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Client Newsletter Volume XV Number 3 November 1, 2009

I. <u>Good News About Index Funds From *Kiplinger's*:</u>

"Good News…" is the title of an article which appeared in the September 9, 2009 edition of *Kiplinger's Personal Finance Managzine*.:

> Funds that merely mimic the market did better than expected during the downturn. They're also attracting gobs of cash.
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> Relax, indexers, your strategy weathered the Great Crash just fine.
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> Actually, telling index fund investors to relax is like telling the Rock of Gibraltar to stand still. When the market nose-dived last fall and investors rushed to get their cash out of actively run funds, devotees of index funds kept pouring money in. Fund consultant Strategic Insight found that investors put $200 billion into stock and bond index funds last year—an amount that was actually up from 2007. Meanwhile investors withdrew more than $200 billion from actively managed funds. All told, individual investors have about $604 billion in stock and bond index funds, according to the Investment Company Institute.
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> That isn't to say that index funds fared well in the bear market; virtually all stock funds took a licking. But the perseverance of indexers gets to the heart of the strategy, which is as much a mind-set as it is a way to own stocks and bonds. The classic indexer is satisfied with beating most comparable funds over time and happily abdicates responsibility for handicapping the talents of fund managers. 'Index investors believe in long-term buy-and-hold investing' and tend not to succumb to the temptation of chasing the hot fund du jour says Gus Sauter, chief investment officer of the Vanguard Group, a fund family that helped pioneer index funds.
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> Index funds are simply low-cost mutual funds that seek to mimic a market benchmark—such as Standard & Poor's 500-stock index, which measures the performance of big U.S. companies. You can buy a fund run by people who try to beat an index by picking stocks or bonds (sometimes both) that they believe will do better. But you'll pay total fees that, in the case of domestic, large-company funds, average 1.27% a year. By contrast, Vanguard 500 Index, the largest index mutual fund, charges just 0.16% of assets per year…
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> Although only 11% of mutual fund assets are in index funds, the proportion is rising. And a recent survey of institutional investors (such as pension funds and endowments) by Greenwich Associates found that one in five had moved money from actively managed funds to index funds in the past year. Chris McNickle, managing director of Greenwich Associates,

says that 'in a market where some active managers underperformed spectacularly, many institutions are seeking the predictability of index funds.'

Smartt comment: when I began investing in Vanguard's first index fund, the S&P 500 fund, two decades ago, the cost was 0.25% per year. The cost of this fund has continued to fall as the fund has grown larger and Vanguard passes along economies of scale to we the shareholders. As the owners of Vanguard, one of few true mutuals in the investing business, we share Vanguard's success through lower expenses.

Even lower expenses are obtainable via use of Vanguard ETFs (exchange traded funds) which are separate classes of regular Vanguard index funds. Because brokerage firms keep the share ownership lists, and through other cost cutting means, ETFs have lower expenses than regular index funds. And low cost is almost always worth pursuing.

When Vanguard's Total Stock Market Index fund became available a few years later, I changed to this more diversified fund. Broader diversification makes sense for investors because it reduces the fluctuations in value which affect only one or only a few companies. Further, since the S&P 500 index changes at least annually, some companies added, others dismissed from the 500, the Total Stock Market Index fund generally has lower expenses of trading; it already owns both the new entries to the 500 and those cast out.

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 September 30, 2009	Clients	The Smartts
Money Market Funds	2.9%	1.2%
Bond Funds	31.8%	4.0%
Stock Funds	65.3%	94.8%
Totals	100.0%	100.0%

Remember each of us has different goals and needs and our asset allocation should fit us and our family.

III. Vanguard Rates of Return (through September 30, 2009):

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

Periods ended September 30, 2009	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index	**21.6%**	(44)	**1.8%**	(36)	**0.8%**	(40)
Tax-Managed Capital Appreciation	**21.6%**	(44)	**1.8%**	(35)	**0.4%**	(47)
Tax-Managed Small Capitalization	**19.6%**	(77)	**3.0%**	(37)	**7.2%**	(40)
REIT Index	**18.8%**	(49)	**1.7%**	(39)	**9.4%**	(32)
Tax-Managed International	**26.1%**	(58)	**6.4%**	(36)	**2.7%**	(37)
Balanced Index	**15.9%**	(77)	**3.5%**	(30)	**3.3%**	(39)
Total Bond Market Index	**5.9%**	(88)	**5.1%**	(21)	**6.0%**	(22)
High–Yield Corporate Bond	**32.4%**	(82)	**4.0%**	(67)	**4.8%**	(53)

For comparison, here are several stock and bond benchmarks:

Periods ended September 30, 2009	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**19.3%**	**1.0%**	**-0.2%**
Russell 2000 (small stocks)	**22.4%**	**2.4%**	**4.9%**
Barclays Aggregate Bond Index	**5.7%**	**5.1%**	**6.3%**
CS First Boston High-Yield Index (bonds)	**45.2%**	**5.7%**	**6.7%**

Vanguard mutual funds and ETFs continue to perform as expected.

I continue to be surprised by the recovery of values of high yield ("junk") bonds. Most clients own a portion of their bond holdings within Vanguard's High-Yield Corporate Bond fund. Last year, it declined by less than the average high-yield bond fund and this year it has increased by less. The Vanguard fund takes a lower level of risk than the average "junk" bond fund; it too has performed as expected.

IV. Burton Malkiel Talks the Random Walk:

"Burton Malkiel…" is the title of an article which appeared on an internet site, Advisor Perspectives, dated July 7, 2009. Malkiel has been a Vanguard director for many years.

> Passive investing has no more outspoken advocate than Burton Malkiel. At age 72, Malkieel remains every bit as committed to the efficient market hypothesis as when he wrote A Random Walk Down Wall Street in 1973.
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> [He] has taught finance at Princeton for the past 20 years. He insists that investors should buy and hold index funds.
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> Against institutional investors, who are responsible for 98% of all trading, individuals don't stand a chance, Malkiel said. 'Institutions can't beat the market because they are the market,' he said, and individuals can't expect to do any better.
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> Fundamental analysis does give investors an edge, but Malkiel said that it works so well that any valuable information gets reflected so quickly in stock prices that investors cannot make any money using it.
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> Investors who choose stocks with certain characteristics, such as low P/E [price/earnings] ratios, high growth rates or upward EPS [earnings per share] revisions, are likely to fail because these metrics are 'too isolated' to work in the long run.
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> Malkiel finds other active strategies even flimsier. 'Technical analysis,' he said, 'is most akin to astrology.' It does not give investors a dependable way to beat the market. He conceded that there is a 'modicum of truth' that momentum helps explain stock prices. But he said the resistance to momentum can be enormous and 'there is not enough momentum to make excess profits.'
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> Malkiel scoffed at the suggestion that investors…could profit by detecting patterns in stock movements. Malkiel said he hears claims like this 'all the time' from his students. 'If you massage the date long enough you will eventually find a pattern. There are lots of patterns

that look like they work,' he said, ' but very few will continue to work – and nothing that is truly dependable.'

If stock picking and fund picking are out of the equation, can financial advisors still add value?

Unquestionably, Malkiel said, the answer is yes. His view of financial advisors has evolved, and he now believes they should play a much bigger role for investors. 'The most important thing is to keep investors in a steady state,' he said.

Widows and widowers of his fellow Princeton professors seek Malkiel's advice for investments…Many came to him in late 2008, weakened by the market and wanting to sell, which he said would be the ' biggest mistake' they could make. Advisors can help in those situations by 'keeping people on an even keel.' Even younger people can benefit from financial advice, such as encouragement to dollar-cost average rather than 'quit the program' when markets turn down.

Malkiel recited the results of numerous studies showing that investors, on average, underperform the funds in which they invest, because they tend to sell at the bottom and buy at the top. 'I am absolutely convinced financial advisors can play a critical role in addressing this,' he said.

Smartt Comment: I continue to be grateful that the vast majority of my clients have "stayed the course" during the last couple of years. Although all of us have been unsettled, worried about the economic future of our country, as well as the value of our investments, very few have sold out of the stock market. There is no guarantee of future positive stock market returns, if there were a guarantee, the returns would be significantly lower, but continuing to bear stock market risk places us in a position to reap future rewards which markets may provide; and have provided in the past.

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