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I. Most Retirees Should Delay Taking Social Security

An article titled "Why Most Retirees Should Delay Taking Social Security," appeared in the December, 2014 edition of the *Morningstar ETFInvestor*.

> "One of the biggest financial decisions a retiree makes is when to begin collecting Social Security retirement benefits, which come in the form of an inflation-indexed lifetime annuity. Americans can start collecting 75% of their 'full retirement age' benefits once they turn 62. Each year they wait, their benefit grows until it hits 'full' benefits at 70. Many, if not most, Americans choose to collect at 62. Only a minority delay until they're over 66.
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> Almost every expert and study…consulted agrees that most retirees today should not start collecting at 62. The divergence between expert opinion and common practice is breathtaking. After running some numbers…and considering the qualitative factors, I heartily endorse the expert consensus—collecting early is a big mistake for most retirees.
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> At least some delay is the best strategy for all but unhealthy singles. However, I think the qualitative considerations make delaying a slam dunk. First, it cheaply and easily hedges longevity risk, the chance you'll outlive your assets…Second, it's a cheap and direct inflation hedge. The only hedge that's better is taking out a fixed-rate 30 year mortgage at today's rock-bottom rates. Finally, delaying makes your portfolio much more robust to a wide variety of risks, including fraud, error, and cognitive decline."

Smartt comment: I recommend that before making the decision, one ought to visit one's physician, discuss one's family/genetic history, and ask specific questions as to whether long life is a reasonable prospect. I had planned to begin taking Social Security at age 70 but began three years earlier in order to have more money to invest in what has proven so far to be a very, very good stock market.

Actuaries of old <u>did</u> advise taking benefits at 62, because people formerly did not live as long as in the present day. My spouse, a two-time cancer survivor, began takings hers at age 62.

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 December 31, 2014	Clients	The Smartts
Money Market Funds	2.0	1.7%
Bond Funds	25.5	5.4%
Stock Funds	72.5	92.9%
Totals	100.0%	100.0%

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

Over long years stock investments generally perform much better than bonds. But when the financial news is bad, we can be afraid to purchase stock investments; and when the news is good, stocks are so high in price that they may not be quite as good an investment.

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 December 31, 2014	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**12.6%**	(36)	**15.7%**	(14)	**8.1%**	(14)
Tax-Managed Capital Appreciation Admiral	**12.5%**	(37)	**15.5%**	(16)	**8.0%**	(16)
Tax-Managed Small Capitalization	**6.2%**	(25)	**17.3%**	(13)	**9.1%**	(14)
REIT Index Admiral	**30.3%**	(32)	**17.0%**	(14)	**8.5%**	(29)
Total International Stock Index Admiral	**-4.2%**	(33)	**4.4%**	(69)	**4.8%**	(36)
Balanced Index Admiral	**10.0%**	(9)	**11.3%**	(12)	**7.1%**	(12)
Total Bond Market Index Admiral	**5.9%**	(30)	**4.4%**	(68)	**4.7%**	(42)
Interim-Term Investment-Grade Bond	**5.8%**	(61)	**6.2%**	(60)	**5.4%**	(46)
High–Yield Corporate Bond	**4.6%**	(2)	**8.5%**	(23)	**6.5%**	(50)

For comparison, here are several stock and bond benchmarks:

Periods ended December 31, 2014	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**13.6%**	**15.4%**	**7.6%**
Russell 2000 (small stocks)	**5.0%**	**15.6%**	**7.8%**
MSCI World Index	**4.9%**	**10.2%**	**6.0%**
Barclays Aggregate Bond Index	**6.0%**	**4.3%**	**4.5%**
BofAML US High Yield Master II TR (bond index)	**2.5%**	**8.9%**	**7.6%**

Vanguard mutual funds and ETFs (exchange-traded funds) 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.

The Vanguard High Yield Corporate Bond fund takes significantly less risk that the average "high yield" (also known as "junk bond") fund. When junk bonds are doing well, the Vanguard fund doesn't compare as well. I continue to recommend it as an additional diversification from good quality bonds and am satisfied with its absolute performance exactly because it takes significantly less risk than the average high-yield fund.

For the last several years, in an atmosphere of very low interest rates, the managers of many actively managed bond mutual funds have been betting that higher risk bonds will have higher returns. This has increased both the relative return of their funds, as well as the risk. Vanguard bond funds have a long-term, clearly stated range of investments and are both lower-cost and more predictable as to rate of return.

If you have questions about your investment asset allocation, please contact me.

IV. Tax Pain Coming for Active Funds

In a January 5, 2015 article in *Investment News*, the magazine notes that losses from the financial crisis have been used up:

> "It's hard to imagine mutual fund managers nostalgic for the big losses many booked in the financial crisis. But for actively managed [e.g. not indexed] funds, those realized losses did come to serve one useful purpose—as the bull market stretched on and managers took profits, they offset capital gains.
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> Six years into a bull market, those losses are largely used up. That means more investors who own actively managed funds in taxable accounts will confront the biggest taxable distributions seen since before the crisis.
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> …More than 500 funds have stated they are likely to make taxable distributions of more than 10% of their NAV [net asset value], according to capgainsvalet.com, which tracks mutual fund gains distributions.
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> That's an increase of over 70% from the 291 funds Morningstar found making distributions of at least 10% in 2013. It's also higher than the 496 funds that did so in 2007, the last year before big stock market loses came into play.

Smartt comment: Other studies over the years have found that the average stock-based mutual fund pays out enough of its taxable capital gains (usually in late December, hence known as "the December Surprise) to cause a tax bill of approximately 2% of the value of the mutual fund. A very unpleasant surprise indeed. Index funds don't try to pick winners and thus don't trade as often and thus, generally, are almost free of capital gains distributions. The only distributions I saw from Vanguard funds generally used by clients were very small, less than ½% of the value of the fund, declared by a couple of Vanguard bond funds and ETFs.

The tax laws are another reason to be "buy-and-hold investors," as this generally results in fewer sales of investments and lower levels of capital gains taxation,

V. Other News and Notes:

In another article in the same, January 5, 2015 issue of *Investment news,* titled, "401(k) Suit May Disrupt Retirement Planning", the author noted that a California US District Court case has reached the US Supreme Court. In the case, a 401(k) plan participant is suing his employer who provided about 40 mutual funds for use within the plan. Several of these mutual funds were regular investor class funds, when the same fund, it is alleged, could have been made available in lower cost, institutional class. One of the implications is that the investment advisor/plan sponsors were being compensated by the mutual fund company. The US Dept. of Labor has been requiring the disclosure of all costs of 401(k) plans for the last few years.

The Fiscal Times provided Yahoo Finance online with an article I found on January 12, 2015 titled: "Mutual Funds, Why Vanguard Won 2014 and What That Means for 2015." Here are quotes:

> "Among the stock market's big winners in 2014, Vanguard stood tall.
>
> That's not all that remarkable, really: It has now been more than decade since a mutual fund company *other* than Vanguard dominated the lists chronicling year end asset flows. What is astonishing, however, is the magnitude of the sums involved. Vanguard sucked in an eye-popping $233 billion over the course of last year, according to data from mutual fund research firm Morningstar. That's higher than the original estimates, and far more than any mutual fund [family] has attracted in any year, ever.
>
> The reasons behind Vanguard's huge haul will matter to investors as they survey the market in 2015. That's because the surge of money flowing into Vanguard represents a kind of capitulation really.
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> As the S&P 500 index climbed to one record after another last year, the vast majority of mutual fund managers actively picking stocks trying to beat the market fared very, very poorly. Among 1,417 large-cap growth mangers that Morningstar tracks, only 171, or about 12% managed to beat the 13.7 percent total return of the S&P 500 for the year."

And, finally, from *Business Insider*, online, an article titled, "REMINDER: You Are 'Shockingly' Terrible at Investing," found December 26, 2014:

> "Most people are just terrible at investing. We hear about this frequently.
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> Richard Bernstein…considers twenty years of historical data for this new research note.
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> The performance of the typical investor…is shockingly poor. 'The average investor has underperformed every category except Asian emerging market and Japanese equities. The average investor even underperformed cash (…3-month t-bills)! The average investor underperformed nearly every asset class…Their underperformance suggests investors timing of asset allocation decisions must have been particularly poor, i.e., investors consistently bought assets that were overvalued nd sold assets that were undervalued.'"

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