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

Client Newsletter Volume XVIII Number 4 May 1, 2013

I. Becoming More Vigilant as We Age

Recently I have been giving presentations as a result of a couple of recent books I've read. The first, Pound Foolish by Helaine Olen is an indictment of MY industry, the financial advice industry. A young writer for the *LA Times*, the author originated the "financial makeover" column a decade or so ago at the newspaper. *Money Magazine* has the same sort of article; an individual or family is chosen for a financial makeover; their investments, budgets, income, retirement savings, wills, insurance, etc. all reviewed by various financial advice professionals. Several years later, she began to circle back to her earlier makeover families and was surprised by the percentage who were not doing very well.

This led her to a book which is about 98% indictment and 2% prescription for improvement, a stance which has drawn criticism from fellow practitioners. Please note that I approve of the book and recommend it. One of her primary points is that many pay too much for their investments; index funds are my answer and continue to be a great answer to this.

One of her findings, based on the research of others, is that our ability to make financial decisions peaks at about age 53 and then to decline, but our confidence in our own judgment does not decline. She asserts that this sets us up to become the victims of more than our share of financial fraud (and for often paying too much some of our financial investments). She notes that those who live to age 85 have a very high (50/50) chance of some impediment to our decision making.

Couple these findings with a second book, also recommended: The Vigilant Investor by Pat Huddleston. He is an attorney and former Securities and Exchange Commission investigator (Did you know that the SEC has 500 of them on their staff?, none of whom found the Madoff scheme, even when reported to them years earlier). He quotes FBI findings that the amount of financial fraud to which we are subject in the US is about $40 billion per year—that's the equivalent of a Madoff scheme EACH YEAR.

Put the information excerpted from the two books together and you see the need for additional arrangements/protection as we age.

There are many facets to this. I believe that this is a wake up call for all of us to make sure that we have a couple of arrangements:

- Wills and powers of attorney for financial matters. If our arrangements are in place and, importantly, if those we have chosen know that they might be responsible for assisting us at some point, we are better off.

- Discussion of our finances and our investments with our family or others. Each family is different. My parents were, (20 years ago) open to sharing their finances with yours truly and my three siblings. They accepted my advice that not only would this allow my generation to assist when and where needed but would allow my generation to do some additional financial planning

Some parents are very reluctant to share such information with any of their family. They reason that if my child knows he is in line for an inheritance it may reduce his incentive to continue to work and strive independently. Others fret that some of their children are more financial successful than others, for various reasons, and do not wish to speak about maters which may cause disharmony.

I believe that we will be safer, less liable to be "taken to the cleaners," if we have family involved. An alternative is the involvement of others. I am proud of the trust of my clients and would welcome a chance to assist you in reasoning your way through this.

Please contact me if I can be of assistance.

Most of you know that I am aged 68. To insure that my judgment and intelligence continues unimpaired I periodically take a series of tests, administered professionally, to determine if I still have "all my marbles." This is an obligation taken seriously. It is my goal to continue to assist you through age 78 and I look forward to that opportunity. I'd be pleased to answer questions.

II. <u>What Are OUR and THEIR Asset Allocations?</u>

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

As of March 31, 2013	Clients	The Smartts
Money Market Funds	2.3	0.9%
Bond Funds	31.9	4.3%
Stock Funds	65.8	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.

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, 2013	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**11.0%**	(30)	**6.6%**	(15)	**9.4%**	(15)
Tax-Managed Capital Appreciation Admiral	**10.8%**	(36)	**6.2%**	(20)	**9.2%**	(19)
Tax-Managed Small Capitalization	**11.7%**	(75)	**9.3%**	(22)	**12.4%**	(18)
REIT Index Admiral	**8.1%**	(12)	**7.3%**	(17)	**12.4%**	(29)
Tax-Managed International Admiral	**4.6%**	(24)	**-0.7%**	(44)	**9.9%**	(32)
Balanced Index Admiral	**6.5%**	(29)	**6.6%**	(9)	**8.0%**	(24)
Total Bond Market Index Admiral	**-0.1%**	(76)	**5.4%**	(66)	**5.0%**	(46)
Interim-Term Investment-Grade Bond	**0.3%**	(38)	**7.2%**	(19)	**5.9%**	(19)
High–Yield Corporate Bond	**1.8%**	(88)	**9.5%**	(49)	**7.8%**	(78)

For comparison, here are several stock and bond benchmarks:

Periods ended March 31, 2013	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**10.6%**	**5.8%**	**8.5%**
Russell 2000 (small stocks)	**12.4%**	**8.2%**	**11.5%**
MSCI EAFE Index	**5.1%**	**-0.9%**	**9.7%**
Barclays Aggregate Bond Index	**-0.1%**	**5.5%**	**5.0%**
BofAML US High Yield Master II TR (bond index)	**2.9%**	**11.3%**	**9.9%**

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.

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, as they have for ten years per the above benchmark, 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. So many other investors attempted to buy this fund that it closed in May, 2012. Until it reopens several are using a low cost, non-Vanguard ETF, pending reopening of the Vanguard fund.

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

IV. The America That Works, Four Reasons for Optimism

The Economist Magazine, March 16-22nd, 2013 edition, presents four main reasons to be optimistic about our economic future. In a sixteen page separate section the magazine sites the following:

- Education. Of the top 30 research universities in the world, 27 are in America. Although public education continues to be stretched for funding and there are lots of issues unsolved, *The Economist* believes that the fact that states are individually responsible for education is leading to each state, in an attempt to create better conditions, becoming 50 (or 51 with DC) laboratories for what works and how it can be applied. Some of these innovations are beginning to bear fruit. "American schools are getting their biggest overhaul in living memory," says the magazine.

- Innovation. The US Patent Office granted some 700,000 US patents to foreigners and foreign corporations in a recent year. "The number of patents issued to Americans is growing too, and is also near its historic peak relative to the population according to a new study from the Brookings Institution, a think-tank. Issuance has been rising steadily since the late 1980s. Moreover, the recent crop appears to be of relatively high quality judging by how often they are cited and claims on them are made." Further, America remains the world's biggest spender on research and development; corporations doing a lot of the development and various federal government agencies (DARPA in the Pentagon and the National Institutes of Health, and many others) continuing to do much of the basic research.

- Infrastructure. Think faster commutes to work on highways and faster internet "pipes." States and cities are, in the face of budget constraints, getting more creative with financing needed improvements to infrastructure.

- "The shale gas and an oil bonanza are transforming America's energy outlook and boosting its economy." Because much of the rest of the world, including most developing countries are paying more, and will continue to pay more for energy, our new energy sources are already beginning to help reawaken manufacturing in the US. The cost differences are narrowing between the US and labor markets in developing countries due to both energy costs to manufacture, and energy costs to ship goods to us, and to other countries.

  "All told, says the HIS [a research firm], unconventional oil and gas accounted for $238 billion in economic activity, 1.7 million jobs and $62 billion in taxes in 2012. That includes the exploration and extraction itself, the supply chains they rely on and the extra spending by all those oilmen. But it leaves out the second-order effects of cheaper gas, electricity and chemicals. And natural gas use produces less harmful effect on our environment than does petroleum burning."

As always there are clouds which are a bit darker. (1) The national political tussle shows no clear signs of ending, this increases economic uncertainty, for businesses and for all of us as individuals and investors. (2) Immigration, especially of talented individuals willing and able to come to America, a driver of economic growth for centuries, is holding us back. Almost a decade ago we begin to decrease the number of job slots available for talented foreigners and imposed a devilishly complicated set of procedures which US companies must complete in order to obtain foreign talent. And there are others.

Please note well that neither stock nor bond prices fluctuate in lock step with economic development, but I found it comforting, long term, to view *The Economist's* perspective.

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