The BAUMAN LETTER

— YOUR GUIDE TO ROGUE FREEDOM & BOLD PROSPERITY —

Hack Your Tax:

Beating the IRS in 2018

FOR most of my working life, I've been a contractor.

No, I don't build or remodel houses. I just wasn't directly employed by the people who paid me. Instead, I sold my services to them as a product.

Sometimes my relationship with my clients was at arm's length. I did contractual work at a per-piece rate. Other times, I received a regular retainer under long-term contracts.

No matter the format, this setup had several things in common:

1. I managed my financial affairs — and my taxes — as a business separate from my household. I had business income and expenses that were separate from my personal finances. My personal income was whatever was left over.
2. I was responsible for calculating and paying my own taxes on that "leftover" income. My clients didn't withhold anything or hand it over to the government. I did that myself, every quarter.
3. Nobody told me how, where or when to do my work. I always cooperated with my clients' reasonable requests, of course ... but the final call was always mine.

The lifestyle had its pros and cons.

The main downside was that my income fluctuated. I had to maintain a healthy reserve of cash to meet my personal expenses. I also had to manage my commercial reputation, which is quite different from workplace relationships.

But the pros outweighed the cons. I was — and, above all, *felt* — independent. I had more control over my income and work effort. My time was flexible. I worked from home most of the time ... and no commute!

But the main advantage was the leverage being an independent contractor gave me over the taxman.

In this report — prompted by the recent tax bill passed by Congress and signed by the president — I am going to show you:

- How the new tax code creates huge advantages for self-employed, incorporated individuals.
- When it makes sense to set yourself up as a "business" ... even if you're currently an employee.
- Why you should get expert advice and where to seek that advice.

You see, the revised tax code — which was supposed to be fairer and simpler — in fact, creates several hacks that allow some people to *pay less taxes than others doing the same work.*

These hacks are hugely contentious in the tax community ... but they are now legal and far from simple.

INSIDE THIS ISSUE

My goal here is to give you an *accessible* summary of these new tax opportunities so you can decide whether they make sense for you.

After all, *The Bauman Letter's* mission is to show you how to take advantage of any opportunity to enhance your income and protect your wealth!

Pass-Through to Heaven

During halftime of the recent Georgia-Alabama national college championship game here in Atlanta (sorry, Dawgs!), I asked my pal Joey if he knew what a "pass-through" was.

He thought it had something to do with digestion.

Nice try, Joey, but no cigar.

In U.S. tax parlance, a pass-through is any corporate entity that pays no *corporate* income tax. All a pass-through entity's profits "pass-through" to the owner(s), who pay income tax on those profits as an individual. (Lawyers call them "disregarded entities" because they are ignored for tax purposes.)

This contrasts with C-Corporations, which pay tax directly on their own account, which is separate from their shareholders, who pay tax on dividends.

Pass-through entities (PTEs) include sole proprietorships, partnerships, limited liability companies (LLCs) and subchapter S-Corporations (see the "Species of Corporations" box).

Up until now, the owners of such businesses have paid tax on their net income at *individual* rates.

But the tax law that went into effect on January 1 effectively lowers the tax rate on PTE income to *well below the individual rate.* This creates a big opportunity for you.

Not Quite the Same as the Old Boss

Those who drafted the new tax law had to change the way PTEs are handled.

The new top U.S. corporate tax rate — levied on shareholder-owned C-Corporations — is 21%. If Congress had left the treatment of PTEs as it was, their owners would pay much more tax than C-Corporations because the top five individual tax brackets are well above 21% — 22%, 24%, 32%, 35% and 37%.

Now, let's be clear: many PTEs aren't small businesses owned by Main Street Americans who would be cruelly disadvantaged by paying more tax on their profits than corporate behemoths.

In fact, 70% of PTE equity is in multimillion-dollar businesses. PTE structures are especially common in finance and real estate. Almost all of President Trump's businesses, for example, are organized as LLCs. More than two-thirds of all U.S. PTE income goes to the top 1% of U.S. households by income.

Nevertheless, the average small businessperson would be enraged if they had to continue to pay taxes on their profits at individual rates while the corporate rate was slashed to 21%.

Congress' solution to this political problem creates an opportunity for significant tax savings for those of us who aren't multimillionaires.

As I've said, until January 1, PTE income was taxed as personal income, up to 39.6%.

But the new rules grant a 20% deduction for "qualified business income" (QBI) ... PTE owners can now simply deduct 20% of their business's income from their taxable income, *and pay no tax on it.*

For many people, this results in a big tax cut compared to the previous pass-through system.

For example, let's say you are married filing jointly and employed as a senior electrician at an annual salary is $75,000. Under the new tax brackets, your tax will be $7,233, or 9.64%.

If you create a PTE, however, and pay yourself an

About Ted Bauman

Ted Bauman is the editor of the Plan B Club, a blueprint to help protect your wealth and escape excessive taxation, regulations and wealth confiscation in America. He is also the editor of *The Bauman Letter*, a newsletter that's brimming with up-to-the-minute asset protection strategies, tips on buying and investing in real estate abroad, and retirement and residency secrets in American-friendly countries around the globe. Ted has been published in a variety of international journals, including the *Journal of Microfinance*, *Small Enterprise Development* and *Environment and Urbanization*. Email Ted your thoughts and questions at baumanletter@banyanhill.com annual salary of $12,000, your tax under the new system will be $5,721, or 7.63%.

This also creates a paradoxical situation for owners of PTEs. Under the new rules, if you're a PTE owner and you want to pay less tax, *pay yourself the smallest possible salary* (since it's taxed at individual rates) and *push as much income as possible in the qualified business income category* (so you can deduct 20% of it from your taxable income).

Instantly, "qualified business income" becomes hugely important. Just what is QBI?

QBI is "the net amount of items of income, gain, deduction and loss with respect to your trade or business." In other words, it's your business' *profit* … what's left after you've paid all your operating costs, including your own salary.

(Of course, if QBI is less than zero, it's treated as a loss from a qualified business in the following year, and can be used to offset your taxes then.)

Under the new rules, in other words, the more business income you can shoehorn into QBI, the more you can save on tax, since 20% of that amount is now tax free.

It gets even better.

You've probably heard that there is now a $10,000 cap on the deductibility of state and local income and property taxes. That's going to hurt folks who pay a lot of those taxes.

But PTEs can deduct the *full* amount of any state and local taxes they pay as a business expense. That home office makes a lot more sense now … you'll be able to use it to reduce your nondeductible personal property taxes by shifting some of it to your business accounts.

Naturally, there are some catches.

First, QBI excludes passive income such as capital gains, dividends and interest income (unless the interest is received in connection with a lending business). You can't put your brokerage accounts into a PTE and get 20% of your returns tax-free.

Second, the new 20% QBI deduction phases out for individuals who make more than $157,000 a year, or $315,000 for joint filers — with an important exception, as I'll show you below.

Third, the QBI deduction is limited to PTEs that provide a "specified service trade or business."

Species of Corporations

A **sole proprietorship** is the simplest form of business entity. Taxpayers do not file a separate tax return and instead, business income and expenses are reported on a federal form 1040, Schedule C.

A **partnership** is an association of two or more persons to carry on a business and can take different forms (like limited or general partnerships). A partnership files a separate return, a federal form 1065, and passes income and losses to the individual partners who are responsible for reporting that information on their individual tax returns.

A **Limited Liability Company (LLC)** is a hybrid entity that offers the option to be taxed as a partnership or a corporation.

A **Single Member Limited Liability Company** is an LLC with a single member, typically treated as a "disregarded entity" for federal tax purposes. That means there's no separate tax form and income and expenses are reported on a Schedule C, just as with a sole proprietorship.

An **S-Corporation** is a corporation with tax treatment similar to a partnership. An S-Corporation files a federal form 1120-S, which passes most items of income or loss to shareholders who are responsible for reporting that information on their individual tax returns.

A **C-Corporation** is what most people think of when it comes to business. A C-Corporation files a federal form 1120 and pays any tax due. Shareholders also pay tax at their individual income tax rates for dividends or other distributions from the company (this is where the term "double tax" comes from).

A **Professional or Personal Service Corporation** is a corporation for service professions like lawyers, doctors and architects. ■

If your PTE provides services in health, law, consulting, athletics, financial services, brokerage services or anything "principally relying on the reputation or skill of one or more of its employees or owners" (except, for some unfathomable reason, architects and engineers), you're not invited to the party.

The new tax law calls such excluded occupations "listed professions." Even if you are in one of them, however, if your taxable income is under $157,000 individual/$315,000 joint, then you can take the full 20% QBI deduction. After that, the deduction phases out through a complicated formula until you hit $207,500 individual/$415,000 joint, at which point you lose the deduction completely and the old rules apply … you pay tax at the individual rate.

Finally, even if you exceed this income cap, you can take another form of QBI deduction depending on how many employees and/or how much capital your PTE has.

Simpler? Hah!

So much for filing your tax return on a postcard.

In this section, I'm going to expand a bit on two typical types of PTEs. For simplicity, I'm going to call them the "Independent Professional" and the "Corker Rule" cases.

The Independent Professional

This version of the PTE tax break is aimed at people who have few employees — perhaps only themselves as a single employee — or a small partnership. It's limited by income to prevent high-earners from declaring themselves "consultants" to escape tax. The rationale is that if you are contributing mainly your labor and not much capital, and/or not creating many jobs, then you can access the deduction only if your income is below certain thresholds.

Here's how it works.

For people in nonlisted professions *and* for those in listed professions earning under the thresholds above: If your taxable income is below $157,000 individual/$315,000 joint, the tax-free portion of QBI for any PTE you own is simply 20%.

So, if your income is $100,000 and your QBI is $75,000, then your deduction is $15,000, or 20% of your QBI. You don't pay any tax on that income. Period.

As I explained above, you can continue to take a partial, pro-rated QBI deduction until you hit $207,500 individual/$415,000 joint taxable income.

The Corker Rule

All is not lost if you are above the threshold amounts, however. Two further types of PTEs can join the game:

- You have a multimillion-dollar LLC that has a dozen or so employees — say, a car dealership. You pull in a decent six-figure income, so you're above the $207,500 individual/$415,000 joint taxable income cap.
- You have an LLC with a lot of equity in real estate, but few employees. Again, your taxable income is above the cap.

In both cases, you have the option of calculating your QBI deduction as the *greater* of:

1. 50% of W-2 wages paid by your PTE, including your own, or…

2. The sum of 25% of W-2 wages paid by your PTE plus 2.5% of the original, undepreciated value of all qualified property. Qualified property is physical property used to produce QBI available for use in your PTE at the end of the tax year. This includes all capital equipment … and, significantly, real estate.

For example, let's assume your car dealership pays $250,000 in W-2 wages, and owns a building worth $1,000,000.

- Under the first option, 50% of W-2 wages equals $125,000.
- Under the second option, 25% of W-2 wages plus 2.5% of unadjusted basis of your qualified property is $62,000 plus $25,000 equals $90,000.

So, your best option is to use the first method and declare $125,000 of your QBI as nontaxable income.

In the second case, let's say you're a real estate mogul like President Trump (or Senator Bob Corker of Tennessee, after whom this rule is named. He changed his vote from a "nay" to a "yea" after this option was slipped into the bill at the last minute). You have few employees and a small W-2 wage bill of $50,000, but your PTE owns $50 million worth of hotels, office buildings, condos and so on.

- Under the first option, 50% of W-2 wages equals $25,000.
- Under the second option, 25% of W-2 wages plus 2.5% of unadjusted basis of your qualified

property is $12,500 plus $1,250,000 equals $1,262,500.

I'm sure I don't need to tell you which deduction you're going to take in that case.

The Corker Rule — which was clearly created to benefit multimillionaires, including the authors of the bill — creates an intriguing angle for us lesser mortals, and *it's a biggie.*

2018: Year of the Tax Lawyer

All the profit-shifting shenanigans that multinationals engage in will now be relevant for domestic businesses.

That quote comes from a document called "The Games They Will Play," an evolving analysis of the new tax law by a group of top tax-law professors that's circulated on the internet for the last few weeks.

The professors are right. The new tax treatment of PTEs is a windfall for lawyers who design and create LLCs, partnerships and S-Corporations.

Remember that the new tax treatment of PTEs doesn't apply to "specified service trades or businesses." These "listed professionals" include doctors, lawyers, financial consultants, etc.

If they earn too much, these poor souls aren't allowed to take advantage of the 20% QBI deduction! Rats!

But the Corker Rule creates a new quiver of lawyerly tricks ... and I predict it's going to generate a lot of traffic at state company registration offices around the country this year.

Here's why:

Assume you're a partner in a law firm called LawFirm LLC. You and your partners form SideCar LLC, contributing some capital and using it to buy and hold the building you currently rent. SideCar LLC rents the building back to LawFirm LLC at an above-market rent.

BOOM! You suddenly have qualified "Corker Rule" income in a real estate PTE! Before, you were shut out of the game because you practiced a listed profession. By splitting your business into parts, you save on tax.

All it took was some company formation work, and you're sending less to the IRS.

This is the same as the "transfer pricing" trick U.S. multinationals use to shift income from U.S. to foreign subsidiaries. Create a foreign subsidiary and transfer something of value that your business uses to it — say, Apple's patent on the iPhone — then have the subsidiary rent it back to you at an inflated cost. That slashes your taxable income in a high-tax situation (Apple, Inc., subject to U.S. corporate tax) and shifts income to a low-tax situation (Apple Cayman Islands, Inc., paying little to no tax).

Now, under the new law "listed professionals" can play the same game. Just split an existing PTE into an unqualified (high-tax) professional PTE and one or more qualified (low-tax) PTEs.

The low-tax PTEs then can charge fees to the high-tax professional PTE — for example, rent for office space, secretarial services, a medical practice's' X-ray operation ... even interest on loans from one PTE to another. Those business-to-business payments reduce QBI for the disqualified PTE and shift it to the PTE that can use the 50% W-2 wage or Corker Rule deductions ... just like Apple does when it parks its patents in a foreign subsidiary in a low tax jurisdiction.

Bam. Doctors and lawyers are now in the real estate business!

There are other ways to hack the new system. The tax professors who wrote "The Games They Will Play" say, "borrow(ing) from the terminology of gerrymandering strategies, let's call them 'cracking' and 'packing.'"

- **Cracking.** The first strategy is to "crack" apart the revenue streams from an existing PTE, so as much income as possible can qualify for the deduction. The anecdote above referred to the real estate angle. But "listed" professionals could also form separate service-providing PTEs providing non-listed services — PTEs handling their accounting, document management, software, secretarial services and so on. Again, the game would be to overcharge the main PTE for these services and manipulate the two alternative QBI deduction methods to minimize taxes.
- **Packing.** The second strategy is to "pack" qualifying professional activities into a PTE to transform it into one that isn't primarily

providing a "listed" service. For example, real estate lawyers might both provide legal advice and manage real estate — mixing the businesses so that the IRS can't distinguish them to get the 20% PTE deduction for the whole operation. Another route is for a "listed" professional simply to join a PTE that doesn't provide "listed" services. For example, a lawyer that becomes a partner in a PTE that does real estate development could take advantage of the exception for "architecture" or "engineering" PTEs.

Finally, the new treatment of PTEs creates an opportunity for *employees* of PTEs, too. For example, associates at law firms could band together into what the professors call "Associates, LLC — a separate partnership paid to provide services to the original firm." Each associate might then qualify for the 20% QBI deduction.

Now you see why I say that 2018 is going to be the year of the tax attorney.

Does it Make Sense?

I can hear you thinking, "Wow, Ted, this is fascinating, but it seems like a lot of effort!"

True. But for some of you, the time to act is *now* — you only get the new tax treatment once your PTE is up and running.

First, if you own a PTE in one of the so-called "listed professions" forbidden from taking advantage of the 20% PTE deduction — whether as a sole owner or partner — you should book an appointment with a tax lawyer ASAP. The hacks I described in the previous section are real, and they could save you a ton of money.

Second, if you are a nonlisted professional employee of a company — an engineer working for a power utility, for example, or a junior architect at a large practice — you should sit down with a tax adviser to see whether you'd be better off "quitting" your job and becoming a "consultant" to your old employer. If your current taxable income is less than $157,000 individual/$315,000 joint, you will save money on your taxes by going solo.

There is one caveat: Leaving permanent employment to become a PTE-based consultant means giving up corporate benefits like medical, dental and 401(k). But there are couple of reasons that might not be as big a problem as you might think:

1. Self-employed people can contribute up to 25% of their QBI into a SEP-IRA, traditional or Roth. The current annual cap is $54,000 a year; you're not limited to $5,500. That is a viable alternative to a 401(k) — especially since you can manage your IRA investments yourself, as I've described several times in *Bauman Letter* reports about self-directed IRAs.
2. The Trump administration recently authorized the formation of independent health insurance associations, which are ideal for self-employed

Can You Retain Earnings in a Pass-Through?

What if you don't actually take any profits from your PTE? What if you just leave them in your PTEs bank accounts? Can you defer tax?

Unfortunately, no. The only business entity which can retain earnings and not distribute them as taxable to the shareholders is a C-Corporation. Here are the various scenarios for each type of company:

1. With an **LLC**, all earnings flow through to the shareholders in the year the earnings are made. None of the earnings can be classified as anything other than personal income, and none of the earnings can be retained by the corporation without being reported as income to the owners.
2. With an **S-Corporation**, all the earnings each year must flow through to the shareholders, either in the form of wages or dividends. The shareholders must path themselves a reasonable wage. Profits in excess of the reasonable wage can then be declared as dividends. This may make a difference in the case of someone receiving Social Security benefits, however, since only the wages are treated as "earned" income. ■

people. Once they are up and running, self-employed people will be able to form insurance pools with others in their situation and benefit from the same risk-spreading actuarial dynamics that produce lower insurance premiums for corporate health plans.

3. When you're self-employed, you're going to find that you can book many "personal" expenses to your business accounts. Your home office, your PC and laptop, your phone, a portion of your utilities — anything that you use for work can be written off as a business cost, at least in part. That means that although your overall cash flow may be the same as a self-employed PTE owner as it was when you were an employee, you're going to still have access to many things that you need — and enjoy a lower overall tax burden since they are deductible business expenses.

And don't forget ... the new tax law eliminates *all* "miscellaneous deductions" — including the deduction for home office expenses for employees who work remotely. That makes setting up as a PTE even more attractive, since all those expenses could be assigned to your business, reducing your taxable income and keeping you below the threshold to take the full 20% QBI deduction.

Conclusion

Though Republicans promised a simpler tax system, all these new loopholes are certain to keep the nation's CPAs and tax attorneys busy.

For many people, the opportunity to game the tax system this way will be irresistible. But if you're on the fence about it, consider this ... you may have no choice.

Consider existing partnerships, for example. Each partner will have to figure out their individual values for qualified business income and qualified property to calculate their tax-deductible QBI ... just to file their individual 1040s. They'll have to figure out their individual share of the unadjusted basis of the partnership's qualified property. Based on how the law is written, many tax experts think this includes everything from real estate to paperclips.

And they'll have to be able to document all of this to the IRS, if necessary.

So many of us are going to have to grapple with this new PTE tax regime even if we don't choose to take advantage of any new loopholes. The rules for PTEs — including the simplest LLCs and partnerships — have changed, and you're going to need help figuring them out.

It's not just an accounting issue, either. You're going to need advice.

Much of the actual practice of tax law is shaped by opinions issued by the IRS in the form of "private letters" and other rulings on how to interpret the tax code.

That code now has some radical new modifications. That means the IRS is going to spend the next few years reacting to the good-faith efforts of tax attorneys to interpret the new rules for their clients. The IRS can't just throw the book at someone who adopts a particular strategy based on good-faith efforts to interpret the new law during the period when the IRS is trying to figure it all out.

That creates a window of opportunity for many of us ... one we should seize ... but with experienced expert advice.

It's been a while since I recommended a specific professional in *The Bauman Letter,* but in this case I have no hesitation in doing so.

To my mind the most qualified tax attorney I know is Josh Bennett, who has worked with me, and with my father Bob Bauman, for many years. Whether you are based in Florida or not, he's a great place to start if you think any of this is going to apply to you this year — voluntarily or not:

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I'm interested in hearing more from you. What is your No.1 concern when it comes to your assets and your freedom? Send your comments to me at baumanletter@banyanhill.com

An IT Security Department in Your Basement?

By Brad Deflin

IF you are an investor, member of an affluent family, a trusted business person or perhaps all three, you may have wondered to yourself: "Is cyberrisk getting so bad these days I need my own IT security department just to keep us safe?"

Imagine it, for a moment, having your own information technology (IT) security department in your home, office or small business. Smart, experienced technicians on the job every day, using the latest technology and intelligence to protect all your devices and everything you do online. Here, you enjoy the internet for all it's worth; doing business, investing, banking, shopping, emailing and sharing — all without worry or risk.

Not long ago, this scenario would have been impossible without a dedicated staff and significant expense. It required racks of complicated hardware, kept cool in its own dedicated room and maintained by engineers to keep it all running. The notion of this level of advanced protection was out of the hands of all but the largest organizations with big budgets and "mission-critical" needs.

Welcome to the Future

Well, welcome to the future. Now, with recent developments in software and network technology, the "IT security department in the basement" scenario we described is increasingly within reach of us all. Affluent investors and families, small businesses and professional practices, home and remote offices — those who need this level of protection most now have the access and affordability they need.

How Did It Happen?

Advances in technology over the last few years have changed just about everything in our lives. Smart software using vast amounts of data is replacing the need for hardware and labor. Progress in network technology (think: clouds) allows remote operations where once it all had to be on-site. The result is vast improvement in performance and cost.

Concurrent with the progress in software and network technology, the cybersecurity business was turned upside down. Beginning in 2012, Wall Street started to see a long cycle of cybercrime ahead and got bullish on the prospects for growth in defensive technologies. Since then, the industry has enjoyed record-high capital investment inflows, and it's advancing innovation at a pace we've never seen before.

The fresh investment funding that fuels the IT security industry today has a new mandate for its entrepreneurs: Innovate using the recent advances in software and networks to protect people, the technology they use every day, their homes, offices and small businesses from the emerging epidemic in cybercrime.

Imagine the potency of the mix. Next-generation software and data science blended with network engineering that is so effective we call the result "clouds." Now stir in a generous measure of smart, experienced entrepreneurs and innovators with fresh slates from which to work and plenty of capital to bring their new, competitive ideas to bear. Finally, throw in stock options and incentives to motivate with the potential for personal wealth, and a mission to change the world.

Five years of this brew has created dramatic progress and produced some pretty amazing innovations. Now, the "IT security department in the basement" scenario we describe has arrived.

Security in the Cloud

Using these new software and network technologies, the traditional IT security department is fast becoming the "IT security center in the cloud" — a remote operations center staffed by technicians working around the clock serving many customers at a time.

Information security is now "cybersecurity as a service" or, as it is sometimes referred to, "firewall as a service." Instead of purchasing expensive, difficult-to-use servers and hardware firewalls (and paying for IT support technicians), the "as a service" approach bundles it all comprehensively and cohesively, and customers "subscribe" to receive the benefits.

It's kind of like having a gym membership instead of all the equipment and trainers at your location. As John Chambers, the then-CEO of Cisco famously said just a couple of years ago when trying to turn the culture at his firm toward the new paradigm: "No one wants to buy boxes, they want to buy results!"

How It Works

Picture the internet as a massive cloud with a long pipe that connects to your location — say your home or office. Now think of your cable modem as the spigot on the end of that pipe. You can turn the spigot on or off, but, like your public water utility, you can't control the quality of what comes out.

An IT security department in the cloud sits on your pipe between the internet and your spigot. All the bad stuff is filtered out before getting to your cable modem and into your network. In this case, the filter works in both directions.

Unlike water, your internet activities come in and go out — upload and download. This way, not only is your information safe at your location, but it is also encrypted, and made private and secure, before reaching the hostilities and risks of the internet.

The "Full Network Security" Approach

What I'm describing is what we call generically "Full Network Security." The term implies comprehensive cybersecurity at the network's node, versus on individual devices. With this approach, all devices connected to your internet network, including the Wi-Fi signal, receive a full suite of protective measures that are optimized and updated 24/7 and in real time.

Computers, phones, printers, smart TVs — anything connected to your internet is automatically secured and safe from cyberattacks and hackers around the world.

As cyberthreats morph and evolve to evade yesterday's security measures, your team in the cloud is on the job 24/7. Without fail, in real time, they work to keep malicious actors, spammers and cybercriminals out.

Full Network Security is subscription-based and includes an "appliance" for connecting your network to the service. The appliance is a small box, about the size of a novel, and it sits between your cable modem and Wi-Fi router. It's simple to install and, once connected, everything is automatic and in the hands of the remote IT security center that does all the work for you.

Clean Air, Clean Water, Clean Internet

We want our basic needs — air and water — to be clean and healthy. The same holds true for the internet service that we consume every day of our lives.

We use the term "virus" when describing internet risk for a good reason — the quality and security of everyday life is increasingly dependent on inoculating ourselves to online risk and crime.

The list of features of the Full Network Security approach is extensive and too lengthy to include here, but it covers EVERYTHING. What it means to you, your family, clients and business is that all you do within the fixed network is protected all the time.

Your personal and professional information is safe, banking and investing is secure, passwords, credit cards, even security cameras and internet-connected smart homes — all activities are sealed from the outside and off the grid from hackers and cybercriminals who look to do you harm.

At the remote IT security center, where all the work is being done, the action is fast and furious. Systems and defenses are constantly updated using the latest intelligence from around the world. Known bad actors, spam campaigns, ransomware botnets: They're all kept out before getting anywhere close to you and your location. With Full Network Security, your internet is clean, safe, fast and reliable, and without the garbage and risk that barrages the public more and more every day.

> ***We want our basic needs — air and water — to be clean and healthy. The same holds true for the internet service that we consume every day of our lives.***

This level of security is so effective that the service meets or exceeds all regulatory requirements for information security — including the especially stringent compliance levels of HIPAA and PCI laws — without the need for hardware and technical expertise!

Our Experience and Recommendation

At Total Digital Security, we have been testing versions of "Full Network Security" since 2014. We knew its day would come before too long. Since October of last year, we have been using and analyzing a service from OmniNet, a recognized leader in this emerging field.

Now, we are so impressed and pleased with every element of performance from the OmniNet solution that we are using it exclusively in our corporate office, and I'm even using it in my own home. And we are introducing the service to our clients around the world.

If you are interested in learning more about how to get your own IT security department in the cloud, and how to utilize the OmniNet solution to protect your office, business or home, you can contact me at brad@totaldigitalsecurity.com. ■

Brad Deflin is a seasoned business executive with success at both the large corporate level, and in the pioneering of start-up companies. Brad co-founded Total Digital Security. Contact Brad at Brad@TotalDigitalSecurity.com.

The *Smart* Way to Rotate Your Portfolio

As you know from previous issues of *The Bauman Letter*, the *Smart Money* system uses a set of rules — an algorithm — to determine our specific trades.

But we also use a rules-based system to determine which two U.S. sectors to hold at any given moment. (We are always in two U.S. sectors, one commodity and two emerging markets.)

This is known as "sector rotation." It involves simply shifting investments from one sector of the economy to another to maximize gains.

When we rotate sectors, we use the proceeds from the sale of an exchange-traded fund (ETF) in a sector that is near a top to purchase an ETF in another sector that is on its way up.

Gaining Momentum

Sector rotation is typically restricted to professional portfolio managers because of the sheer volume of data analysis involved. The *Smart Money* system squeezes this process into a sophisticated algorithm based on a careful analysis of past investment performance going back to 2007.

In other words, we apply the same technique to sector rotation that we do to individual ETFs within those sectors.

Traditional sector rotation strategies capitalize on the fact that not all sectors of the economy perform well at the same time. Traditionally, broad market sector rotation investing seeks to follow "market cycles."

These cycles are usually associated with bullish and bearish periods as well as recessions, recoveries, expansions and contractions. Sector rotation strategies following economic market cycles seek to identify bullish opportunities in expanding sectors and mitigate losses through rotation to safe havens in recessionary markets.

But there is another way to approach sector rotation — through the lens of "momentum" investing. Momentum investing is based on the fact that asset prices that are rising tend to keep rising, and vice versa.

This isn't necessarily related to market cycles. Sometimes it's just a result of fluctuations in investor behavior. Big institutional investors, for example, often move money from sector to sector to take profits and capture growth in new areas.

Cycling Your Portfolio

Particularly in a period of long economic expansion, such as 2009 to the present, market cycles aren't the main driver of sector rotation. Instead, investors look for value in sectors that have been neglected for a while.

For example, at the end of 2017, the tech sector, which had enjoyed a long bull run all year, declined — but financial stocks went on the upswing. That means tech stocks, which continue to enjoy good fundamentals, are a good value right now ... which is why we are in the **Technology Select Sector SPDR (NYSE: XLK)** at the moment.

Executive Publisher .... **Aaron DeHoog**
Editor .... **Ted Bauman**
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The Bauman Letter Portfolio is an equally-weighted strategy and does not include dealing charges to purchase or sell securities, if any. Taxes are not included in total return calculations. "Adjusted Total Return" is the price appreciation adjusted for dividend payments, interest payments, and stock splits, and any gains or losses due to currency fluctuation on securities listed on non-U.S. exchanges. Purchase Price is based on the lesser of "buy up to price," if that price was available after the recommendation's release, or the first closing price after the recommendation's release. For transparency's sake, we want you to know that we have an advertising relationship with EverBank. As such, we may receive fees if you choose to invest in their products. Stop-losses: *The Bauman Letter* Portfolio issues stop-losses on an individual stock basis. Sources for price data: S&P's Capital IQ and Everbank.

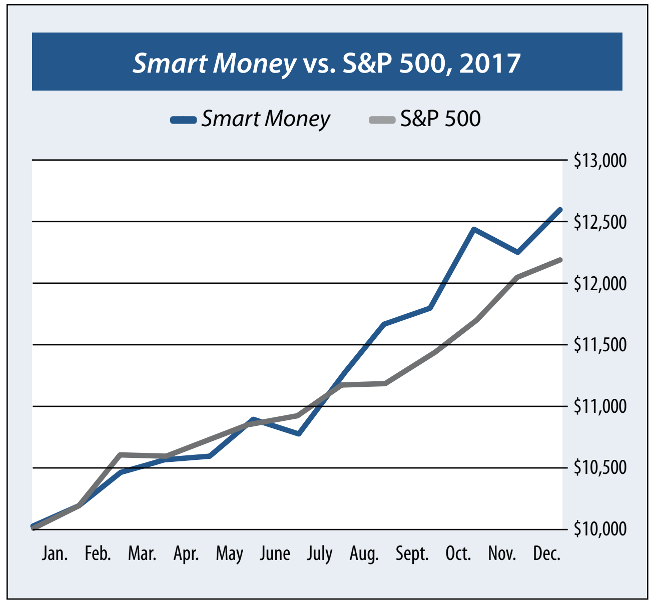
To capture such opportunities, the *Smart Money* system invests in sectors showing the strongest performance over a specific time frame, just as we do with our individual ETF positions. We use indicators like the Relative Strength Index (RSI) and moving averages of sector indexes to identify those that are likely to perform well in coming months.

It all adds up to a great system that consistently outperforms our benchmark, the S&P 500. At right is our performance since the beginning of 2017.

And below is our portfolio as we went to print.

Kind regards,

Ted Bauman, Editor



The Bauman Letter Recommendations

Investment	Date Added	1/17/2018	Purchase Price	% of Portfolio	Adjusted Total Return	Advice
PowerShares DB Energy ETF (DBE)	10/3/17	$15.10	$12.69	20.00%	18.99%	Hold
WisdomTree Emerging Markets SmallCap Dividend Fund (DGS)	1/3/18	$54.63	$53.13	20.00%	2.82%	Hold
VanEck Vectors Indonesia Index ETF (IDX)	1/3/18	$26.11	$24.97	20.00%	4.57%	Hold
PowerShares Aerospace & Defense Portfolio (PPA)	8/1/17	$56.54	$48.02	20.00%	18.26%	Hold
Technology Select Sector SPDR (XLK)	1/3/18	$67.55	$64.74	20.00%	4.34%	Hold

***Smart Money's* total gains since January 2017: 29.95%.**

S&P 500 since January 2017: 21.71%.

***Smart Money's* outperformance: 19.57%.**