Reallocation Memo

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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 single 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 2017. 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 maximizing return expectations given a target risk profile.

Overall Asset Allocation Positioning

- Equity markets rallied in 2017 with the S&P 500 Index rising 21.83% and the MSCI EAFE Index rising 25.62% in dollar terms. Growth outperformed value as the Russell 1000 Growth Index rose 30.21% versus the rise in the Russell 1000 Value Index of 13.66%/ Emerging markets outperformed international developed markets as the MSCI Emerging Markets Index returned 37.75% outpacing the return of the MSCI EAFE Index.

- Our return expectations for U.S. stocks remain low, and we continue to find more value in international developed and emerging markets stocks.

- Among U.S. stocks, we are reducing our exposure to growth in favor of value stocks across the market-capitalization spectrum, following the strong performance of growth in 2017.

- Within fixed income, we are further reducing our allocation to high-yield bonds and emerging-markets debt as the reward for risk has deteriorated over the past 12 months. We are increasing our exposure to short-term bonds, which offer better relative value amid rising yields and a flatter yield curve.

Key Asset Allocation Changes – Equity

U.S. Equity

- We increased allocations to value stocks, as growth's valuation and heavy weighting in tech stocks lead us to dislike the reward for risk picture; we expect higher returns from value stocks moving forward.

- We increased our exposure to REITs as our valuation-implied return for the asset class improved.

International Equity

- We maintain our 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

High Yield & Emerging-Markets Debt

- We continued to reduce our exposure to high yield and hard currency emerging market bonds as valuations continued to become stretched in 2017.

Aggregate and Short-Term Bonds

- We increased our allocations to short-term bonds as interest rates increased at the short-end of the yield curve in 2017, offering an attractive potential reward for risk among fixed income assets.

- We also marginally increased our exposure to aggregate bonds, as we favor investment-grade bonds over high yield.

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 returns 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.

We recommended the introduction of a mid-cap value strategy, American Century Mid Cap Value to the MF and VA target risk and target income portfolios. This strategy is meant to replace ClearBridge Variable Mid Cap and Deutsche Small Mid Cap Value in the VA target risk portfolios and Deutsche Small Mid Cap Value in the VA income portfolios.

American Century Mid Cap Value is also recommended to replace Deutsche Mid Cap Value in the MF target risk and target income portfolios.

Lead manager Kevin Toney and the team at American Century Mid Cap Value stick with a process that is designed to navigate a variety of markets. Strong stock selection by an experienced team drives the fund's strong near- and long-term results, earning it a Morningstar Analyst Rating of Silver. The team looks to invest in companies with high returns on capital that have low levels of debt and are cheap based on at least two of five valuation measures, including price/earnings, price/free cash flow, and dividend yield.

The team's process attempts to identify those quality companies that are currently at a low point in their earnings cycle, typically adding them to the portfolio as their capital spending and reinvestment rises. The team's emphasis on quality characteristics should help to avoid value traps. Still, it can take time for some of their picks, which usually are at the bottom of their earnings cycles, to pan out, and that can cause the fund to lag peers.

We also recommended the addition of Ivy Small Cap Core to the VA target risk and target income models as a dedicated small cap blend strategy.

Kenneth Gau runs this strategy and utilizes Ivy's centralized analyst team, other Ivy small-cap managers, and sell-side research to source ideas. They use a screen to identify stocks exhibiting relative strength and exclude stocks with low liquidity. They winnow the field further by looking for stocks with sharp upward price moves (usually value stocks) or strong price momentum (typically growth stocks). They then examine business fundamentals, favoring firms with competitive advantages and seasoned management teams that focus on delivering for shareholders.

Portfolio construction is also solid at this strategy. The managers build a relatively compact portfolio of 40 to 60 stocks. They pay close attention to the balance between more-cyclical and defensive sectors in the portfolio and aim for sector diversification in its largest holdings. They limit stock-specific risk by restricting the largest position sizes to 5%. Gau is an eager consumer of Ivy's risk-management tools, helping the team monitor unintended portfolio exposures.

We also recommended the addition of Janus Henderson Small Cap Value to the MF target risk and target income models as a dedicated small cap value strategy.

This strategy, previously named Perkins Small Cap Value, seeks to capitalize on Perkins' value-conscious investment philosophy. The team looks to avoid dicey fare, analyzing the potential for loss before considering upside. This cautiousness leads them to companies that they believe exhibit strong free cash flows, reasonable debt levels, and healthy balance sheets. While the firm's managers make the final decisions, they rely on research from the firm's sector analysts.

We recommended the addition of Fidelity Real Estate as a dedicated public real estate strategy within the MF and VA target risk and target income portfolios.

This Fidelity public real estate strategy has been managed by a longtime Fidelity portfolio manager, Samuel Wald, since 2004. The strategy seeks both income and long-term capital growth by investing in securities of companies that either own and/or operate commercial real estate properties. This strategy focuses on bottom-up research that utilizes both a dedicated real estate team within Fidelity, in addition to the firm's broader research resources. This strategy's process focuses on selecting real estate investment trusts, or REITs, based on the relative value of individual REITs.

A new dividend-focused large cap value strategy, BlackRock Equity Dividend, was recommended as an addition to the MF and VA target income portfolios. BlackRock was recommended as a replacement for ClearBridge Dividend Strategy.

This strategy looks for stocks with a balance of earnings and dividend growth, yield, quality, and low valuations.

The team behind this strategy begins its investment process by screening the 500 largest U.S. stocks, homing in on those that have growing dividends, profitable and defensible business models, strong free cash flow, competitive dividend yields and attractive valuations. The quant screens are merely an initial step to generate ideas and the team performs bottom-up analysis of individual companies and industries to find affordable shares of large companies generating enough profits and cash flow to satisfy dividend payments without stinting on research and development, capital spending, and debt service. Lead portfolio manager Tony DeSpirito meets with the entire team daily and individual members at least once a week to discuss the portfolio and research ideas.

The process usually keeps the fund focused on businesses with competitive advantages that help enable them to seek consistent returns on invested capital in all kinds of economic environments--in other words, blue chips. The fund's price-consciousness, however, has kept it firmly in the large-value corner of the Morningstar Style Box.

PIMCO Low Duration was recommended as an addition to the MF target risk and target income models to replace PIMCO Short-Term.

This strategy's robust, well-supported process looks similar to the one in place at flagship PIMCO Total Return but with a focus on the short end of the yield curve, earning a Positive Process Pillar rating. The fund 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 fund'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 PIMCO's Investment Committee) and bottom-up analysis to determine interest-rate, yield-curve, currency, country, sector, and security-level decisions. Themes prominent in PIMCO Total Return's portfolio tend to surface here, too.

PIMCO Low Duration targets a benchmark with a slightly longer duration than PIMCO Short-Term. As interest rates rose in 2017, particularly on the short-end of the yield curve, we felt more comfortable adding additional interest rate exposure to the portfolios, hence the change.

Lord Abbett Series Short Duration Income was recommended as an addition to the VA target income models to replace PIMCO Short-Term.

This recommendation was suggested to add the potential for additional income to the VA target income models. While the fund courts higher credit risk than PIMCO Short-Term, it can offer a higher yield.

In late-2007, the management team shifted this strategy away from its prior focus on U.S. government-backed bonds to focus on yield, adding allocations to credit sectors including CMBS, ABS, investment-grade corporates, high-yield corporates, and, to a lesser extent, emerging-markets bonds. The fund still holds some U.S. government bonds, though its allocation is generally less than 10%. The managers keep the fund's duration in line with its ICE Bank of America Merrill Lynch Corporate Credit 1-3 Year Index benchmark. Occasionally, they will also make big moves in and out of sectors.

The team believes that the liquidity of short-dated securities allows it to take on increased credit risk and is willing to hold more credit-sensitive assets than many of the fund's short-term bond peers. But the fund's hefty allocation to credit-sensitive corporates and securitized assets is unusual for a short-term bond fund and has generated a category-topping yield on par with that of intermediate-term bond funds. That yield may have proved alluring to investors and contributed to the fund's asset growth since

2008, but the outsize credit and liquidity risk may make it vulnerable to underperformance in periods of market stress.

PIMCO Income was recommended as an addition to the VA target income portfolios to replacie Fidelity Strategic Income.

Like all of PIMCO's funds, this one relies on numerous top-down and bottom-up calls. Thanks to its income focus, the fund has weightings in higher-income areas, such as high-yield corporates and non-U.S. bonds, and has for years had a strong preference for nonagency mortgages relative to the multisector-bond category. This also means that while the fund will reflect PIMCO's macro themes when implementing its strategy, the portfolio will diverge meaningfully from siblings such as PIMCO Total Return. The fund also typically employs some leverage, mostly via derivatives.

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