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FINANCIAL COUNSELING & ADMINISTRATION
Registered Investment Advisor

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I. Warren Buffet's Annual Letter to Shareholders:

Over the years many have pointed my attention to Warren Buffet's annual letter to shareholders of his Omaha-based, publicly traded holding company, Berkshire Hathaway. Many like his folksy style and he has a fine, long-term record of increasing the value of the shares of his company's stock. My youngest brother, his wife and I ate at his favorite steakhouse in Omaha last August. The following quote from the most recent letter to shareholders tells of a bet that Buffet made regarding hedge funds. Hedge funds, of which there are hundreds, seek higher investment returns without (somehow?) higher risk to investors. They are famous for making their managers rich and for taking 20%+ of the profits generated.

About ten years ago Buffet offered the following bet…

> "…I publicly offered to wager $500,000 that no investment pro could select a set of at least five hedge funds – wildly-popular and high-fee investing vehicles – that would over an extended period of time match the performance of an unmanaged S&P-500 index fund charging only token fees. I suggested a ten-year bet and named a low-cost Vanguard S&P fund as my contender. I then sat back and waited expectantly for a parade of fund managers – who could include their own fund as one of the five – to come forth and defend their occupation. After all, these managers urged *others* to bet billions on their abilities. Why should they fear putting a little of their own money on the line?
>
> What followed was the sound of silence. Though there are thousands of professional money managers who have amassed staggering fortunes by touting their stock-selecting prowess, only one man -- Ted Seides – stepped up to my challenge. Ted was a co-manager of Protégé Partners, an asset manager that had raised money from limited partners to form a fund-of-funds – in other words, a fund that invests in multiple hedge funds…
>
> For Protégé Partners' side of the bet, Ted picked five fund-of-funds whose results were to be averaged and compared against my Vanguard S&P index fund. The five he selected had invested their money in more than 100 hedge funds, which meant that the overall performance of the fund-of-funds would not be distorted by the good or poor results of a single manager.

Smartt comment:

Buffet's letter next presents a table, not reproduced here, which contains the annual rate of investment return of the Vanguard S&P 500 fund and each of the five hedge fund-of-funds selected for each of the first nine individual years of the bet. The Vanguard fund was up 85.4% over the period, the best hedge fund-of-funds was up 62.8%, and the worst was up 2.9%.

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 June 30, 2017	Clients	John Smartt
Money Market Funds	2.7	1.2%
Bond Funds	24.6	17.4%
Stock Funds	72.7	81.4%
Totals	100.0%	100.0%

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

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 June 30, 2017	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**9.0%**	(44)	**14.5%**	(21)	**7.4%**	(13)
Tax-Managed Capital Appreciation Admiral	**9.6%**	(23)	**14.9%**	(13)	**7.4%**	(13)
Tax-Managed Small Capitalization	**2.6%**	(55)	**15.3%**	(6)	**8.5%**	(6)
REIT Index Admiral	**2.6%**	(46)	**9.3%**	(16)	**6.2%**	(20)
FTSE All-World ex-US Index Admiral	**14.7%**	(46)	**7.6%**	(58)	**1.5%**	(29)
Balanced Index Admiral	**6.3%**	(51)	**9.6%**	(16)	**6.6%**	(9)
Total Bond Market Index Admiral	**2.4%**	(58)	**2.1%**	(65)	**4.5%**	(49)
Interim-Term Investment-Grade Bond	**2.9%**	(81)	**3.4%**	(73)	**5.5%**	(49)
High–Yield Corporate Bond	**4.8%**	(21)	**6.2%**	(31)	**6.6%**	(28)

For comparison, here are several stock and bond benchmarks:

Periods ended June 30, 2017	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**9.2%**	**14.6%**	**7.1%**
Russell 2000 (small stocks)	**4.8%**	**13.7%**	**6.9%**
MSCI World Index	**10.7%**	**11.4%**	**4.0%**
Barclays Aggregate Bond Index	**2.4%**	**2.2%**	**4.4%**
BofAML US High Yield Master II TR (bond index)	**4.9%**	**6.9%**	**7.5%**

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 <u>top 1/3 before taxes based on low cost</u>, and they <u>ought to be in the top 1/4 (stock funds) after income taxes</u>.

Note that the Balanced Index fund is comprised of 60% Total Stock Market Index fund and 40% Total Bond Market Index fund. For the ten year period presented, if, ten years ago, you sought to invest in a US stock mutual fund and a US good quality bond fund, you had only a one in eleven chance of doing better than merely using the Vanguard balanced fund. Such fine results cannot be expected to recur in quite that spectacular a fashion.

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. <u>A Bit of This and a Bit of That:</u>

First: From the April 10, 2017 issue of *Investment News*, the article is titled: "Jackson Life 401(k) Suit:"

> "Jackson national Life Insurance employees have charged that the company selected high-cost, proprietary products for its 401(k) plan, violating its fiduciary duty, according to a class-action lawsuit.
>
> The suit…seeks to have the insurance company pay the plan for 'all losses resulting from each breach of fiduciary duty and restore to the plan any profits made through Jackson National's imprudent use of the plan's assets.'
>
> The plaintiffs…charge that their plan lost unspecified millions of dollars as a result of participants being offered 18 funds, out a total of 21, that were Jackson's [own] proprietary funds….
>
> The employees cite Morningstar Inc. reports that those funds' fees were above average and that their performance significantly lagged appropriate benchmarks."

Second: From the 2016 annual report of the Vanguard Total Stock Market Index Fund: on page 19 for the ETF shares, Financial Highlights section, the report states that for the years ended December 31, 2012 through 2015, the ratio of total expenses to average net assets (total cost ratio) was 0.05%. For the year ended December 31, 2016, the figure was 0.04%, a 20% decrease in costs for this index ETF.

This exchange traded fund is the largest individual holding of my clients and of myself. As Vanguard becomes larger, now several trillion dollars of investment assets under management, and since Vanguard is a cooperative (e.g. we who own the mutual funds and ETFs own the Vanguard company), they reduce the costs of the funds/ETFs. This can be expected to continue, though perhaps at a slower rate, as Vanguard continues to grow.

Third: From an Investment News issue of February 27, 2017, in an article titled: "Fraud Victims Share Similar Traits: AARP:"

> "Investors most susceptible to fraud typically exhibit an unusually high degree of confidence in unregulated investments and tend to trade more actively than the general investor population, according to a survey conducted by AARP.

Most of the investment scam victims also reported that they value wealth accumulation as a significant measure of success in life and acknowledged being open to unsolicited telephone and email sales pitches, the organization said in a release…

Unlike most investors, those prone to becoming fraud victims reported -- in addition to valuing wealth accumulation as a measure of success and being open to sales pitches…They also said they frequently receive phone calls and emails from brokers, make five or more investment decisions a year, and respond to remote sales pitches, including TV commercials. Most are older, male, married and military veterans."

Fourth: Quoting from an article by Ralph Wagner in the *Morningstar Advisor* magazine, titled: A Hurricane of Disintermediation, advisors, mutual fund managers are in a dangerous season:"

"Making a one-time decision to put your assets into an indexed portfolio and hold it forever is practical but it is completely boring as a story. Investing has gone from the lights and noise of a Las Vegas casino to the mind-numbing efficiency of an ATM. ATMs work fine, but you don't want to read an essay about them.

Some people will take the index fund mantra of "buy and hold forever" and eliminate the "hold forever" end-part. A portfolio of ETFs can be used as a trading vehicle. Trying to be a market timer will generate an exciting story, and there will certainly be a business of selling such a service to the public. The problem with being a great market-timer is that most people are not great market-timers, and the losses they create will have written an opera with a tragic ending."

Smartt comment: Indexing works but is, per the author boring. Many say that we accountants are boring and so I may be a good fit to assist individuals and families with their index-based investing.

Fifth: From an article in the *Economist* magazine, June 24, 2017 issue, titled: "The Past is a Foreign Country, Why fund managers do not perform consistently."

"The big investment shift of recent years is from active to passive. Clients have been buying index funds, which passively track a benchmark like the S&P 500 index, shunning fund managers who actively try to pick the best shares.

One reason for the shift is that passive managers charge lower fees than active funds. Many clients would be happy to pay more if that translated into better performance. However, it is very difficult for investors to select managers who can reliable beat their peers. Performance does not persist…

The average fund manager runs a portfolio for only about four-and-a-half years. So if you pick a fund based on its record, the chances are that a new person is in charge. The old saying that 'past performance is no guide to the future' is not a piece of compliance jargon. It is the truth."

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