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NEW CLIENTS

City of Littleton

Metropolitan State University

Western Colorado University

Adams State University

VGIF (Women First International Fund)

It is not known whether the listed clients approve or disapprove of the services provided. The new clients on page one and in the Nonprofit Spotlight are listed with their approval and permission.

RETIREMENT PLAN PARTICIPANTS SHOULD THINK TWICE ABOUT EQUITY-INDEXED ANNUITIES

Rich Todd
CEO & CO-FOUNDER, PRINCIPAL

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VICE PRESIDENT

Equity-Indexed Annuities (EIAs) are complicated financial products with considerable disadvantages. However, EIAs are often sold by annuity salespeople who may be motivated by sizable commissions, rather than their client's best interest. It has become increasingly clear to us at Innovest that many people who have invested in these products will not receive what they expect. In this article, we will review EIAs and how their earnings are calculated, explore the issues that arise from salesperson compensation, and examine a recent case study.

What is an Equity-Indexed Annuity?

With an annuity, you exchange a certain amount of principal up front for payouts by an insurance company in retirement. The payouts for EIAs, sometimes called "index annuities", are somewhat based on the performance of an equities index, like the S&P 500. If stock prices rise during a specific time period, EIA owners receive an interest rate based on the partial rise in stocks. If stocks fall, EIA owners earn a minimum interest rate. FINRA (the Financial Industry Regulatory Authority) describes EIAs as "having characteristics of both fixed and variable annuities. Their return varies more than a fixed annuity. EIAs offer a minimum guaranteed interest rate combined with an interest rate linked to a market index."

How are earnings for EIAs calculated?

Earnings for EIAs are calculated somewhat differently than traditional annuities. Generally, the insurance company that sells the EIA will declare an index participation rate—or a percentage of the index's gain—that is promised to the annuity owner. If the participation rate is 80%, the investor will be credited with 80% of the index return. Also, many EIAs have a maximum cap that limits how much gain can be received over a defined time period. Importantly, dividends are

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typically not included in the return calculation of the index. Dividends are a key component in total market return and help to reduce volatility. The exclusion of dividends is a real cost to the investor. The recent S&P 500 dividend rate was 2%. As Ethan Schwartz of The National states, "the S&P 500 isn't travelling at full speed" when dividends are excluded.

The second component, like a fixed annuity, is the declared rate component. This rate is typically paid on at least 87.5% of the investment and is usually a 1% to 3% interest rate.

The third component is the "spread" per cost, a deduction against the return, which typically ranges between 1.5% to 3.5%.

Here is the formula:

Index Returns (without dividends) + Declared Rate - Spread = Earnings

How are earnings taxed?

Earnings are deferred until distributed to the annuity owner. Distributions are taxable at ordinary income tax rates. There is no tax advantage to owning an annuity in a retirement plan or an IRA.

What about the costs?

Spread – 1.5% to 3.5% per year

Dividend elimination – for the S&P 500, it was recently 2%

Surrender charges – if the annuity is sold within the first five to 10 years, the owner pays a charge of 4% to 10%

Salesperson Compensation

The salesperson earns a commission from the spread of the product, either front-loaded with a typical commission of 5% to 10% of investment. The higher the spread, the higher the commission to the salesperson– a significant conflict of interest. Further, these salespeople are not legal fiduciaries. Fiduciaries offer advice only in the best interest of their client, while non-fiduciaries do not have this obligation. In addition, the surrender charges are in place primarily to compensate the insurance company for the commission paid to the salesperson.

Two regulatory bodies – the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) -- have offered instructive notices on EIAs. FINRA, predecessor of NASD (The National Association of Securities Dealers), has noted: "NASD is concerned about the way an associated person is marketing and selling unregulated EIAs, and the absence of adequate supervision of these sales practices. For example, FINRA has heard the following claims:

- 'What if the market goes down and you would lose nothing? The market goes up, you gain!'
- 'A win/win investment vehicle'
- 'How your retirement funds can have security of principal, higher than CD rates of interest, opportunity for growth (no losses)'
- 'Pick up where Social Security leaves off with new tax featured annuities… featuring… two indexed accounts linked to a popular market index'
- 'If you're looking for upside potential and no market downside, look no further than (name of EIA). This fixed annuity… enables you to make the most of S&P 500 index gains…'
- 'Growth potential without market risk'"

According to FINRA, investors are being misled by these sales tactics.

Case Study

A participant in a retirement plan recently took a lump sum distribution out of the plan to invest in an EIA instead of keeping her assets in the plan. The total investment and recordkeeping costs in the retirement plan were less than 0.70%. It was explained by the salesperson that there would be "no fees" in the EIA and that it offered protection that she did not have in the plan.

Here were the characteristics of the EIA sold to the participant:

- Spread cost of 2.25%
- Surrender charge starting at 9% for the first four years, then declining by 1% per year for the next five years
- The declared rate was 1% on 90% of the investment
- The future dividends of the index would not be included in the investor return
- "The insurance company pays me," the salesperson said. On a $200,000 investment, the salesperson made either $14,000 up front or $2,000 per year for nine years ($18,000), paid directly from the investment. The compensation came directly from the insurance company's profits created with the annuity purchase.

Conclusion

The low returns of EIAs combined with high costs typically don't make EIAs worth it. By having a sound process for portfolio design and prudent asset allocation, downside risk can be reduced through much lower costs than EIAs. At Innovest, we believe that most EIA purchasers have expectations of higher earnings than they receive because of the dividend elimination and high costs. Further, annuities do not offer any tax advantages as compared to a traditional retirement plan—withdrawals from both are taxed at ordinary income rates. Assets invested outside of a retirement plan can help defer taxes through low-turnover investments, and eventually asset sales should be at a long-term capital gain rate, not ordinary income like an annuity or a retirement plan.

Salespeople prey on retirement plan participants looking for big sales with a "product that a retirement plan can't offer." These participants are better off taking advantage of plan education services that lead to a sounder and much lower cost approach.

References

1. Notice to member. NASD August 2005 Guidance. Equity Indexed annuities.
2. Investor Alert. FINRA Equity Indexed Annuities: A Complex Choice

NONPROFIT SPOTLIGHT: ALLOSOURCE

AlloSource is the world's leading manufacturer of fresh cartilage tissue used for joint repair and skin allografts to heal severe burns. With over 200 types of precise bone, skin, soft-tissue and custom-machined allografts, the organization has grown into one of the largest tissue networks in the U.S.

AlloSource is a Denver-based nonprofit organization dedicated to advancing the science and use of transplantable allogeneic cells and tissue through pioneering research in regenerative therapies. The organization offers lifesaving and life-enhancing solutions in orthopedic, spine, burn, and wound procedures to help restore patient health and mobility.

Thanks to AlloSource's innovative treatments, many patients have been able to return to the activities they love.

Kacey experienced the unimaginable when two students burst into Columbine High School and started shooting. Then 14-years old, Kacey was hiding under a table when she was shot in the shoulder. Due to the extensive damage, doctors thought that she would lose her arm, but thanks to a tissue allograft, Kacey's arm was saved. Now, 20 years later, Kacey continues to be thankful for her gift of tissue and leads what she would consider "a mostly normal life."

It was a warm summer afternoon when nine-year-old Levi crashed his dirt bike. The exhaust pipe of the bike landed on his leg, causing painful second- and third-degree burns. Hospital doctors performed surgery using donor skin to cover and protect Levi's burn. After several months of rehabilitation and rest, Levi was able to get back to riding his bike and being active.

A bulging disc and broken bone in his back prevented Brent from participating with his son in Boy Scouts of America events, one of their favorite ways to spend time together. The pain in his back and leg became so severe he could not stand or walk for longer than 10 to 20 minutes at a time. To ease his debilitating pain, Brent underwent a posterior lumbar spinal fusion that included AlloPac® cortical/cancellous chips.

"The transplant has completely changed my daily life," said Brent. "I am able to walk and stand for long lengths of time without pain. I have been able to go on campouts, extended summer camps and hikes that before I would never have been able to do because of the pain."

Innovest is honored to provide investment advice to nonprofit clients like AlloSource that are making a difference in so many lives.

Founded in 1994, AlloSource is a nonprofit leader in maximizing tissue donation to help surgeons heal their patients.

Thanks to AlloSource's innovative treatments, many patients have been able to return to the activities they love.

HOW TO AVOID CYBERCRIMINALS

Plan sponsors face risks from cybercriminals. Tips for both sponsors and participants to keep their information secure include:

1. Separate personal and work emails. With email being the most central form of communication for most enterprises, a compromised system poses an enormous threat. Using reputable providers that offer spam filtering and multi-authentication is paramount. It is also recommended that unique email addresses be created for subscriptions and other interests.

2. Create unique passwords for each online profile. If one profile were to be compromised, it would not affect your whole network. Passwords should be a complex mix of numbers, cases and characters.

3. Minimize the use of unsecured, public networks. Entering personal credentials on an unsecured network allows hackers to capture keystrokes and gain access to personal information. Virtual Private Networks (VPNs) can help secure online sessions.

RETIREMENT SUMMIT: KEY TAKEAWAYS

Christian O'Dwyer, CFA
VICE PRESIDENT

Innovest joined more than two hundred plan sponsors, advisors, and asset managers in New York City in May to discuss how the industry can continue improving products and services that drive better outcomes for retirement plan participants. The discussions, which took place at the J.P. Morgan Retirement Summit, included a variety of topics: auto enrollment and escalation, target date funds, fee-related regulatory and legislative updates, and protecting personal and plan information from cybercrime.

As the retirement landscape evolves, new trends have emerged. Total industry assets currently stand at approximately $27 trillion and are split evenly between defined contribution, defined benefit, and individual retirement accounts. Among defined contribution plans, 64% of plans have adopted auto-enrollment, and 62% offer target date funds. Of the plans offering target date funds, 78% use them as the Qualified Default Investment Alternative.[1] These statistics demonstrate that many plan sponsors are facilitating retirement savings and helping younger employees to invest earlier. However, of the plans with auto enrollment, only 50% also use auto escalation, which has led to lower average contribution rates. Participants who are not actively engaged in monitoring and managing their

retirement savings most likely will not save enough to fully fund retirement with average auto enrollment amounts of 3% to 6%. Therefore, plan sponsors should consider the appropriateness of adding auto escalation to their plans.

The retirement summit also focused on litigation pertaining to fiduciary responsibilities. As Innovest consistently reminds its clients, one of the key fiduciary responsibilities is to act prudently and in the best interest of plan participants. Two important court decisions in 2018 helped to clarify how plan sponsors can meet that standard when selecting investments. In White v. Chevron, participants in Chevron's retirement plan alleged the plan sponsor breached its fiduciary duty by failing to select the cheapest investment vehicles and failing to monitor asset-based revenue sharing. In November 2018, the Ninth Circuit Court of Appeals affirmed the district court's dismissal of the case.[3] According to the district court's decision, "Fiduciaries have latitude to value investment features other than price (and indeed are required to do so)", for example "potential for higher return, lower financial risk, more services offered, or greater management flexibility."[4] Similarly, the Eight Circuit Court of Appeals recognized that the duty of prudence does not require selecting the investment strategy that ultimately performs best.[4] In the words of the district court's opinion in that case, "one would expect the Wells Fargo and Vanguard funds to perform differently because the Wells Fargo funds have a different investment strategy than the Vanguard funds. ...Therefore, it does not necessarily follow that the Wells Fargo funds were substandard compared to the Vanguard funds."[6]

The summit provided Innovest with a great opportunity to discuss pressing issues with other industry professionals. Some of the key takeaways were that adding auto escalation, when appropriate, is an important complement to auto enrollment; selecting appropriate investments involves assessing the funds' value, not only their costs; and protecting against cybercrime looms as a large challenge for sponsors and participants.

References

[1] J.P. Morgan Plan Participant Research 2018

[2] White v. Chevron Corp., 752 F. App'x 453 (9th Cir. 2018),

3 White v. Chevron Corp., 2016 WL 4502808 at *9-10 (N.D. Cal. Aug. 29, 2016), citing Tibble v. Edison Int'l, 729 F. 3d 1110 (9th Cir. 2013).

4 Meiners v. Wells Fargo & Co., 898 F.3d 820 , (8th Cir. 2018)

[5] Meiners v. Wells Fargo & Co., 2017 WL 2303968 (D. Minn. 2017);

DON'T FEAR THE (MARKET) REAPER

Many of us invest in stocks for their ability to grow our wealth. So when volatility rears its ugly head, our instinct is to take our money out of the market to safeguard it. However, history shows that rather than giving in to fear, staying invested and buying stocks during volatile times can be beneficial in the long run.

That analysis comes from examining the Cboe VIX,[1] an index that measures volatility. It's often referred to as the "fear index" because it gauges the market's expectation of 30-day volatility. On average, the VIX measures around 20. But market events can quickly jolt it higher.

For example, fear of rising interest rates caused the largest one-day spike ever on February 5, 2018: The VIX closed near 37, an increase of more than 115%. After that, fear was subdued and hovered around 15 for several months—until concerns about trade policy stoked fears and the VIX closed at 36 on December 24, 2018.

Seasons Don't Fear the Reaper…

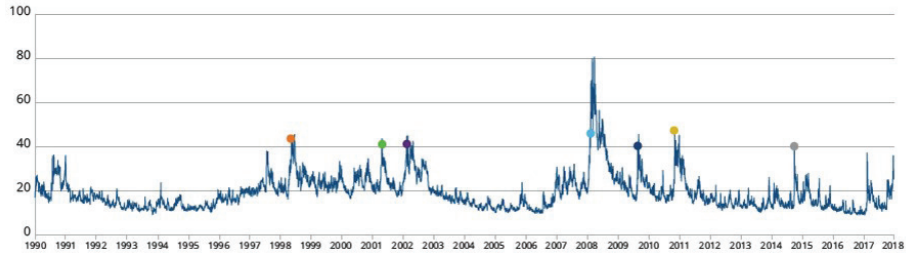
Volatility is, by definition, a rapid and unpredictable change. It's not an enjoyable experience. But there's something to be said about staying the course despite the discomfort.

And if we step back and examine six of the previous VIX spikes above 40, indicating extremely high fear levels, there's a trend. Within three years of volatility-induced declines, the market not only recovered its losses, but also produced additional positive returns in each case. Five years out, those gains remained positive, too.

Buying Stocks When Fear Runs High Has Historically Led to Long-Term Gains

Chicago Board Options Exchange (Cboe) Volatility Index

VIX[1] levels of 40 or higher indicate extremely high levels of fear



S&P 500 Index Returns When VIX >40 Since 1990

Date	1 Year	3 Year	5 Year	S&P 500 Percentage Daily Loss*	Event
8/31/1998	39.82	7.14	2.48	-6.80%	Russia's economic crisis
9/17/2001	-14.64	4.55	6.76	-4.92%	Trading resumes for the first time following the September 11 terrorist attacks
7/22/2002	22.73	16.64	15.43	-3.29%	Accounting scandals highlighted by bankruptcies at Enron and WorldCom
9/29/2008	-1.54	3.90	11.32	-8.81%	US House of Representatives rejects a proposed $700 billion bank bailout plan
5/7/2010	23.05	15.98	15.88	-1.53%	"Flash Crash" causes stocks to decline rapidly with no apparent reason. Dow Jones Industrial Average[2] falls 999 points intraday before recovering.
8/8/2011	28.09	22.59	16.76	-6.66%	European debt crisis and S&P downgrades US government debt from AAA to AA+ for the first time in history
8/24/2015	17.48	20.16	?	-3.94%	China currency devaluation sparks selloff

Assumes reinvestment of capital gains and dividends and no taxes. Past performance is not a guarantee of future returns. Indices are unmanaged and not available for direct investment.
* This column shows the S&P 500 Index's one-day loss on the date shown in column 1.
Source: Hartford Funds, Morningstar, and Factset, 1/19

A takeaway, then, is that while volatility is difficult to endure, it can present opportunities for long-term investors. When the broad sentiment is fear and others are selling, it may be time to be contrarian: consider it an opportunity to not only stay invested, but to buy while prices are depressed.

…Nor do the Wind, the Sun, or the Rain…

Another advantage to resisting fear is that it's impossible to tell when the market will resume its upward course after a bout of volatility. So remaining invested during a market dip means participating in the recovery as soon as it happens, rather than waiting until things seem to be back on track and missing the beginning of the turnaround.

In a stark example of that advantage, take the financial crisis, arguably the most challenging market environment in our collective memory. As the chart and table show, volatility picked up significantly in September 2008. This was followed by a record amount of outflows.

However, Fidelity Investments compared the returns of retirement accounts for those who stayed invested versus those who sold all their stocks in 2008.[3] In the 10 years following the financial crisis, those who stayed invested saw their retirement account balances increase by 240%.

But investors who moved into cash missed out on the market's recovery. Even if they did buy stocks again eventually, after the worst was over, that delay dampened their return potential. Ten years on, investors who sold when the market declined only saw a 157% increase from their pre-crisis account balances.

In short, although difficult, staying the course for the long term meant a better return than giving in to fear.

…We Can Be Like They Are

Now, we realize it's easy to say volatility and market dips work themselves out in time, but we realize it's much harder to experience in reality. It can be incredibly difficult to watch a hard-earned portfolio lose value, no matter how much of a buying opportunity it presents. And in today's world of instant gratification, it can be difficult to keep in mind you're more likely to recoup those losses over time, not immediately.

That's why it's critical to be proactive by working with a financial advisor to put a solid, long-term financial plan in place.

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By doing so, you can build a portfolio that's allocated according to your personal risk tolerances, which can help you stay confident no matter the market's movements. And when you're confident, you can be the contrarian who sees the opportunity in fear.

References

1. "VIX," commonly referred to as the "Fear Index," is the ticker symbol for the Chicago Board Options Exchange (Cboe) Volatility Index and measures the market's expectation of 30-day volatility. VIX levels below 20 reflect complacency, while levels of 40 or higher refl ect extremely high levels of volatility.
2. Dow Jones Industrial Average is an unmanaged, price-weighted index of 30 of the largest, most widely held stocks traded on the NYSE.
3. "Lessons Learned 10 Years After the Global Financial Crisis Serve as Power Reminders for Investors," Fidelity Investments, 10/26/2017

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EMPLOYEE SPOTLIGHT: LORI FOSTER

Lori is an Administrative Assistant at Innovest.

Tell us something unique about you:

While I have lived in Colorado most of my life, I've never skied or snowboarded. I know it may be hard to believe, but it's true! I do enjoy spending time in the mountains, though.

What do you like best about working at Innovest?

One of the many things I enjoy is the culture and sense of family at Innovest. Innovest is a company that ensures our clients and the employees are valued and treated well.

How do you give back to the community?

I participate in the various charitable events that Innovest supports. One of my favorite events is The Food Bank of the Rockies. I also donate each year to their cause. I volunteer at events at my church throughout the year as well.

What are your hobbies and interests?

I enjoy cooking, gardening, outdoor activities, and spending time with family and friends.

Lori Foster and her daughter Chrissy

Tell us about your family:

I have two adult children, Bryan and Chrissy, and two granddaughters, Karly (4) and Maizy (9 months). Bryan is a glazier and installs glass in commercial buildings, and his wife, Amber, works in the restaurant industry. My daughter, Chrissy, is a caregiver at a retirement facility, and her husband, Jacob, is an electrician and is currently attending school to obtain his master electrician license. I enjoy spending as much time as possible with them, whether it be barbequing at my house, holiday dinners, or all of us going on outings together.

AROUND THE INNOVEST FIRM

Promotions

Kathy Lalone: Manager
Kyli Hanson: Manager
Kenny Senour: Manager
Cheryl Wilks: Lead Senior Analyst
Christine Hudek: Manager
Jordan Rice: Lead Senior Analyst
Eileen Pohs: Senior Analyst.
Zach Heath: Analyst
Brooks Urich: Analyst

Speaking Engagements

Vice President, Jared Martin, spoke about Financial Wellness for Plan Participants, at the College and University Professionals Association Annual Conference in Arizona on June 21st. Marianne Marvez, RPA, Vice President, gave a workshop about "What to Expect from your Service Providers" at the annual PlanSponsor conference.

Continuing Education

Congratulations to Kenny Senour and Jordan Rice for passing the CFP® exam! Earning the CFP® designation involves meeting requirements in formal education, performance on the CFP® exam, relevant work experience, and demonstrated professional ethics.

Fun News!

Analyst, Zach Heath, proposed to his girlfriend Emily and she said, "Yes!" The couple is planning an April 2020 wedding.

RICH'S QUARTERLY QUOTES

Even if you are on the right track, you'll get run over if just sit there.

–Will Rogers

A pessimist sees the difficulty in every opportunity; an optimist see the opportunity in every difficulty. I choose optimism.

–Winston Churchill

A goal without a plan is just a wish.

–Antoine de Saint-Exupery

Worry not that no one knows of you; seek to be worth knowing.

–Confucius

Character cannot be developed in ease and quiet. Only through performance of trial and suffering can the soul be strengthened, ambition inspired, and success achieved.

–Helen Keller

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