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- I.      Cost of Vanguard ETFs Still Decreasing
- II.     What Are OUR and THEIR Asset Allocations?
- III.    Vanguard Rates of Return (through Latest Quarter End)
- IV.    Genes and Investing – “Natural Stock Selection”
- V.     Sharing Your Financial Position and Plans with Your Family

**I.   Cost of Vanguard ETFs Still Decreasing**

In March I received the annual report of Vanguard’s Total Stock Market Index Fund. Since then I have been asking some clients, acquaintances, and friends the following question: “What is your favorite purchase, something you have purchased more than once, and did it increase in cost in 2011 or did it decrease in cost?”

There are a very few things we buy which we expect to be lower in cost each year—computers and computer peripherals. Perhaps cell phones, smart phones, and Ipads are on this list as well.

Most of us who own significant amounts of the Vanguard Total Stock Market Index Fund own the share class which is an ETF, an exchange traded fund. At last look, this single class of this single Vanguard fund comprised about 3/8ths of all of our investments, more than \$8 million in market value.

Whereas, twenty years ago, when Vanguard “invented” the index fund, the fund’s annual operating expenses were about 25/100%, the 2010 cost of the ETF class of the fund was 6/100%--the greatest investment bargain I know.

The Total Stock Market index Fund annual report, for the ETF version of the fund, states that the “Ratio of Total Expenses to Average Net Assets” for 2011 was 5/100%. This small decline in the cost of the ETF is good news for investors. Vanguard continues to find ways to reduce the cost of their products and we, the owners of the shares, benefit.

Recall that Vanguard is one of only a couple of true mutuals in the investment world, companies which are organized on the principal of ownership of the *company* by those who own the investment products. (The other mutual is TIAA-CREF, the large company which assists colleges, universities and other non-profits to provide retirement benefits for employees.)

Earlier in March Vanguard announced a decrease in the cost of other ETFs, including VEU, the all-world ex-US stock index ETF which many of us use as our international stock fund. Here the costs are 23/100% per year, significantly higher than the US stock ETF, but declining in cost.

## 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 March 31, 2012	Clients	The Smartts
<b>Money Market Funds</b>	1.2	0.2%
<b>Bond Funds</b>	31.0	6.0%
<b>Stock Funds</b>	<u>67.8</u>	<u>93.8%</u>
<b>Totals</b>	100.0%	100.0%

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

If you have questions about your asset allocation, or your retirement plan investments, I'd be pleased to assist.

## III. Vanguard Rates of Return (through Latest Quarter End)

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

Periods ended March 31, 2012	Yr.-to-date		5 Years		10 Years	
<b>Total Stock Market Index Admiral</b>	<b>12.9%</b>	(37)	<b>2.5%</b>	(19)	<b>5.0%</b>	(13)
<b>Tax-Managed Capital Appreciation Admiral</b>	<b>13.0%</b>	(36)	<b>2.3%</b>	(23)	<b>4.7%</b>	(20)
<b>Tax-Managed Small Capitalization REIT Index Admiral</b>	<b>11.9%</b>	(56)	<b>3.8%</b>	(18)	<b>7.6%</b>	(26)
<b>Tax-Managed International Admiral</b>	<b>10.7%</b>	(33)	<b>0.4%</b>	(25)	<b>10.6%</b>	(37)
<b>Balanced Index Admiral</b>	<b>11.5%</b>	(61)	<b>-3.2%</b>	(54)	<b>5.9%</b>	(32)
<b>Total Bond Market Index Admiral</b>	<b>7.7%</b>	(61)	<b>4.5%</b>	(10)	<b>5.7%</b>	(19)
<b>Interim-Term Investment-Grade Bond</b>	<b>0.3%</b>	(91)	<b>6.2%</b>	(38)	<b>5.6%</b>	(43)
<b>High-Yield Corporate Bond</b>	<b>2.4%</b>	(19)	<b>7.0%</b>	(18)	<b>6.4%</b>	(14)
	<b>4.3%</b>	(85)	<b>6.5%</b>	(37)	<b>7.1%</b>	(73)

For comparison, here are several stock and bond benchmarks:

Periods ended March 31, 2012	Yr.-to-date	5 Years	10 Years
<b>S &amp; P 500 (large stocks)</b>	<b>12.6%</b>	<b>2.0%</b>	<b>4.1%</b>
<b>Russell 2000 (small stocks)</b>	<b>12.4%</b>	<b>2.1%</b>	<b>6.5%</b>
<b>MSCI EAFE Index</b>	<b>10.9%</b>	<b>-3.5%</b>	<b>5.7%</b>
<b>Barclays Aggregate Bond Index</b>	<b>0.3%</b>	<b>6.3%</b>	<b>5.8%</b>
<b>BofAML US High Yield Master II TR (bond index)</b>	<b>5.2%</b>	<b>7.8%</b>	<b>9.0%</b>

Vanguard mutual funds and ETFs continue to perform as expected. I expect each Vanguard fund or ETF, for each ten year period to be in the top 1/3 before taxes based on low cost, and they ought to be in the top 1/4 (stock funds) after income taxes.

#### **IV. Genes and Investing – “Natural Stock Selection”**

The following article appeared in the March 10, 2012 issue of *The Economist*.

Natural Stock Selection, a New Excuse for Lousy Investors:

Economists work on the assumption that people act rationally. If only life were that simple. Investors certainly don't always act as they should. Among other follies, they trade too much, do not diversify their portfolios enough and are loath to discard underperforming stocks. They may have been born to behave that way. A recent study into investment behavior by Stephan Siegel of Arizona State University's WP Carey School of Business and Henrik Cronqvist of Claremont McKenna College, illuminates the role that genes play in determining investment decisions.

The authors examine the investment behavior of 15, 208 pairs of Swedish twins, using data from the country's twin registry and its tax authority, which until 2007 kept comprehensive records on every financial transaction. Controlling for various factors, they find that identical twins, who share all their genes, were more similar in their investing behavior than fraternal twins, who share about half their genes.

The authors calculate that *genetic factors account for between a quarter and half of the variations in irrational investment behavior between individuals* [Emphasis added.]. These factors are at work across more dimensions than just investing. Twins who showed a bias towards buying familiar shares rather than taking a punt [e.g. a bet] on unknown ones, for example, also showed a preference for living closer to their place of birth and for marrying a spouse from the same region. Investors with large portfolios were particularly susceptible to genetic influences.

If genes explain up to a half of the variations in investor behavior, what governs the rest? The authors also calculated the impact of shared environmental influences on the twins as well as the effect of experiences unique to one half of a twin pair. Common childhood experiences like schooling were found to have almost no influence on investment behavior. But *individual experiences explain half of the variations between twin pairs—as much as, and often more than, genes*. [Emphasis added.]

The study has its limitations. It looks at data from only one country during a limited period of time, for example. But it suggests that attempts to nudge people to invest more rationally have some big inbuilt biases to overcome.

If you know someone who could use assistance with their investing (either to assist them to do a better job of it themselves, or use ongoing investment management), please mention my name and credentials; or website: [www.johnsmarttcpa.com](http://www.johnsmarttcpa.com).

#### **V. Sharing Your Financial Position and Plans with your Family**

My parents allow me to tell stories on them if such might help others. When I returned to Knoxville more than two decades ago, my parents began, usually separately, to approach me with various financial issues, or often an investment, with which they had a question. I began to summarize this information and when they determined that their investments were of a size which required their wills to be redrawn, I assisted them to find an attorney and to take care of this.

Their next step was to write a letter to each of the principal beneficiaries of their will stating (1) the fact of the future bequest and (2) a summary of their investments.

I have visited on this topic with many others, clients, friends and acquaintances. There is a large diversity of thought about whether this is a good idea. Those who oppose do not wish to interfere with the incentives of their children to continue to work hard, and save for the future. Others have children in quite differing financial circumstances and wish, as a result of being unable to see a way to provide “fairness”, to avoid the issue entirely.

The good thing about disclosure is that those who will receive a bequest will have the opportunity to consider this within their own financial planning. With the assistance of a good attorney experienced in estates and family law, most any issue of fairness can be dealt with. I urge you to consider whether your will is up to date and whether disclosure of your financial plans could help those to whom you will bequeath your wealth after you have finished using it.

If you have questions about how to do it, or other concerns, I’d be pleased to assist.

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