. And it's another reason why I suggest investors work with a financial professional. An adviser may have tools to help people assess their personalities and what biases they are more prone to exhibit.

Medicare Open Enrollment Tips

To fill any gaps in Medicare's coverage, most people sign up for a supplemental plan and a Part D prescription-drug plan, or a Medicare Advantage plan. Medicare's open enrollment, during which you can choose a Part D plan or Medicare Advantage plan for the following year, is from October 15 to December 7.

It's smart to look at your plan options every year. The drugs you take and the doctors you see may have changed. Or the costs and coverage under your current plan may have changed. There also may be new plans available that are better suited for your needs.

As we are in the middle of Medicare's open enrollment, here are some tips to help choose the right plan for you.

1. **Estimate your healthcare needs in 2019** – that means listing all the medications and medical care received in the past year that will carry forward into next year. This will help you locate the right plans for your anticipated needs.

2. **Take a look at your current plan's annual notice of change** – this form will notify you of any changes in cost and coverage and help you determine if you need to switch plans.

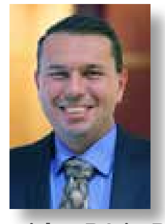
3. **Use the Medicare Plan Finder at Medicare.gov** – this online tool helps you compare plans as well as estimate your total out-of-pocket costs.

4. **Find out if your doctors are covered** – the Medicare Plan Finder won't list providers of each plan. Therefore, you may have to contact the insurer to learn which doctors and hospitals are included.

5. **Consider getting some help** – The State Health Insurance Assistance Programs (SHIPs) provide personalized counseling and assistance with choosing Medicare plans. Visit shiptacenter.org or call 877-839-2675 to find your local SHIP. ■

Advance Capital Welcomes Sean Egan, J.D.

We are proud to introduce a new addition to the Advance Capital team. **Sean Egan, J.D.**, has joined our Grand Rapids



advisory team. Before joining Advance Capital, Sean was employed by the International Brotherhood of Electrical Workers (IBEW) Local Union 876 as Legal Counsel. Prior to that, he spent 10 years as the principal elected officer of IBEW Local 275 in Western Michigan. Sean graduated from Davenport University with a BA in Business Administration with a concentration in Finance and is a graduate of Thomas M. Cooley Law School with a Juris Doctor.

Sean is committed to supporting working families, individuals and institutions on the path to financial security. Please join us in welcoming Sean. ■

Year-End Finance Steps

As tax season revs up in January, the end of the year is the perfect time for some financial housekeeping. Here are some steps to take that'll help make 2019 a financial success:

1. If working, try to maximize contributions to your retirement savings accounts.
2. Check your tax withholding.
3. Schedule a meeting with your adviser for a portfolio review.
4. Update your beneficiaries.
5. Review your budget.
6. Check your credit reports.
7. Shop around for more favorable insurance rates.
8. Consider charitable giving.

As always, your adviser is available to further discuss these steps with you! ■

HEADQUARTERS
One Towne Square
Suite 444
Southfield, MI 48076
(800) 345-4783
(248) 350-0115 Fax

GRAND RAPIDS, MI
625 Kenmoor Avenue SE
Suite 307
Grand Rapids, MI 49546
(800) 444-1053
(616) 954-2499 Fax

LISLE, IL
4225 Naperville Road
Suite 160
Lisle, IL 60532
(800) 327-3770
(630) 955-3404 Fax

INDEPENDENCE, OH
Crown Centre
5005 Rockside Road, Suite 215
Independence, OH 44131
(800) 457-4304
(216) 520-1535 Fax