John M. Smartt, Jr., CPA
FINANCIAL COUNSELING & ADMINISTRATION
Registered Investment Advisor

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I. Morningstar 2015 Fee Study—Investors Are Driving Expense Ratios Down
II. What are OUR and THEIR Asset Allocations?
III. Vanguard Rates of Return (through latest quarter end)
IV. Abigail Johnson's Blind Spot
V. Other News and Notes

I. Morningstar 2015 Fee Study—Investors Are Driving Expense Ratios Down

I found the eleven-page study published online in mid-April.

Here are some of the findings:

> Investors are choosing low-cost funds. Over the past decade, 95% of all flows (net new money invested in mutual funds and ETFs) have gone into funds in the lowest-cost quintile. Passive funds have benefitted disproportionately.
>
> Mutual funds and ETFs with expense ratios ranking in the least-expensive quintile of all funds attracted $3.03 trillion of estimated net inflows, compared with just $160 billion for funds in the remaining four quintiles.
>
> The asset-weighted expense ratio across all funds was 0.64% in 2014, down from 0.65% in 2013 and 0.76% five years ago.
>
> During that 10-year period, industry assets increased 143% while the asset-weighted expense ratio declined 27% and industry fee revenue grew by approximately 78%.
>
> Thus the industry—rather than fund shareholders—has benefitted most from the increase in asset[s] under management.

Smartt comment: Vanguard's average expense ratio (this is the percentage of fund assets which are removed from shareholders' accounts each year by Vanguard as its charge for running each fund) fell from 0.20% in 2009 to 0.14% in 2014. Vanguard's market share of assets rose during that five years from 15.0% to 19.2%, up 4.1% (rounding involved). No other mutual fund or ETF family market share gained even 1% during the same period.

Over the years I have found four studies which compare the return on investment of mutual funds in relation to their costs. In each study, in each category of mutual funds (e.g., US stock, foreign stock, good quality bond, high yield bond, municipal bond) the trend is virtually 100 percent true—low-cost funds return a higher rate of return; high-cost funds don't do as well.

Part of the trend, which Morningstar found, I believe, is accounted for by the US Department of Labor's requirement a couple of years ago that each 401(k) plan must present the total cost of each participant's account to the participant annually. When investors see how much they are paying, they are beginning to get the message—"low cost wins."

My clients generally pay less than the Vanguard average cost of 0.14% per year because, increasingly they own ETFs (exchange-traded funds) rather than mutual funds. ETFs at Vanguard have the same investments, in the same proportion, as the similarly-named mutual funds, but have lower annual costs.
I believe average client annual fund costs are just below 0.10%.

After a speech in February by President Obama, the Dept. of Labor ("DOL") released (in mid-April) proposed regulations which would require brokers (not just Registered Investment Advisors) to adhere to a fiduciary standard (in which clients' interests are placed in front of brokers' interests) if brokers are providing services for IRAs which have resulted from rollovers from 401(k) retirement accounts. The DOL is charged under ERISA to protect the interests of employees in business-sponsored retirement plans. The DOL is spending less time with company pension plans (investment risk resides in company), there are fewer of them, and more time with 401(k) plans (investment risk resides with the individual).

Brokers will still be able to earn sales commissions on products sold to individuals' IRAs but the broker must be able to explain that, in spite of the commissions, the investor is getting a fair deal.

Brokerage firms are expected to fight the proposed regulation. Only Merrill Lynch has announced qualified support. At present brokers must recommend investments which are merely "suitable" for investors.

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, 2015	Clients	The Smartts
Money Market Funds	1.7	1.6%
Bond Funds	24.9	7.0%
Stock Funds	73.4	91.4%
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 March 31, 2015	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**1.8%**	(28)	**14.8%**	(12)	**8.6%**	(13)
Tax-Managed Capital Appreciation Admiral	**1.9%**	(24)	**14.7%**	(14)	**8.4%**	(15)
Tax-Managed Small Capitalization	**4.0%**	(49)	**16.2%**	(14)	**9.7%**	(15)
REIT Index Admiral	**4.7%**	(39)	**15.8%**	(17)	**9.9%**	(24)
Total International Stock Index Admiral	**4.1%**	(71)	**4.9%**	(75)	**5.2%**	(39)
Balanced Index Admiral	**1.7%**	(57)	**10.8%**	(9)	**7.4%**	(12)
Total Bond Market Index Admiral	**1.6%**	(39)	**4.4%**	(62)	**4.9%**	(43)
Interim-Term Investment-Grade Bond	**2.3%**	(42)	**6.0%**	(65)	**5.7%**	(46)
High–Yield Corporate Bond	**2.0%**	(71)	**8.2%**	(21)	**6.9%**	(46)

For comparison, here are several stock and bond benchmarks:

Periods ended March 31, 2015	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**0.9%**	**14.4%**	**8.0%**
Russell 2000 (small stocks)	**4.3%**	**14.6%**	**8.8%**
MSCI World Index	**2.3%**	**10.0%**	**6.4%**
Barclays Aggregate Bond Index	**1.5%**	**4.3%**	**4.8%**
BofAML US High Yield Master II TR (bond index)	**2.5%**	**8.4%**	**8.0%**

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. Abigail Johnson's Blind Spot

In an April 9, 2015 posting on the "reformed broker" website, Joshua M. Brown talks about the Fidelity family of mutual funds and its principal owner, Abigail Johnson:

> "The Wall Street Journal's article about how Fidelity has whiffed on the most important shift in the investment marketplace, passive and ETFs, is a great read. Fidelity saw a net $16 billion pulled from its funds last year, double the outflows from the prior year, even as the stock market rallied.
>
> Fidelity isn't special in this regard; investors removed a net $99 billion from active mutual funds last year and handed it to Vanguard…and various other purveyors of evidence-based, passively-managed or index products…That's an enormous vote of non-confidence in more expensive funds in favor of cheaper alternatives.
>
> Despite the numbers, Ms. Johnson believes investors' push into passive funds is a temporary trend and will reverse when performance improves.
>
> Abigail Johnson's family built an amazing company that's endured for almost 70 years. [Her father's] original premise - that with hard work and a disciplined research process, investors could produce returns for themselves above and beyond what the crowd was getting – was a seminal idea. And it worked. Over the following decades following its founding in 1946, Fidelity has produced an incredible track record for investing excellence.
>
> The problem is it worked *too* well. Now, there are hundreds of thousands of disciplined, professional managers attempting to assemble and manage market-beating stock funds…. Everyone has an MBA from Wharton, many have PhDs as well. The overall level of talent and resources being applied to the game is not going to decline.
>
> Michael Mauboissin points to this as the *Paradox of Skill*, in which the more skilled the players in a sport become overall, the harder it is for any one skilled player to differentiate his own abilities or make them count. He notes that the baseball feats of Babe Ruth and Ted Williams could probably not be repeated in today's day and age. If we accept that, then shouldn't we also accept that the stock-picking feats of Bill Miller and Peter Lynch can't either?"

V. Other News and Notes:

The Sunday edition of USA Today for February 22, 2015 contained a half page on when you should take Social Security. Here is one of the questions and answer:

> "Q What is the biggest mistake people make with Social Security?
>
> A: People take their benefits too soon, because they are worried about dying before they collect. In so doing they may reduce or lose entirely the auxiliary benefits they can collect…The real risk is living until 100 on relatively low benefits because you were impatient and took reduced benefits before your full retirement age. Benefits in real dollars (inflation adjusted) are 76% higher [per year] if you start them at 70 than if you start them at 62."

John M. Smartt, Jr., CPA	Phone: (865) 588-4159
2001 Partridge Run Lane	E-mail: johnsmarttcpa@yahoo.com
Knoxville, TN 37919-8967	Website: www.johnsmarttcpa.com