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I. Investors Continue to "Ditch" Active Management

From an article titled "Investors Ditch Money Managers" which appeared in the January 14, 2016 issue of the *Wall Street Journal*:

> "More investors are losing faith in old-school money managers as financial markets sputter.
>
> Clients yanked $207.3 billion in 2015 from U.S.-based mutual funds that hand pick their positions while pouring $413.8 billion into funds that mimic broad indexes for a fraction of the cost, according to new data from research firm Morningstar Inc. …The shifts are the latest evidence of a sea change in the asset-management business in which investors are increasingly opting for products that track the market rather than relying on managers to pick winners.
>
> The moves have boosted companies such as indexing pioneer **Vanguard Group**, while hurting firms that have long been synonymous with their star stock pickers. Vanguard last year attracted an industry record inflow of $236 billion.
>
> Some of the money pulled out of these mutual funds likely found its way back into stocks through exchanged traded funds or other passive [e.g. indexed] stock funds.

II. What Are YOUR and MY 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, 2015	Clients	John Smartt
Money Market Funds	1.7	0.6%
Bond Funds	25.3	8.6%
Stock Funds	73.0	90.8%
Totals	100.0%	100.0%

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

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

I contemplate withdrawing more from my IRA in the future (in order to make qualified charitable contributions) and I therefore increased my allocation to bonds late in 2015.

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, 2015	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**0.4%**	(38)	**12.2%**	(22)	**7.5%**	(13)
Tax-Managed Capital Appreciation Admiral	**1.7%**	(18)	**12.5%**	(13)	**7.4%**	(16)
Tax-Managed Small Capitalization	**-1.9%**	(19)	**11.5%**	(5)	**8.0%**	(10)
REIT Index Admiral	**2.4%**	(64)	**11.8%**	(26)	**7.6%**	(26)
Total International Stock Index Admiral	**-4.3%**	(79)	**1.3%**	(82)	**2.9%**	(43)
Balanced Index Admiral	**0.5%**	(12)	**8.7%**	(8)	**6.6%**	(11)
Total Bond Market Index Admiral	**0.4%**	(28)	**3.1%**	(56)	**4.5%**	(43)
Interim-Term Investment-Grade Bond	**1.5%**	(1)	**4.4%**	(48)	**5.3%**	(39)
High–Yield Corporate Bond	**-1.4%**	(16)	**5.7%**	(6)	**6.0%**	(33)

For comparison, here are several stock and bond benchmarks:

Periods ended December 31, 2015	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**1.3%**	**12.5%**	**7.3%**
Russell 2000 (small stocks)	**-4.5%**	**9.2%**	**6.8%**
MSCI World Index	**-0.9%**	**7.6%**	**5.0%**
Barclays Aggregate Bond Index	**0.5%**	**3.1%**	**4.3%**
BofAML US High Yield Master II TR (bond index)	**-4.6%**	**4.8%**	**6.8%**

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. 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. A lot of the US oil "fracking" industry has apparently been financed by "junk bonds." The Vanguard fund, which takes less risk, continues to rank very highly in the more recent rankings.

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

IV. Is It Safe to Invest All Your Money With One Fund Company?

From a recent article in one of the Morningstar publications, by Russell Kinnel, one of Morningstar's editors:

> "I'm often asked if it's OK to have all or most of your money with one fund company.
> My answer is that it depends. In some cases it's perfectly fine to invest with one fund company. The most important reason is that mutual fund assets are held by custodians not affiliated with the fund company. Thus, a fund company that was in financial trouble couldn't start tapping mutual fund assets to make ends meet. The custodian holds a fund's securities and processes transactions. I've never heard of a fund company employee stealing from a 1940 Act fund [e.g. mutual fund]…
>
> Vanguard is the firm at which I would feel most comfortable investing all my money. It has passive funds for just about any need, so I wouldn't have to worry about everyone making the same bet or leaving at the same time. In addition, it spreads actively managed money around quite a few subadvisors, so there's not much exposure to any one subadvisor. And if there were a brain drain at one of the subadvisors, Vanguard could easily fire the firm and move the money to a more stable company.
>
> So, by all means diversify by asset class, style and sources of active management. But you can invest quite a lot with a good firm with losing any sleep.

Smartt Comment: At one point, more than a decade ago, my father had the same concern. Both of my parents continued to trust Vanguard with the bulk of their investments. I have no such concern. Further, after spending 18 years with Price Waterhouse as an auditor, it is with some pride that I note that, the last time I looked, Vanguard was audited by PWC (Price Waterhouse Coopers).

V. Other News and Notes:

A. Staying the course can help you stay closer to your fund's return:

Here is advice contained in a recent Vanguard shareholders' report:

> "When stock markets are highly volatile, as in recent months, it's tempting to run for cover. But the price of panic can be high.
>
> A rough measure of what can be lost from attempts to time the market is the difference between the returned produced by a fund and the returns earned by the fund's investors.
>
> The results shown in your fund's Performance Summary…are its *time-weighted* returns—the average annual returns investors would have earned if they had invested a lump sum in the fund at the start of the period and reinvested any distributions they received. Their actual returns, however, depend on whether they subsequently bought or sold any shares. There's often a gap between this *dollar-weighted* return for investors and the fund's time-weighted return.
>
> Many sensible investment behaviors can contribute to the difference in returns, but industry cash flow data suggest that one important factor is the generally counter-productive effort to buy and sell at the 'right' time. Keeping your emotions in check can help narrow the gap.

B. John Bogle Interview: October 19, 2015, quoted in the *NAPFA Advisor* magazine:

"Question: Does the rapid growth of new types of investments such as ETFs, make any difference in the need for regulation?

Bogle: The stock market is heavily driven by speculation. We like to think of the stock market—the financial system—as being 'the grease that oils the wheels of capitalism.' We raise money for new innovation—additional assets for companies that want to make new investments—to bring out new IPOs with great promise, and yet the market trades approximately $40 trillion a year, and the amount of money raised in the way of new capital is around $300 billion.

About 0.8 percent of what Wall Street does is its basic, agreed-upon function, which is raising capital for new business or the growth of an existing business. The other 99.2 percent is people trading stocks with each other. This is all going to change and indexing is going to make it change. Or is it?

We now have exchange-trade index funds, which trade almost as much as stocks every day…

The turnover of stocks is less than 200 percent a year, and the turnover of ETFs is around 1,400 percent a year. So there's a big difference between the old traditional index fund (TIF) and the ETF.

Wall Street wanted to stamp out index funds back in the early years. Wall Street hated the index fund. As I said in one of my talks, if you want to understand why Wall Street has gone from hating to loving the index fund, follow the money. Indexing is now hugely profitable! ETFs are largely trading vehicles, and Wall Street loves them.

Smartt comment: John Bogle founded Vanguard and founded the first index fund in the 1980s. He believes in buy-and-hold, you purchase an investment and allow it to grow by continuing to own it. He sees ETFs as trading vehicles and ETFs can be traded. But my clients who own ETFs continue to own them day after day, year after year. No clients turn over their ownership of ETFs at the rate of 1400 percent (buying and selling the same security 14 times per year!). ETFs are used because they are very low cost and because, for smaller dollar amounts, at TDAmeritrade, they generally cost less to purchase and to sell than traditional mutual funds. We own ETFs because they cost less, not because we are stock traders.

C. John Bogle interview in the *Journal of Indexing*, December, 2014 issue:

"I'm just a simple guy, I started off with an idea that has been, for want of a better word, bastardized. Our S&P 500 index fund—the world's first index mutual fund—simply allows investors to own the whole US stock market and hold it forever, at very low cost. It works! Why do you think investors are knocking down our doors at Vanguard? (That's not quite true in a literal sense.) We're capturing about 60% of the industry's net cash flow this year. No one has ever done that before. We're almost 20 percent of the industry's long-term (stock and bond fund) assets. No firm has ever held anywhere near that dominant position before.

It's not as if Vanguard had some huge marketing budget or that we're trying to sell some hot fund. We're not. We're trying to give people a fair share of market returns. We're trying to give them assurance that if they bring their money here they earn their fair share of the market's return. That modest promise is essentially the Vanguard promise.

Smartt comment: Rather than use the S&P 500 fund or ETF I use the Total Stock Market Index fund and ETF because it is just as low cost and it is even further diversified (into medium and small capitalization stocks as well as large cap.).

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