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I. Picking Winners is So Very Tough
II. What Are OUR and THEIR Asset Allocations?
III. Vanguard Rates of Return (through Latest Quarter End)
IV. Happy Money, The Science of Smarter Spending (a Book Review)

I. Picking Winners is So Very Tough

A couple of months ago a weekly investment newspaper, *Investment News*, reported the results of a research study on mutual fund rates of return. The study covered the 10 years ended December 31, 2012.

Imagine that 10 years ago you were trying to pick a winning stock fund, a fund rated in the top 50% of similar stock funds. Your hope is that it will be a good performer, will stay a good performer after you buy it, and that it will be a better than average performer for most years.

Looking back, the probability of finding a stock-based mutual fund which was in the top 50% for the ten years of the study AND the last 5 years of the study AND the last three years of the study was 1 in 9, a success rate of 11 percent. Conclusion: most mutual funds bounce around in their relative return on investment and the overwhelming majority are not in the top half of performance for MOST periods.

So you have an 11% chance of finding one mutual fund which is consistently good. Note that just because a fund has been consistently good in the past offers no guarantee of its future "goodness." This is so true that the SEC's regulations require this warning to be posted as part of mutual funds' printed advertising.

What if you want to invest in two mutual funds, say a stock fund and a bond fund, and you wish that both of them will be superior and consistently superior. If the probability of finding one fund is 11%, 11 chances out of 100, then the chance of finding two such funds is equal to 11% times 11%, which is roughly ONE PERCENT! The chance of finding three such funds is roughly $1/10^{th}$ of a percent.

This is true whether you choose the funds yourself, pay someone to choose them for you at the point of investment, or whether you pay an investment manager a continuing fee to choose and monitor them for you.

What to do?

You will be assisted in your quest by giving up the requirement that the funds perform better than average in the shorter (3 years and 5 years) time periods, e.g. that you swallow hard and **concentrate on the long term**. Investors who lack patience have a harder time keeping themselves in position to earn acceptable rates of investment return. Jumping in and out of investments doesn't generally work both because others have beaten you to the punch and also because there are additional costs of such changes, costs which lower your return on investment.

I believe that there are two attributes of investments which will provide you with a significantly higher probability of sustained, better-than-average investment return: (1) very low cost and (2) broad diversification.

Low-cost, widely diversified indexed mutual funds and ETFs are the answer and have been the answer for about three decades. Most people do not understand how this can happen. "Indexing" is a strategy which accounts for less than half of investments, though the proportion is growing slowly. For 2012 Vanguard, the leader in low-cost investing, took in $138 billion, which was both # 1 for investment companies and set a record for a single year of net inflow.

Indexing works; it requires patience, and a bit of guidance might help. I'd be pleased to assist. It is said that more than half of 401(k) investment decisions are made within 15 feet of the water cooler. In other words, individuals need assistance with their investment decisions and get that assistance from fellow employees in an informal setting. There is a better way. I provide by-the-hour assistance to individuals with their investment choices, including 401(k) choices or ongoing management at 50 basis points per year and no hourly charge for assistance. If you know someone who needs to make those decisions, you might suggest contacting me.

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 June 30, 2013	Clients	The Smartts
Money Market Funds	1.9	0.7%
Bond Funds	29.1	6.9%
Stock Funds	69.0	92.4%
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 June 30, 2013	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**14.1%**	(34)	**7.5%**	(15)	**8.1%**	(15)
Tax-Managed Capital Appreciation Admiral	**13.9%**	(39)	**7.0%**	(23)	**7.9%**	(19)
Tax-Managed Small Capitalization	**16.1%**	(33)	**9.9%**	(22)	**10.8%**	(17)
REIT Index Admiral	**6.3%**	(10)	**8.1%**	(21)	**11.0%**	(33)
Tax-Managed International Admiral	**3.5%**	(28)	**-0.4%**	(39)	**7.9%**	(35)

Balanced Index Admiral	**7.3%**	(30)	**7.1%**	(12)	**7.0%**	(22)
Total Bond Market Index Admiral	**-2.5%**	(49)	**5.1%**	(65)	**4.5%**	(44)
Interim-Term Investment-Grade Bond	**-3.0%**	(78)	**6.8%**	(19)	**5.1%**	(21)
High–Yield Corporate Bond	**-0.5%**	(97)	**8.9%**	(43)	**7.0%**	(75)

For comparison, here are several stock and bond benchmarks:

Periods ended June 30, 2013	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**13.8%**	**7.0%**	**7.3%**
Russell 2000 (small stocks)	**15.9%**	**8.8%**	**9.5%**
MSCI EAFE Index	**4.1%**	**-0.6%**	**7.7%**
Barclays Aggregate Bond Index	**-2.4%**	**5.2%**	**4.5%**
BofAML US High Yield Master II TR (bond index)	**1.5%**	**10.6%**	**8.8%**

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. This ETF, with the symbol "JNK" costs 0.40% per year, significantly less than the average junk bond mutual fund (which costs 1.12% per year per Morningstar) but significantly more than the Vanguard mutual fund (which costs 0.23% per year).

I recommend that all stock investors, if they have a regular (non-IRA, non-401(k)) account, invest some small portion of their stock investment capital into funds or ETFs which own corporations based outside the US. This is an additional diversification. Such diversification is undertaken not to try to increase the rate of investment return on the stock portion of portfolios but to dampen, to a small extent, the fluctuations in value of the stock portion of the portfolio. The international stock portion will not always outperform the US stock portion. This is the small price we pay for a broadly diversified set of investments. I continue to believe it advisable to invest some small percentage of your stock market investments within corporations headquartered in other countries. Diversification works in the long run.

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

IV. Happy Money, The Science of Smarter Spending (a Book Review)

This small book, only 157 pages plus notes, was written by Elizabeth Dunn, a professor of psychology, and Michael Norton, a professor of marketing. The authors found about 17,000 articles on the relationship between money and happiness.

The book has five chapters, one for each principle for increasing happiness by changing spending habits. Here, from the prologue, are some thoughts and a description of the five principles:

“Around the world, income has surprisingly little influence on whether people smile, laugh, and experience enjoyment in a typical day. And in the US, once people are earning around $75,000 per year, making more money has no *impact at all* on their day-to-day feelings of happiness.

1. Buy Experiences. Material things (from beautiful homes to fancy pens) turn out to provide less happiness than experiential purchases (like trips, concerts, and special meals). Whether you’re spending $2 or $200,000, buying experiences rather than material goods can inoculate you against buyer’s remorse.

2. Make It a Treat. When something wonderful is always available, people are less inclined to appreciate it. [The authors] describe new research showing that driving a luxury car provides no more happiness than an economy model.

3. Buy Time. By permitting us to outsource our most dreaded tasks, from scrubbing toilets to cleaning gutters, money can transform the way we spend our time, freeing us to pursue our passions. … When people focus on their time rather than their money, they act like scientists of happiness, choosing activities that promote their well-being.

4. Pay Now, Consume Later. …by paying up front and delaying consumption—you can buy more happiness, even as you spend less money. Because delaying consumption allows spenders to reap the pleasures of anticipation without the buzzkill of reality, vacations provide the most happiness *before* they occur.

5. Invest In Others:…spending money on others provides a bigger happiness boost than spending money on yourself. …Investing in others can make individuals feel healthier and wealthier.

I don’t follow quite all of the logic presented by the authors. I recommend the book, thoughtfully presented with lots of research results, quick to read. If you read the book, I’d like to hear what you think about it.

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