Reallocation Memo

06 2020

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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 2019. 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

- First quarter of 2020 saw sharp decline in equity markets as the effects of the Coronavirus (COVID-19) rippled throughout the world, leading to increased expected returns across equities and credit bonds.

- We have increased allocation in Value as we believe it to be more attractive relative to Growth.

- We are also maintaining overweights to International Developed Value compared to US to take advantage of more favorable valuations outside the US.
- Within fixed income, we are increasing our allocations to TIPS and High Yield Bonds (or credit) and decreasing allocation in Short Term Bonds due to more attractive inflation break-even rates and credit spreads.

Key Asset Allocation Changes – Equity

U.S. Equity

- We are recommending increased allocations to value stocks, which we believe retain higher expected returns relative to growth stocks.

International Equity

- We recommend maintaining an overweight to international and emerging-markets stocks as we continue to find more relative value in equity markets outside the U.S..

Key Asset Allocation Changes – Fixed Income

Inflation-Protected Bonds

- For the target-risk and income models, we recommend increased exposure to TIPS due to more attractive inflation break-evens

High Yield (Core Plus)

- We recommend increasing allocations to High Yield (or Core Plus) bonds due to more attractive credit spreads
- We recommend a reduction in short-term bonds to fund our exposure to both TIPS and High Yield (or Core Plus).

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.

Recommendations

We recommend two fund removals this year. We also recommend reallocating among existing funds to tilt portfolios toward areas of the market we feel have more favorable reward for risk.

Increase the allocation to Invesco Oppenheimer International Growth, as that strategy continues to find opportunities in Japan, where our expected returns for stocks remain favorable.

Managers George Evans and Rob Dunphy have been through many market environments with this fund. Evans has managed it for more than 23 years, and the firm promoted Dunphy to comanager in 2012 after working with Evans as an analyst for about eight years before that. The portfolio managers favor companies with sustainable competitive advantages and good management, operating in growing industries. Often these stocks fit into one of four themes: mass affluence, new technology, restructuring, and aging. These themes, which also form the foundation for the portfolios of several other Invesco Oppenheimer international funds, have been in place for years.

Increase the allocation to Templeton Foreign, as that strategy plies a value approach overseas, where we see higher expected returns

Lead manager Chris Peel utilizes Templeton's global equity analyst group to find stocks trading at attractive valuations, but their approach lacks an edge. The analysts look for companies that are inexpensive compared with their five-year earnings potential, which keeps turnover low. The analysts use quantitative and qualitative screens to narrow the fund's investment universe of about 10,000 global stocks, and follow up with fundamental analysis. Analysts then pitch their best stock ideas, and the managers construct the portfolio.

Increase the weighting in Janus Henderson Small Cap Value, as value stocks continue to higher expected returns from our perspective.

Comanagers Justin Tugman and Craig Kempler of Perkins Investment Management, a subsidiary of Janus Henderson Investors, use their firm's sensible, risk-conscious approach to value investing. They don't buy stocks just because they look cheap. Instead, they consider the whole business, analyzing the potential for losses before potential gains, and invest only when the latter significantly outweighs the former. The result is a relatively compact portfolio tilted towards predictable businesses, particularly within the industrials and materials sectors. The quality of holdings relative to the Russell 2000 Value Index is reflected in the portfolio's lower aggregate debt levels and higher margins, returns on assets, and returns on equity.

Increase the weighting in PIMCO Real Return, as inflation break-evens become more attractive

To beat the Bloomberg Barclays U.S. TIPS Index, the team looks to obtain cost-efficient exposure to U.S. Treasury Inflation-Protected Securities and other inflation-linked bonds by seeking better execution than passive investors receive. It employs macro-driven strategies (driven by real growth, inflation, and country-specific analysis) and micro-driven themes (including Consumer Price Index seasonality, on-the-run/off-the-run premiums, and implied inflation volatility). Although U.S. TIPS and, to a lesser extent, other global inflation-linked bonds dominate the portfolio, the strategy can invest up to 20% in other sectors, such as corporates and securitized fare.

Increase the weighting in Pioneer Bond, as core-plus sectors have become more attractive, in our opinion.

Ken Taubes and his team are sensitive and responsive to shifting valuations across their investment universe, which includes most fixed-income sectors. Allocation decisions are driven by their assessment of the relative valuations of sectors and individual securities, in addition to their views on economic growth, credit cycles, and interest rates. They also track various themes, such as the direction of inflation or movement of credit spreads, which may have an impact on the fund. Their views on these themes are updated regularly, and the portfolio is adjusted whenever there are meaningful changes. The fund is designed to be a core fixed-income holding, so the bulk of assets are investment-grade, but it does allow up to 25% in "plus" sectors such as high-yield and emerging-markets debt.

NOTE:

For the VA Target Risk Models (Growth, and Aggressive Growth), we recommended increasing the allocation to Ivy VIP Small Cap Core II. We also recommended increasing the weighting in foreign strategies Invesco Oppenheimer VI Intl Gr II and Templeton Foreign VIP 2.

For the VA Target Risk Model (Moderate Growth), we recommended increasing the allocation to Ivy VIP Small Cap Core II and Templeton Foreign VIP 2. We also recommend increases to Pioneer Bond VCT II and PIMCO VIT Real Return Adv.

For the VA Target Risk Model (Moderate), we recommended increasing the allocation to Templeton Foreign VIP 2. We also recommend increases to Pioneer Bond VCT II and PIMCO VIT Real Return Adv.

For the VA Target Risk Model (Conservative), we recommend increasing the weighting in foreign strategies Invesco Oppenheimer VI Intl Gr II and Templeton Foreign VIP 2. We also recommend increases to Pioneer Bond VCT II and PIMCO VIT Real Return Adv.

Within the High-Income and Diversified-Income Portfolios, we increased the weighting to high-yield bonds via Lord Abbett High Yield R3

The management team, led by Steve Rocco, starts by using economic forecasting and analysis of credit conditions to help decide which sectors to downplay or overweight before looking for the most attractive individual high-yield issues with the help of its analyst team. To identify attractive opportunities, analysts marry their fundamental approach with a proprietary quant tool that produces a relative-value score for individual issues and enables the analyst to verify their bottom-up credit work. The portfolio remains diversified with position sizes limited to half a percent of assets (this limit is halved for equity positions, which have accounted for up to 7% of assets). The team may slightly exceed this cap when it finds an opportunity that it deems higher quality and with relatively shorter duration. A focus on smaller issues does increase liquidity risk slightly. When faced with outflows, the management team has not hesitated to draw on its line of credit, which adds a dash of leverage to the portfolio. While the strategy has typically paid these loans back within a week, when compared with peers that mostly avoid leverage, this tactic does add a degree of risk.

Within the High-Income and Diversified-Income Portfolios, we increased exposure to PIMCO Real Return to gain access to TIPS.

To beat the Bloomberg Barclays U.S. TIPS Index, the team looks to obtain cost-efficient exposure to U.S. Treasury Inflation-Protected Securities and other inflation-linked bonds by seeking better execution than passive investors receive. It employs macro-driven strategies (driven by real growth, inflation, and country-specific analysis) and micro-driven themes (including Consumer Price Index seasonality, on-the-run/off-the-run premiums, and implied inflation volatility). Although U.S. TIPS and, to a lesser extent, other global inflation-linked bonds dominate the portfolio, the strategy can invest up to 20% in other sectors, such as corporates and securitized fare.

NOTE:

For the VA High Income and VA Diversified-Income Portfolios, we lowered exposure to short-term bonds and increased exposure to high yield via Lord Abbett Series Bond-Debenture VC, and TIPS via PIMCO VIT Real Return Adv

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