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I. The Great Recession—A Lost Decade:

From *The Economist*, December 16, 2017 edition, article titled "A Lost Decade:"

> "Ten years ago this month, America entered the 'Great Recession.' A decade on, the recession occupies a strange space in public memory. Its toll was clearly large. America suffered a cumulative loss of output estimated at nearly $4 trillion, and its labour markets have yet to recover fully. But the recession was far less bad than it might have been, thanks to the successful application of lessons from the Depression. Paradoxically, that success spared governments from enacting bolder reforms of the sort that might make the Great Recession the once-a-century event economists thought such calamities should be.
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> …public borrowing and spending on benefits did far more to stabilize the economy than they did during the Depression. Policymakers stepped in to prevent the extraordinary collapse in prices and incomes experienced in the 1930s. They also kept banking panics from spreading, which would have amplified the pain of the downturn. Though unpopular, the decision to bail out the financial system prevented the implosion of the global economy.
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> But the success of those policies, and the relatively bearable recession that resulted, allowed governments to avoid more dramatic interventions of the sort which, after the 1930s, gave the world half a century of (relative) economic calm. By reducing the need for radical innovation, the speed and efficacy of the response left the world economy less reformed and so vulnerable to the same forces that made the crisis possible in the first place.
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> …the international system that facilitated the more recent financial crisis has been neither abandoned nor reformed. Open capital flows can put countries at the mercy of sudden swings in market sentiment. To manage this, many emerging markets accumulate foreign-exchange reserves, which can be drawn on in crisis. But these reserves add to a global glut of capital which depresses interest rates and encourages borrowing. Because reserves are so often held in the form of dollar-denominated bonds, they can destabilize the American economy. They also heighten the world's exposure to American financial stumbles. This regime helped turn an American housing bust into a global crisis and remains in place now. Although dangerous financial vulnerabilities in America will take time to build up again, the present financial peace is likely to be far shorter than the 75 years that separated the Depression and the Great Recession.
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> …The Depression enabled radical change by discrediting untrammeled capitalism and the elites who supported it. That had dangerous side-effects: it also empowered fanatical and dangerous political outsiders. Though financial and political elites were not spared a populist backlash after the Great

> Recession, they have largely kept their seat at the table, blocking the enactment of bolder reforms. The success of the response to the downturn helped avoid some of the disasters of the 1930s. But it also left the fundamentals of the system that produced the crisis unchanged. Ten years on, the hopes of radical reform are all but dashed. The sad upshot is that the global economy may have the opportunity to relearn the lessons of the past rather sooner than hoped."

Smartt comment:

For those of us who kept our jobs and did not have to sell our homes, the Great Recession was an opportunity to continue investing and being made wealthier by a US stock market which recovered reasonably quickly. The crash of 2007-2009 was painful while it lasted but looks a bit less major in the rearview mirror of more recent higher than average stock market returns. *The Economist* article is a good reminder that financial and market risks don't just go away during a recovery. We have a still improving labor market and businesses appear to be using the tax cut to reward workers as well as shareholders.

In 2017, corporate profits increased by roughly as much as the stock market, over 20%. Forecasts are for more of the same, but risks continue to be a significant part of the system. There is no, long-term, free lunch.

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, 2017	Clients	John Smartt
Money Market Funds	2.2	7.3%
Bond Funds	22.7	17.7%
Stock Funds	75.1	75.0%
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.

In January, 2018 I sold more stock 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 December 31, 2017	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**21.2%**	(45)	**15.5%**	(22)	**8.7%**	(15)
Tax-Managed Capital Appreciation Admiral	**22.4%**	(22)	**16.0%**	(9)	**8.7%**	(14)
Tax-Managed Small Capitalization	**13.1%**	(45)	**15.9%**	(4)	**10.4%**	(7)
REIT Index Admiral	**4.9%**	(57)	**9.2%**	(26)	**7.6%**	(26)
FTSE All-World ex-US Index Admiral	**27.2%**	(26)	**6.9%**	(63)	**2.1%**	(36)
Balanced Index Admiral	**13.9%**	(43)	**10.1%**	(13)	**7.1%**	(12)
Total Bond Market Index Admiral	**3.6%**	(55)	**2.0%**	(51)	**3.9%**	(61)
Interim-Term Investment-Grade Bond	**4.2%**	(74)	**2.8%**	(74)	**5.1%**	(60)
High–Yield Corporate Bond	**7.0%**	(38)	**5.1%**	(34)	**6.8%**	(40)

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)	**21.8%**	**15.8%**	**8.5%**
Russell 2000 (small stocks)	**14.6%**	**14.2%**	**8.8%**
MSCI World Index	**22.4%**	**11.6%**	**5.0%**
Barclays Aggregate Bond Index	**3.6%**	**2.1%**	**3.9%**
BofAML US High Yield Master II TR (bond index)	**7.5%**	**5.8%**	**7.9%**

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 under stress, the Vanguard fund shines. Over the last ten years the Vanguard fund has captured approximately 70 percent of the excess of junk bond returns over good quality bond returns—well within 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 Economist*, a sidebar in the November 18, 2017 edition, titled "Competition:"

> "What explains the remarkable strength of corporate profits and the sluggish growth of real wages in recent years? One explanation is that industries are getting less competitive. Work by *The Economist* found that two-thirds of American industries are more concentrated in in the hands of fewer firms in 2012 than in 1997. Research by AXA Investment Managers Rosenberg Equities into

the language used in American annual reports [of publicly traded corporations] points in the same direction.

Sherlock Holmes famously talked of the dog that did not bark in the night. It may be similarly important that companies refer to rivals much less than they did; usage of the word 'competition' in annual reports has declined by three-quarters since the turn of the century. Business is less cut-throat than it used to be."

Second: The January 20, 2018 issue of *The Economist* has an article about the effect of Amazon distribution centers' presence on local wages. There are 75 fulfillment centers and 35 sorting centers which Amazon operates which are manned by 125,000 fulltime employees.

When a new Amazon center is opened, according to the article, local warehouse wages increase by an average of 8%. In the ten quarters after its arrival, they fall by 3%. To its credit, Amazon wages may be lower because the company offers fulltime employees health care, retirement saving plans and company shares. Such generous perks explain why the company pays below-market wages.

This is another demonstration of the effect of the relative lack of competition on wages and profits. When there are few competitors, business gets more of its way and is generally more profitable.

Third: The December 4, 2017 issue of *Investment News*, in a section subtitled "Vacuuming up Assets:"

"The mutual fund behemoth [Vanguard] vacuums up investor assets like an elephant sipping from a baby pool. Investors have poured in an estimated $348.6 billion net inflow into Vanguard mutual funds and ETFs in the 12 months ended October, 31, according to Morningstar, giving the company a 23.6% market share. (Those figures exclude money market funds and fund of funds.)"

Vanguard has gotten larger, but, instead of keeping higher profits, and believe me when a mutual fund grows larger it is more profitable, Vanguard is a true mutual. You and I as shareholders own our part of Vanguard. Vanguard responds to growing larger by reducing the per-unit costs of its mutual funds and ETFs. For example the All World ex-US stock ETF (symbol VEU) annual cost was 0.15% four years ago; it is 0.11% now. A small change, but such changes aid the compounded growth of investments.

Fourth: a word of thanks. Yesterday's stock market record close pushed the client investment assets I manage up over $40 million for the first time. I am grateful for your patronage. You have allowed me to become a philanthropist. I have markedly increased the contributions I make to my charities, my church, my university and others. I am grateful.

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