Reallocation Memo

09 2023

Updated September 2023

Target Risk and Target Income Portfolios

LiveWell Portfolios

Affected Portfolios

- LiveWell Mutual Fund IRA:
  - Conservative
  - Moderate
  - Moderate Growth
  - Growth
  - Aggressive Growth
  - Diversified Income
  - High Income
- LiveWell Variable Annuity:
  - Conservative
  - Moderate
  - Moderate Growth
  - Growth
  - Aggressive Growth
  - Diversified Income
  - High Income

At Morningstar Investment Management LLC, we recently updated the asset allocation target recommendations we provide for the Sammons Retirement Solutions platform's LiveWell portfolios to reflect the results of our most recent financial, economic, and portfolio research. In this memo, we outline the changes in our outlook and the updates we made to our asset allocation target recommendations, including the mutual fund (MF) and variable annuity (VA) portfolio versions.

About Our Methodology

At Morningstar Investment Management, our investment philosophy holds that asset allocation policy is one of the biggest factors in determining a portfolio's risk and return characteristics over time. Further, we are guided globally by seven investment principles which shape our recommendations and outlook:

1. **We put investors first.**
2. **We're independent-minded.**
3. **We invest for the long term.**
4. **We're valuation-driven investors.**
5. **We take a fundamental approach.**
6. **We strive to minimize costs.**
7. **We build portfolios holistically.**

To develop an effective asset allocation for each portfolio, we develop capital market forecasts for every asset class, using a combination of historical return data and current market information. Next, we incorporate these data into our models, testing them under a variety of market conditions to help create a diversified, real-world asset allocation (the mix of asset classes, including stocks, bonds, real estate, alternatives, cash, etc.) for each portfolio.

Earlier this year, we finalized our most recent capital market assumptions, analyzing and incorporating data from 2022 As a result, we made adjustments to our asset allocations, which represent the asset mix we think is appropriate over the long term to achieve a desired risk and return profile. Changes are designed to help keep the portfolios diversified among asset classes while striving to maximize return expectations given a target risk profile.

Overall Asset Allocation Positioning

- This reallocation reduced slightly exposure to developed international equities. While we continue to believe that foreign stocks broadly are more attractive than their domestic counterparts, we trimmed the overweight position across the models. The move accounts for recent foreign stock strong relative performance in 2022, and the moderately improved valuations among some pockets of the US equity market, including financials and communication services. It's not lost on us either that international stocks are more vulnerable to energy markets, given a lower level of domestic production,

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and geopolitical challenges including the ongoing war in Ukraine are more prominent overseas. Despite the trim to developed non-US stocks and emerging-markets, we still believe they offer exceptional value relative to domestic equity markets. At the same time, we increased exposure to small-cap stocks on the margin, which have lagged their larger-cap brethren and look relatively cheap from our perspective.

- Within fixed income, we trimmed emerging-market debt, as foreign bonds are no longer part of our stated benchmark. We also reduced slightly our exposure to TIPS.

Key Asset Allocation Changes – Equity

U.S. Equity

- We are recommending increased allocations to US stocks, which lagged in 2022, making them slightly more attractive from a valuation perspective. The increase has been funded by reduced exposures to foreign stocks and REITs.

Key Asset Allocation Changes – Fixed Income

Inflation-Protected Bonds

- For the target-risk and income models, we recommend slightly lower exposure to TIPS as nominal Treasuries have become attractive.

Duration and Credit

- We recommend lowering allocations to emerging-market bonds due to the increasing attractiveness of higher quality bonds in the US and a change in our blended benchmark, which now excludes foreign fixed income.

Fund-Specific Changes

- There are many reasons why a portfolio may stray from its stated objective, thus requiring adjustment over time. These reasons include varying market conditions, manager changes, and fund style drift.

- A portfolio's asset allocation should be reviewed regularly to ensure it stays in line with its stated strategy objective, within acceptable risk ranges, and competitive within respective peer universes.

- The recommendations we made to Sammons Retirement Solutions® Inc. below are designed to help maximize the portfolio's return potential while seeking to maintain an effective target asset allocation. Given annual changes to the asset allocation targets detailed above, we recommended the following fund reallocations. In addition to the following recommendations, we suggested small individual fund allocation adjustments to account for fund style drifts and new asset allocation targets, to help realign portfolios to a long-term asset allocation target. The main goal of fund selection is to hit our targets. Sammons Retirement Solutions® Inc. has final decision-making authority over whether to implement any of Morningstar Investment Management's recommendations.

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Recommendations

Target-Risk Model Fund Additions:

BlackRock Equity Dividend

Yield and dividend growth play a role here but are far from being the sole focus. Lead manager Tony DeSpirito sifts his universe of the 500 largest U.S. stocks with quant screens focused on business quality factors such as operating efficiency, capital allocation discipline, and balance-sheet strength. Valuation screens sort on measures such as earnings and cash flow; they typically take a backseat to quality, but DeSpirito has flexibility here. The portfolio was more value-oriented in the second half of 2022, with a price/earnings ratio well lower than its average in 2020-21. The process aims to deliver on dividend growth, quality, and value at the portfolio level, but DeSpirito doesn't require every holding to meet every goal. For example, he bought no-dividend stocks Amazon.com AMZN and Alphabet GOOGL in December 2022 and has previously owned Berkshire Hathaway BRK.B for the same reason: These stocks fit all his criteria except for paying dividends. Similarly, he'll trade quality for value (Citigroup C, for example), and isn't afraid to pay up for higher quality names (such as Eli Lilly LLY).

T. Rowe Price Mid-Cap Growth

Since the fund's 1992 inception, manager Brian Berghuis has remained committed to his valuation-conscious approach to mid-cap growth investing even when the going has been tough. He looks for mid-cap companies with sustainable business models and capable management teams able to grow revenues or earnings at least 12% annually. What distinguishes this strategy from others, though, is what it won't wade into. Berghuis won't buy fast-growing companies if he can't reasonably justify the assumptions that underpin their prices. He also believes that markets will always come back to cash flow and earnings-based valuation frameworks and in recent years has kept less capital than the Russell Midcap Growth benchmark in unprofitable companies and those that pursue sales growth at the expense of per share profitability. That philosophy has treated investors very well historically, particularly in periods such as 2000-02 when the dot-com bubble burst, as well as in 2022, when formerly untouchable growth darlings came tumbling down.

Columbia Select Mid Cap Value

The strategy's investment process is its strength. Lead manager Kari Montanus looks for cheap mid-cap stocks with growth catalysts. To do that, Montanus and her team screen for stocks with low price multiples and conduct fundamental research to see which companies can improve their prospects, either through earnings growth, management changes, or business cycle shifts. Montanus aptly divides the portfolio into three buckets based on holdings' return potential and risk profile. The first group includes stocks that have recently declined but have growth catalysts that are in their beginning stages. The second holds equities whose catalysts are playing out but still haven't fully transformed the company in question. The third contains steady compounders whose catalysts have taken effect, but the firms still have room to grow. This approach, along with other risk management tools, mitigates downside volatility relative to the Russell Midcap Value Index

Target-Risk Model Fund Increases:

Increase the allocation to Janus Henderson Small Cap Value

The strategy benefits from an experienced team. It had been run by longtime subadvisor Perkins Investment Management, which was a wholly owned subsidiary of Janus Henderson that was fully integrated within the larger firm in May 2021. The restructuring didn't result in any major changes or dent this team's advantages. Managers Justin Tugman and Craig Kempler remain at the helm, while Tugman also runs highly rated sibling strategy Janus Henderson Mid Cap Value JDPAX alongside manager Kevin Preloger. All three have tenures with the firm dating back nearly two decades. They draw on a dedicated seven-person analyst team, which maintained a stable core amid the restructuring, and which is also experienced, averaging 20 years in the industry and 13 at the firm.

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The safety-first approach has been consistent. The managers don't buy stocks just because they look cheap. Rather, they consider the whole business and only invest when potential gains significantly outweigh potential losses. The approach produces a portfolio of strong, competitively advantaged businesses, which have held up relatively well in all major drawdowns since Tugman's 2009 start, capturing just 80% of the Russell 2000 Value Index's monthly losses through year-end 2022—a commendable amount.

Increase the allocation to ClearBridge Large Cap Growth

Comanagers Peter Bourbeau and Margaret Vitrano utilize a sensible investing framework. The two look to invest in dominant, industry-leading businesses whose growth prospects are underappreciated by the market. They like low-debt, high-margin companies which operate in industries with high barriers to entry. Guardrails hold this strategy close to its Russell 1000 Growth benchmark, at least from an allocation perspective. The managers keep the portfolio within 50% of the benchmark's sector weights, and it is uncommon for a single sector to be over- or underweight by more than 5 percentage points. Single-stock risk is limited by capping the active weight on a single stock at 5%.

Increase the weighting in Pioneer Bond.

Pioneer stalwart Ken Taubes, who also doubles as the firm's chief investment officer, draws support from seasoned comanagers and sector teams. Brad Komenda joined the management ranks in February 2018 and boasts more than 25 years of investment industry experience. The firm added 35-year industry veteran Tim Rowe as comanager in June 2018 to replace longtime manager Charles Mechreit, while multisector deputy director Jonathan Scott began comanaging this strategy in November 2021. The managers lean heavily on the firm's corporate credit and securitized research squads; each maintains an average of 19 and 22 years of investment industry experience, respectively. The group executes a measured approach that keeps a keen eye on valuations across its investable universe. The strategy's target portfolio allocation reflects its core fixed-income holding intention; investment-grade issues will constitute at least 80% of portfolio assets, while its "plus" sector allotment--which traditionally includes high-yield bonds, emerging-markets debt, and bank loans--will round out the portfolio.

Increase the weighting in PIMCO Low Duration Fund.

The strategy's robust, well-supported process looks similar to the one in place at flagship Pimco Total Return PTTRX but with a focus on the short end of the yield curve. The portfolio invests in traditional core sectors--government debt, mortgages, and investment-grade corporates--but also takes modest positions in high yield, developed- and emerging-markets debt, and currencies (the strategy's benchmark is the narrowly focused Bank of America Merrill Lynch 1-3 Year Treasury Index). The managers start with the firm's macroeconomic forecasting (determined by the firm's investment committee) and bottom-up analysis to determine interest-rate, yield-curve, currency, country, sector and security-level decisions. The strategy has protected capital when it counted compared with its yield-chasing competitors which have courted risk in mid- and lower-quality corporate credit and niche asset-backed sectors.

NOTE:

<u>Fund Removals:</u>

For the Mutual Fund Target Risk Model (Income & Growth, Moderate Growth, Growth and Aggressive Growth), we recommend the removal of Fidelity Advisor Real Estate M, as we see less relative value in REITs when compared to other asset classes, particularly with more attractive yields in fixed income.

For the Mutual Fund Target Risk Models (Income-and-Growth, Moderate Growth, Growth and Aggressive Growth), we recommend the removal of American Century Mid Cap Value.

For the Mutual Fund Target Risk Models (Conservative, Income-and-Growth, Moderate Growth, and Growth), we recommend the removal of Templeton Global Bond.

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For the VA Target Risk Model (Conservative), we recommend the removal of Fidelity VIP Real Estate Service 2, as we see less attractive value in REITs versus other asset classes, particularly with more attractive yields in fixed income.

For the VA Target Risk Models (Conservative, Moderate Growth, Growth and Aggressive Growth), we recommend the removal of American Century VP Mid Cap Value II.

For the VA Target Risk Models (Conservative, Income-and-Growth, Moderate Growth, and Growth), we recommend the removal of Templeton Global Bond VIP 2.

Income-Portfolio Fund Additions

Pioneer Bond

Pioneer stalwart Ken Taubes, who also doubles as the firm's chief investment officer, draws support from seasoned comanagers and sector teams. Brad Komenda joined the management ranks in February 2018 and boasts more than 25 years of investment industry experience. The firm added 35-year industry veteran Tim Rowe as comanager in June 2018 to replace longtime manager Charles Mechreit, while multisector deputy director Jonathan Scott began comanaging this strategy in November 2021. The managers lean heavily on the firm's corporate credit and securitized research squads; each maintains an average of 19 and 22 years of investment industry experience, respectively. The group executes a measured approach that keeps a keen eye on valuations across its investable universe. The strategy's target portfolio allocation reflects its core fixed-income holding intention; investment-grade issues will constitute at least 80% of portfolio assets, while its "plus" sector allotment--which traditionally includes high-yield bonds, emerging-markets debt, and bank loans--will round out the portfolio.

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Income-Portfolio Fund Removals

For the High-Income and Diversified-Income Portfolios, we recommend the removal of American Century Mid Cap Value, Fidelity Advisor Real Estate, Templeton Global Bond, PIMCO International Bond (USD Hedged), and Pioneer Strategic Income.

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<u>Income- Portfolio Fund Increases:</u>

Within the High-Income and Diversified-Income Portfolios, we increased the weighting to Janus Henderson Small Cap Value

The managers don't buy stocks just because they look cheap. Instead, they analyze potential losses before potential gains, and invest only when the latter significantly outweigh the former. Portfolio candidates must have strong balance sheets with low debt ratios, financial flexibility, solid recurring cash flows, durable competitive advantages, and committed management teams with significant insider ownership. The managers then use conservative relative and absolute valuations to determine upside and downside 12-month price targets.

Within the High-Income, we increased the weighting to PIMCO Income

Like all Pimco strategies, this one relies on a combination of top-down and bottom-up calls. Thanks to its income focus, the portfolio has weightings in higher-income sectors, such as high-yield corporates and non-U.S. bonds, and it has for years had a strong appetite for nonagency mortgages relative to peers with similar flexibility to invest across sectors. This also means that while the strategy will reflect Pimco's macro themes, it will diverge from higher-quality siblings such as Pimco Total Return PTTRX. It also typically employs some leverage, mostly via derivatives. The team sets a monthly dividend and attempts to stick with it for at least a year. Prudence demands that number be set lower than what the portfolio's holdings produce each month to avoid a shortfall. Thus, there's usually undistributed income at each year-end, which is paid as an extra dividend to avoid running afoul of IRS tax rules.

Within the High-Income and Diversified-Income Portfolios, we increased exposure to BlackRock Equity Dividend Inv A.

Lead manager Tony DeSpirito's team deftly balances quant screens with bottom-up research to find affordable shares of large, solid companies. It has improved the process it inherited from DeSpirito's predecessor, Bob Shearer, in 2017. The quant squad uses screens and an optimizer to supplement bottom-up research and assists with thematic and single-stock deep dives. The managers look for a mix of dividend growth and yield and pay attention to price. The process usually leads to a portfolio of stocks with competitive advantages that can earn consistent returns on invested capital in all environments.

Within the High-Income and Diversified-Income Portfolios, we increased exposure to Lord Abbett Short Duration Income R3

The managers leverage the firm's economic and sector views to develop investment themes and identify undervalued sectors but operate with ample credit risk relative to many short-term bond category rivals and tap into standard risk management tools. The strategy emphasizes corporate exposure across the credit spectrum, which typically ranges between 40% and 55% of assets overall with high-yield issues sometimes accounting for nearly 20%. The strategy's typical peer generally holds less than 5% in high-yield fare. This has contributed to the strategy's volatile profile and yield that often tops category peers, which is on par with that of intermediate-term and core-plus bond funds.

Within the High-Income and Diversified-Income Portfolios, we increased exposure to PIMCO Low Duration

The strategy's robust, well-supported process looks similar to the one in place at flagship Pimco Total Return PTTRX but with a focus on the short end of the yield curve. The portfolio invests in traditional core sectors--government debt, mortgages, and investment-grade corporates--but also takes modest positions in high yield, developed- and emerging-markets debt, and currencies (the strategy's benchmark is the narrowly focused Bank of America Merrill Lynch 1-3 Year Treasury Index). The managers start with the firm's macroeconomic forecasting (determined by the firm's investment committee) and bottom-up analysis to determine interest-rate, yield-curve, currency, country, sector and security-level decisions. The strategy has protected capital when it counted compared with its yield-chasing competitors which have courted risk in mid- and lower-quality corporate credit and niche asset-backed sectors.

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NOTE:

For the VA High-Income and Diversified Income Models, we recommend the removal of Fidelity VIP Real Estate Service 2, Templeton Global Bond VIP 2, PIMCO International Bond (USD-hgd), and Pioneer Strategic Income VCT II

For the VA High Income and Diversified Income Models, we recommend increased exposure to Blackrock Equity Dividend VI III, Columbia VP Select Mid Cap Value 2, PIMCO Income Advisor, Pioneer Bond VCT II, Lord Abbett Series Short Duration Inc VC, and PIMCO VIT Low Duration Adv.

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