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Client Newsletter Volume XXIII Number 2 November 1, 2017

I. Indexing in America; Tocqueville Told Us:

From a Morningstar publication for advisors, August/September, 2017 edition:

> "When Jack Bogle launched the first retail index fund in the U.S. market, his creation was labeled 'un-American' by critics who believed that independent, profit-seeking American investors would never settle for the surety of an average return. Such notions reek of socialism, they cried. Bogle simply did not understand the American character. More likely, it was the critics who had misread America, or at least misread (of left unread) *Democracy in America*, the classic analysis of both democracy and the United States, in which Alexis de Tocqueville lays out exactly the reasons why Americans, sooner than any other nation, would prove apt to embrace indexing 150 years later.
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> According to Tocqueville, democracy was primarily defined by equality. In America, a free people forged a democratic society based on the notion that 'all men are created equal.' Under such beliefs, citizens don't look to a wise leader for guidance, as is done in aristocracies, but instead trust their own instincts and judgments. So far, that would seem to argue that Americans would seek their own investment path and pick their own stocks, which would presumably lead them away from indexing, hence the critics' lambasting of Bogle's 'folly' in launching an index fund.
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> But Tocqueville's theory doesn't stop there. He notes that no one can be an independently forged expert in all subjects…In an aristocracy, people look to those considered the best to be that authority…
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> What is indexing, after all, but turning one's back on the aristocratic notion that superior investment talent exists and can be identified and instead opting to participate in the collective wisdom of all the market's participants? That indexing can be done at lower costs obviously strengthens its case, but that virtue is more linked to the Vanguard narrative than the indexing story. (Vanguard funds are always low cost; index funds have been launched with low and with high costs.)
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> If Tocqueville's read on democracies and aristocracies holds true, we would expect indexing—the choice to mimic the collective actions of the crowd—to take root first in America, then in European nations which have become democratic, but still have the overhang of aristocracy, and then more slowly to countries with a more recent history of totalitarian regimes. While Tocqueville obviously wasn't thinking of indexing, the lessons from his insights have borne fruit. Indexing accounts for over 40% of the asset-management market in the United States, 25% in Europe, and far smaller percentages in emerging markets, especially among retail investors.

Smartt comment:

De Tocqueville's book was required reading in a college sociology class. I remember having the impression that it contained many insights. He seemed to have a good reading on us Americans.

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 September 30, 2017	Clients	John Smartt
Money Market Funds	2.4	5.0%
Bond Funds	23.9	18.1%
Stock Funds	73.7	76.9%
Totals	100.0%	100.0%

Remember each of us has different goals and needs and our asset allocation should fit us and our family. If you have questions about your asset allocation, or your retirement plan investments, I'd be pleased to assist.

During the quarter I increased my money market holdings as I have agreed to help my daughter with a down payment on her first home, located in the high cost Bay Area of California.

If you have questions, don't hesitate to contact me.

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 September 30, 2017	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**13.9%**	(39)	**14.2%**	(19)	**7.7%**	(14)
Tax-Managed Capital Appreciation Admiral	**14.8%**	(20)	**14.5%**	(10)	**7.7%**	(14)
Tax-Managed Small Capitalization	**8.8%**	(44)	**15.5%**	(6)	**9.3%**	(9)
REIT Index Admiral	**3.5%**	(48)	**9.5%**	(20)	**6.0%**	(21)
FTSE All-World ex-US Index Admiral	**21.5%**	(33)	**7.4%**	(60)	**1.6%**	(36)
Balanced Index Admiral	**9.6%**	(51)	**9.3%**	(14)	**6.6%**	(13)
Total Bond Market Index Admiral	**3.1%**	(59)	**2.0%**	(59)	**4.2%**	(58)
Interim-Term Investment-Grade Bond	**4.0%**	(74)	**2.9%**	(68)	**5.3%**	(52)
High–Yield Corporate Bond	**6.9%**	(22)	**5.7%**	(29)	**6.7%**	(37)

For comparison, here are several stock and bond benchmarks:

Periods ended September 30, 2017	Yr.-to-date	5 Years	10 Years

S & P 500 (large stocks)	**14.0%**	**14.2%**	**7.4%**
Russell 2000 (small stocks)	**11.0%**	**13.9%**	**7.9%**
MSCI World Index	**16.0%**	**11.0%**	**4.2%**
Barclays Aggregate Bond Index	**3.1%**	**2.0%**	**4.1%**
BofAML US High Yield Master II TR (bond index)	**7.0%**	**6.4%**	**7.7%**

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. The Vanguard fund, which takes less risk, continues to rank very highly in the rankings over the last ten year period. When the more risky portions of the "junk bond" are stressed, the Vanguard fund shines. Over the last ten years the Vanguard fund has captured approximately 2/3 of the excess of junk bond returns over good quality bond returns—in accord with my expectation. I continue to believe that, for tax deferred accounts, this fund is a reasonable, additional diversification.

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

IV. A Bit of This and a Bit of That:

First: From the same Morningstar publication as that quoted in section I, above. Article entitled: Great Migration: Investors continue to move to lower-cost funds:

> "…Investors paid lower fund expenses in 2016 than ever before…
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> This decline stems from strong investor demand for lower-cost funds, principally passive [e.g. index] funds and institutional share classes that carry lower fees…In other words, on average, the fund industry is not cutting fees on the most widely held funds. The decline in average mutual fund fees paid by investors stems largely from investors migration out of higher-cost funds.
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> Morningstar research has proved that mutual fund costs are a reliable predictor of future fund returns: Low-cost mutual funds generally outperform their more expensive peers. During the past few years, assets have been migrating toward lower-cost funds, and this trend has accelerated. Passive funds continue to be significantly cheaper than active funds, costing investors an asset-weighted average of 0.17% in 2016, compared with 0.75% for active funds.
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> Annual flows into passive funds more than doubled from about $200 billion in 2007 to more than $400 billion in 2016. Flows into passive funds (which include ETFs and index funds) have outpaced flows into active funds in every calendar year since 2011—despite the fact that active funds outnumber passive funds by eight to one."

Smartt comment:

"The trend into index (passive) funds has been mirrored in the size of my investment management practice, which grew by over 30% in 2012 over 2011."

Continuing with the article from Morningstar:

> "Vanguard has had a significant impact on the industry's asset-weighted average expense ratio and the recent pace of fee declines as the company's low-cost passive funds continue to attract large inflows. From 2013 to 2016, the industrywide asset-weighted average expense ratio [e.g. annual mutual fund cost] fell to 0.57% from 0.65%, a 14% decline. Excluding Vanguard, the industry's asset-weighted average expense ratio in 2016 would have been higher, at 0.69%...The asset-weighted average fee of Vanguard's funds fell to 0.11% from 0.14% during the past three years."

Second: From an *Investment News* issue of July 24, 2017 entitled: "Buckley to take the reins:"

> "Tim Buckley has just been handed the keys to the house that Bogle built.
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> But Mr. Buckley, Vanguard Group's new president confronts something that founder Jack Bogle never did in his prime: a world in which cheap market-tracking index funds are everywhere.
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> Mr. Buckley, 48, was tapped July 13 to run the world's second-largest money manager, which oversees $4.4 trillion and is responsible for the savings of more than 20 million investors. He has a Vanguard pedigree. The Harvard MBA joined Vanguard in 1991 as an assistant to Mr. Bogle and rose through the ranks, overseeing first its technology operation and then its core retail unit.
>
> Mr. Buckley will become CEO in January, succeeding Bill McNabb, who has led Vanguard since 2008, weeks before the collapse of Lehman Brothers. Since then, Vanguard's assets have more than tripled, putting the rest of the industry to shame. Its customers have an almost fanatic loyalty to its flinty founder and his company, named for an 18th-century ship.
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> 'I love that everyone is following us,' Mr. Buckley said. 'We are here to change the way people invest, and we are taking that beyond the borders of any one country.'"
>
> Subtitle: "Show me the Money:"
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> "Even strong companies like Vanguard are under pressure today says Nancy Keohn, a Harvard Business School professor who has written extensively on the power of brands.
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> 'It's a much more transactional world,' says Ms. Koehn said. 'It's more about "show me the money" than it is about emotional values like loyalty and trust.'
>
> For now, the Vanguard brand name has been acting like a cash magnet, fueling growth despite an increasingly crowded market for index investments. Investors poured a record $194 billion into the firm's U.S. passive funds in the first half of the year – two-thirds more than runner-up BlackRock and about 10 times more than Fidelity Investments' haul, according to data from Morningstar, Inc."

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