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I. Mutual Fund Performance IS Affected by Performance Advertising

The following quotes are from an article in the June, 2007 issue of *NAPFA Advisor*, the magazine of the National Association of Personal Financial Advisors (the "fee-only" association). I am an associate member.

> [Do you] notice that…mutual funds are hyping their fund's performance in print and broadcast media ads? If so, it could pay to keep a close eye on the fund and its portfolio holdings, according to a study by Henrik Cronqvist, assistant professor at Ohio State University's Fisher College of Business.
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> Funds that advertise tend to pull in a lot of investment dollars and force fund managers to buy stocks at higher prices than they prefer, he reports. Reason: They must keep a fund fully invested to meet its investment style objective.
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> If a …fund suddenly starts promoting performance, the manager could be deviating from his or her investment style through more active trading in hot stocks, the study also found. The study 'Advertising and Portfolio Choice,' was part of Cronqvist's dissertation from the University of Chicago's School of Business.
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> Finally, Cronqvist found that advertising boosts fund expenses and reduces investor returns over the long term.
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> The study suggests that higher fund expenses due to advertising eat into investor earnings and reduce total returns. Cronqvist found statistically significant differences in money flowing into funds that advertised compared with funds that didn't advertise. So it pays for some investment companies to spend heavily on promotion.
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> Cronqvist also cited other research that indicated funds recommended to readers in *Money* magazine, *Kiplinger's* and *Smart Money*, popular financial periodicals, are more likely to be those of past advertisers. That may be one more reason to pull the trigger to sell one of your…highly publicized mutual funds.
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> 'Higher quantities of fund advertising do not signal higher unobservable fund manager ability, because funds that advertise more are not associated with high post-advertising excess returns,' he said in the study. 'Advertising is found to steer people towards portfolios with higher fees and more risk through higher exposure to equities and more active management, and more "hot" sectors.'

Smartt comment: The study also helps explain why individual investors do so poorly. They tend to purchase "hot" mutual funds after their "run to greatness" has already occurred and before they sink into mediocrity. Studies show that investors who do a lot of switching of their investments often buy mutual funds too late so that the investor's average rate of return is significantly below the mutual fund's rate of return. Second, John Bogle (past chairman of Vanguard) has published research that shows that - with a very high frequency - the fund which is hot this year will be colder-than-average next year.

II. What Are OUR and THEIR Asset Allocations?

Each of us has a different ability to live with uncertainty (risk) and so our investments will be different:

As of June 30, 2007	Clients	The Smartts
Money Market Funds	2.7%	0.3%
Bond Funds	25.0%	3.8%
Stock Funds	72.3%	95.9%
Totals	100.0%	100.0%

III. Vanguard Rates of Return (through June 30, 2007):

Performance percentages are per ***Morningstar.*** Amounts in parentheses are percentile rankings (1= best and 100= worst) within category.

Periods ended June 30, 2007	Yr. to date		5 Years		10 Years	
Total Stock Market Index	**7.5%**	(31)	**11.8%**	(19)	**7.8%**	(23)
Tax-Managed Capital Appreciation	**7.8%**	(31)	**11.8%**	(19)	**7.8%**	(23)
Tax-Managed Small Capitalization	**8.7%**	(47)	**14.2%**	(37)		
REIT Index	**-6.3%**	(60)	**18.1%**	(65)	**12.9**	(60)
Tax-Managed International	**10.9%**	(43)	**17.8%**	(19)		
Balanced Index	**4.8%**	(71)	**8.9%**	(45)	**7.2%**	(34)
Total Bond Market Index	**0.8%**	(45)	**4.2%**	(51)	**5.7%**	(27)
High–Yield Corporate Bond	**1.8%**	(92)	**8.1%**	(90)	**5.6%**	(33)

For comparison, here are several stock and bond benchmarks:

Periods ended June 30, 2007	Yr. to date	5 Years	10 Years
S & P 500 (large stocks)	**7.0%**	**10.7%**	**7.1%**
Russell 2000 (small stocks)	**6.5 %**	**13.9%**	**9.1%**
Lehman Brothers Aggregate Bond Index	**1.0%**	**4.5%**	**6.0%**
CS First Boston High -Yield Index (bonds)	**3.7%**	**11.8%**	**6.9%**

The above-listed mutual fund rates of return are for the investor class of the regular, “open-ended” Vanguard mutual fund. Vanguard ETFs have lower costs and, long term, including brokerage and other charges, are expected to yield higher rates of return (e.g. the Vanguard Total Stock market ETF has costs of approximately 0.1% per year less than the regular mutual fund. The dividend yield of the ETF is thus approx. 0.1% HIGHER than the regular mutual fund). Vanguard also has an Admiral class of funds with lower costs for investments of more than $100,000. These funds are also expected to yield higher rates of return.

IV. Jonathan Clements on Owning Individual Bonds vs. Bond Funds:

Clements is my favorite Wall Street Journal writer. He specializes in articles about basic personal finance and investing. From his April 22, 2007 column, here is his take on the differences between bond mutual fund and individual bond ownership:

> If you hold a 10-year bond with good call protection to maturity, you know how much interest you will receive and how much you will get back when the bond matures. By contrast, if you own a bond mutual fund for 10 years, you can't be sure what you will earn.
>
> This uncertainty leads many to conclude that individual bonds are safer. But that isn't the case. If you sell an individual bond before maturity, you could receive far less than the price you paid. More important, your money is riding on a single security. If you're dealing with corporate bonds, there's a real risk of default.
>
> A bond fund reduces this default risk through broad diversification. You also benefit from the fund's buying power, you can automatically reinvest your dividends and you can make purchases with relatively small sums. But many investors ignore these advantages—and instead fret that, when they sell, their shares could be worth a few pennies less than the price they paid.

Smartt comment: The most often overlooked difference, especially by investors who own several bonds ("bond ladders" are one of these ownership arrangements), is the very large spread which investors pay when they buy or when they sell an individual bond. The buying power of the mutual fund significantly adds to the expected rate of investment return by reducing the cost of bond purchase/sale transactions.

Further, diversification is important. Nothing is worse that waking up to find that the corporation whose bonds you hold is now in bankruptcy, or worse. Yes, in bankruptcy bondholders are a preferred creditor, but often they collect much less than 100% of their investment. Diversification is *"the giving up of making a killing for the safety of not getting killed!"*

V. Vanguard Founder Has Education Bone to Pick

This interview first appeared in a small newspaper in New Jersey, and later *The Seattle Times* June 2007:

> John Bogle, the founder of the Vanguard Group…, is worth listening to on any subject. In a recent interview with Bogle…, he talked about high school stock-picking contests, Jim Cramer, and gambling, among other things.
>
> **Q**. Young people are encouraged to invest in individual stocks, via contests, and not in mutual funds and certainly not in index funds, although index funds are clearly the soundest choice. Can something be done about this?
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> **A.** It's tragic and true. High schools and colleges should forget about those foolish stock-picking contests and educate young people sensibly about investing.
>
> They should learn about (a) the compounding of returns over the years (half know something about it already) and (b) the tyranny of the compounding of costs (only half of 1 percent may know about this).
>
> If the market returns 8 percent, investors might get only 5.5 percent of that because of the costs. They don't recognize costs in compounding.
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> There may be no conspiracy to hide this information, but fund marketers happily ignore it.
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> Financial services are a supply-push industry. Salesmen (are) selling something. No-load index funds are a demand-pull industry.
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> Instead of telling people, 'Don't just stand there, do something,' the schools should be telling them, 'Don't do something, just stand there.' (Buy and hold) But the world will go on its merry way.
>
> Jim Cramer (host of TV's "Mad Money") says to buy this, sell that, and he's smart and likeable, but even he doesn't know what the market is going to do.
>
> People seem to be born with an instinct to gamble. They gamble on horse races, at Las Vegas, whatever. And the house always wins.

In the lotteries, the states always win. If people knew the odds against their winning in lotteries, they might get it out of their system. And if people knew the odds against their outperforming the securities markets, more of them might invest in index funds.

VI. Long-Term Care Insurance Available Through Employers

Quoted from the May, 2007 issue of *HR Magazine* in an article entitled "Long-Term Planning":

> Long-term-care insurance is acquiring a higher profile. Year after year, this specialized coverage for people who need care in nursing or assisted living facilities, or at home has been gaining visibility on employers' lists of benefits offerings, and workforce trends suggest it will continue doing so.
>
> Certainly, as baby boomers move toward retirement, more and more are likely to see advantage in having such coverage for themselves, particularly if they can get group-discount prices through long-term-care (LTC) plans arranged by their employers. Now the market for employer-sponsored LTC insurance is broadening to include employees' family members—particularly parents.
>
> While LTC coverage does not extend to health care expenses, it does cover – when needed – professional help with the tasks of daily living, such as bathing, dressing and taking medications as directed. People who are diagnosed with Alzheimer's disease…typically are covered.

Smartt comment: We once heard a seminar presenter say that – with the possible exception of having a will – the next biggest impact on your estate is whether you have long-term care insurance. The really rich don't need it (they can self-insure) and the really poor don't need it (they'll taken care by MediCAID). Everyone else is in the middle, and you need to know that MediCARE only offers nursing home care for rehab days here and there. Medicare does NOT cover ongoing nursing home care. [Read that last sentence several times.] We don't sell LTC and don't get commissions or fees from anyone who does. We just happen to think this is important.

There are many factors to consider when choosing LTC coverage:

- WHERE will the care be provided? Home, hospice, assisted living, nursing home are some options.
- WHAT factors determine the premium to be paid for LTC policies? Age and health at purchase date, benefit amount, benefit duration, etc.
- WHAT triggers the policy to pay? Not being able to do a certain number Activities of Daily Living (ADL) or mental incompetence
- WHAT waiting period should I pick? A policy with a 60-day waiting period will cost more than 180-day wait.
- HOW are benefits paid? Generally as a set dollar amount per day ($100-$200) and may or may not be Inflation-protected.
- HOW long are benefits paid? Generally a policy is for two to six years or for life; longer the period the more it costs.
- HOW is premium paid? Generally for life or until policy is triggered, or paid up by certain age, or paid up in a certain number of years.

The National Association of Insurance Commissioners (NAIC) publishes a very good, free summary of what you need to know if you are considering purchasing LTC. We would encourage you to obtain the booklet: Go to www.naic.org and click on CONSUMERS>, which is on the left side bar of the home page. This takes you to a page that has a left side bar containing a hyper-link: click on the Free Consumer Guide Order form. This takes you to a screen where you check the last publication, "A Shopper's Guide to Long-Term Care Insurance", and you fill in your mailing address: Voila!

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