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Money Matter\$



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Why I'm always talking about Closed-End Fund Arbitrage

by Adam Sommers

During a recent conversation about how to invest her portfolio, while looking at our model portfolio offerings, a client remarked about our Closed-End Fund (CEF) Arbitrage model:

“Well this one appears to have the best potential for higher returns, without taking on any more risk than the ‘Conservative’ model. **Why wouldn't everyone choose CEF-Arb?**”

I agree that when comparing our model portfolios, **the CEF-Arb model has the best risk/reward profile** of any of them. The potential downside is similar to our Conservative Models, yet the upside is similar to our Aggressive models – and it boasts the highest dividend yield of any of them by far. The best of all worlds, right? **That's by design.**

While creating this strategy, I looked for ways to lessen stress for our clients (by trying to avoid big drops in value), provide a nice income yield, still have potential for growth from a professionally-managed, diversified portfolio, all while maintaining intra-day liquidity so our clients have easy access to their funds (unlike a hedge fund's lack of liquidity).

Fine tuning the design of our model portfolio has taken more than a year, thanks to a few of

our intrepid clients acting as guinea pigs while we tested our ideas. Currently, our CEF-Arb model has:

- **A Current Income Yield of 7.1%**
- **A Total Return target of +9.7%**
- Average Fund Expenses of 0.85%
- **Potential 6-month downside: -7%** — with 95% certainty. *(That's even less than the statistical 8% potential drop of our Conservative SIP, and less than half the potential loss of the S&P 500 Index.)*

We obtain these benefits by **investing in heavily discounted, high-yielding closed-end funds, while simultaneously hedging nearly 75% of our exposure** via index ETFs that are inversely correlated with the CEF portfolio holdings. This method of hedging leaves us with 25% of a traditional portfolio's exposure to market volatility. The current CEF-Arb model includes high yield bonds, small-cap and large-cap U.S. and international stocks.

If you've dialed in your Risk Number (You—we—should know this number...) to between 35 and 55, SFM's CEF-Arbitrage may be a fit for you — especially **if you're aiming to generate sustainable income.**

“...less stress for our clients...a nice income yield...potential for growth...diversified...intra-day liquidity.”

12-Month Returns

Dow Jones Industrial 30	
Average:	12.0 %
S&P 500 U.S. Large Company Stock Index:	
	12.5 %
S&P Moderate Allocation	
Index (AOM):	9.1 %
SPDR Gold Index (GLD):	
	16.8 %

ETF EXTRA — PowerShares LadderRite Corp. Bond ETF — (LDRI)

The PowerShares LadderRite 0-5 Year Corporate Bond Portfolio tracks an equally weighted short-term USD investment-grade corporate bond index, resulting in a bond ladder-like portfolio.

The LadderRite Index emerged from the same mind as the designer of the BulletShares Indices that we love to track via Guggenheim's ETFs. LDRI charges 22 bps for a perpetually maturing, short-term (0-5 years) USD investment-grade corporate bond ladder. Each year, the fund will reinvest 1/5 of its portfolio under the prevailing interest-rate environment.

LDRI's Notable Statistics

Dividend Yield:	1.73 %
Total Assets in the Fund:	\$ 18.8 Mil.
Expense Ratio:	0.22 %
12-Month Return:	1.9 %
Max Drawn Down (last 3 yrs):	-4.7 %

iShares Aggregate Bond	
Index (AGG):	5.3 %
SFM's "NAKED ALPHA	
FUND":	16.9 %



Model STOCK Portfolios

GROWTH-oriented portfolio

% Wt.	Symbol	Description	Div. Yield	1-year Return	3-year Return	Expense
22%	VYM	Vanguard High Dividend Stock ETF	2.98%	17.8%	11.6%	0.09%
17%	VB	Vanguard Small Cap Stock ETF	1.49%	12.0%	8.0%	0.08%
19%	USMV	iShares U.S. Minimum Volatility Stock ETF	2.00%	16.1%	14.5%	0.15%
21%	VIG	Vanguard Dividend Appreciation ETF	2.06%	15.5%	8.5%	0.09%
21%	IVV	iShares S&P 500 ETF	2.12%	13.0%	11.2%	0.07%

INCOME-oriented portfolio

Average dividend yield: 2.8%

% Wt.	Symbol	Description	Div. Yield	1-year Return	3-year Return	Expense
20%	SCHD	Schwab U.S. Dividend Stock ETF	2.70%	19.5%	11.1%	0.07%
22%	VYM	Vanguard High Dividend Stock ETF	2.98%	17.8%	11.6%	0.09%
18%	QDF	FlexShares Quality Dividend Stock ETF	3.06%	15.1%	10.9%	0.37%
22%	SDY	SPDR Dividend Select ETF	2.40%	23.4%	13.4%	0.35%
18%	QDEF	FlexShares Quality Low-Volatility Div. Stock ETF	2.92%	14.1%	11.3%	0.37%



Model BOND Portfolios

GROWTH-oriented portfolio

% Wt.	Symbol	Description	Div. Yield	1-year Return	3-year Return	Expense
20%	MBB	iShares Mortgage-Backed Securities ETF	2.28%	3.7%	3.7%	0.29%
19%	BND	Vanguard Total Bond Market ETF	2.40%	5.9%	4.2%	0.06%
21%	BSV	Vanguard Short-Term Bond ETF	1.39%	2.3%	1.7%	0.09%
22%	MUB	iShares National Municipal Bond ETF	2.25%	5.7%	5.6%	0.25%
18%	STWTX	Schroder Tax-Aware Bond Fund	2.55%	7.3%	8.5%	0.46%

INCOME-oriented portfolio

Average dividend yield: 4.1%

% Wt.	Symbol	Description	Div. Yield	1-year Return	3-year Return	Expense
24%	LQD	iShares Investment Grade Corp. Bond ETF	3.21%	9.9%	6.6%	0.15%
26%	PCY	iShares Emerging Market Govt. Bond ETF	4.88%	17.4%	9.7%	0.50%
28%	FATRX	Frost Total Return Bond Fund	3.53%	4.7%	3.9%	0.75%
22%	CSI	Cutwater Select Income (Closed-End Fund)	4.81%	11.4%	11.2%	0.77%



Model ALTERNATIVE Portfolios

GROWTH-oriented portfolio

% Wt.	Symbol	Description	Div. Yield	1-year Return	3-year Return	Expense
19%	AGAQX	361 Global Long/Short Equity Fund	0.00%	2.9%	NA	1.88%
20%	NPSAX	Nuveen Preferred Securities Fund	5.45%	7.6%	7.6%	1.06%
21%	VNQ	Vanguard U.S. Real Estate ETF	3.44%	22.8%	16.4%	0.12%
20%	BAICX	BlackRock Multi-Asset Income Fund	4.57%	6.4%	4.3%	0.84%
20%	NRIAX	Nuveen Real Asset Income Fund	4.96%	14.3%	9.4%	1.17%

INCOME-oriented portfolio

Average dividend yield: 4.8%

% Wt.	Symbol	Description	Div. Yield	1-year Return	3-year Return	Expense
23%	PFF	iShares Preferred Stock ETF	5.66%	7.9%	8.6%	0.47%
20%	NRIAX	Nuveen Real Asset Income Fund	4.96%	14.3%	9.4%	1.17%
19%	NPSAX	Nuveen Preferred Securities Fund	5.45%	7.6%	7.6%	1.06%
19%	IYLD	iShares Multi-Asset Income ETF	4.67%	11.7%	6.1%	0.60%
19%	VNQ	Vanguard U.S. Real Estate ETF	3.44%	22.8%	16.4%	0.12%