John M. Smartt, Jr., CPA
FINANCIAL COUNSELING & ADMINISTRATION
Registered Investment Advisor

Client Newsletter Volume XXIV Number 3 February 1, 2019

I. <u>Hail and Farewell, John Bogle:</u>

John Bogle died last month. He introduced low-cost, indexed mutual funds to the mutual fund industry. The Wall Street Journal published "The Secrets of Jack Bogle's Investment Success" an article by Burton G. Malkiel later the same week. Dr. Malkiel was for many years a director of The Vanguard Group. Excepts appear below:

> "...The best example of an American business hero was Jack Bogle, whose ideals transformed an industry and who gave generations of investors a way to participate in the growth of the American economy, to save efficiently, and to achieve financial security and a comfortable retirement.
>
> Bogle...created the Vanguard Group as the world's most pro-consumer financial services company. 'Consumer driven' is a buzzword that all firms use. Bogle's Vanguard is the one mutual fund company that has truly delivered on that slogan. Vanguard mutual funds have an expense ratio—the cost to administer and manage the funds in relation to their assets—substantially lower than any other fund complex in the world.
>
> A reason for its cost advantage is its unique structure. Vanguard itself is a nonprofit. Many financial institutions call themselves 'mutual' but Vanguard is truly mutual. All 'profits' are returned to the holders of its mutual funds in lower fees. The Bogleheads, a group of acolytes devoted to propagating Jack's investment advice, have written that while 'some mutual fund founders choose to make billions,' Bogle created Vanguard 'to make a difference.'
>
> Bogle's relentless pursuit of cost savings undoubtedly had its roots in his Scottish heritage and the experience of his family's financial ruin during the Great Depression. He was abstemious in everything he did. He flew coach, not first class. He took subways rather than cabs...
>
> There was a good reason to emphasize cost savings. Every dollar not spent on Vanguard's expenses meant an extra dollar for investors. As Bogle liked to put it, 'This is a business where you get what you don't pay for.'
>
> He will be remembered best as the creator of the first index fund available for the general public in 1976. He planned an underwritten offering of shares that was hoped to total $150 million. The most the underwriters could sell was $11 million. The index fund was ridiculed as 'Bogle's folly,' 'guaranteed mediocrity' and even 'un-American.'

The fund remained very small for years but eventually began to grow. Evidence accumulated that index investing did not produce mediocre results but rather guaranteed that investors could achieve the market return at an expense rate lower than that of actively managed funds.

What followed was a family of index funds that encompassed the 'total stock market,' international and emerging market stocks, real estate investment trusts, and bonds. S&P Dow Jones Indices has been keeping a scorecard on how index funds compare with higher cost actively managed funds. Over the past 15 years, the index has outperformed about 90% of active funds.

Index investing provides returns that exceed the returns of active funds by about 1 percentage point—the difference in their costs. There has been enormous competition among index fund providers (and indexed exchange traded funds), and now such funds are available at close to no cost. Thanks to Jack Bogle's innovation, the individual investor is able to earn the full return generated by the market. Index funds give the investor top-decile returns and provide the ideal instrument to invest savings and receive the highest returns available. Index funds now represent almost 50% of all mutual fund assets.

After stepping down from leadership of the Vanguard Group in 2000, Jack ran the Bogle Financial Markets Research Center on the Vanguard campus. He was the author of 13 books, each beautifully crafted with great care taken with his choice of words.

The books emphasize fundamentals to guide the investor: the importance of regular savings, buy and hold, never trying to time the market, diversification and staying the course. Some of the books reflect his strong moral compass and convey the importance of integrity and giving back to the institutions that helped educate and nurture him. In other books he admonishes his industry colleagues for their greed in charging customers unconscionable sales fees and large management expenses. He rails against misleading sales practices.

Bogle was so evangelical in repeatedly criticizing his industry colleagues to the public and the Securities and Exchange Commission that two former assistants, who later worked with competing mutual fund complexes, each gave him a clerical collar at a birthday party roast.

No better accolade has been offered than that of Warren Buffett, who said that Bogle 'did more for American investors...than any individual I have known.'"

II. <u>What Are YOUR and MY Asset Allocations?</u>

Each of us has a different ability to live with uncertainty (risk) and so our investments will be different:

As of December 31, 2018	Clients	John Smartt
Money Market Funds	2.3	1.4%
Bond Funds	30.0	23.3%
Stock Funds	67.7	75.3%
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 December 31, 2018	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**-5.2%**	42)	**7.9%**	(28)	**13.3%**	(15)
Tax-Managed Capital Appreciation Admiral	**-5.0%**	(39)	**8.3%**	(15)	**13.4%**	(11)
Tax-Managed Small Capitalization	**-8.6%**	(12)	**6.3%**	(5)	**13.5%**	(11)
REIT Index Admiral	**-5.9%**	(58)	**7.4%**	(44)	**12.0%**	(27)
Total Int'l Stock Index Admiral	**-14.4%**	(50)	**0.9%**	(23)	**6.4%**	(32)
Balanced Index Admiral	**-2.9%**	(12)	**5.9%**	(10)	**9.5%**	(20)
Total Bond Market Index Admiral	**0.0%**	(31)	**2.5%**	(39)	**3.4%**	(77)
Interim-Term Investment-Grade Bond	**-0.6%**	(19)	**2.9%**	(64)	**5.7%**	(58)
High–Yield Corporate Bond	**-3.0%**	(58)	**3.6%**	(17)	**9.1%**	(61)

For comparison, here are several stock and bond benchmarks:

Periods ended December 31, 2018	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**-4.5%**	**8.5%**	**13.1%**
Russell 2000 (small stocks)	**-11.1%**	**4.4%**	**12.1%**
MSCI World Index	**-8.7%**	**4.6%**	**9.7%**
BBgBarc US Aggregate Bond Index	**0.1%**	**2.5%**	**3.1%**
ICE BofAML US High Yield Master II TR (bond index)	**-2.3%**	**3.8%**	**11.0%**

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>.

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 reasonably highly in the rankings over the last ten year period. When the more risky portions of the "junk bond" investment sector are under stress, the Vanguard fund shines. Over the last ten years the Vanguard fund has captured 76% of the excess of junk bond returns over good quality bond returns—meeting my expectation. I continue to believe that, for tax deferred accounts, this fund is a reasonable, additional diversification and comprises more than 50% of my personal bond holdings.

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

IV. My Investment Journey and "Bogle's Folly":

In order to build my investment management practice I have done a lot of public speaking. (I continue to be interested in speaking to your group too.) One early speech was "Cats and Investors Have Nine Lives," a summary of the various investments I've owned and/or investigated. The first was the three shares with which I was presented as a ten year old for keeping my aunt's dog when she went to London on her honeymoon. Another went something like, "I am a CPA, I can read the footnotes to the financial statements and therefore I can pick individual stocks." That one didn't work very well at all.

Another took a year to eventually reject after buying a paperback which supposedly taught me how to use my new personal computer (an Apple III) to pick stocks. I spend 20-30 minutes each weekend inputting. The results were above the market return that year but it seemed like a very high level of effort without significant additional result.

The ninth "life" was finding Vanguard's first mutual fund in 1989 when having left Price Waterhouse after 18 years as an auditor, I was handed my 401k assets and partnership capital. My money was not part of the first $1 billion to be invested in that first index fund, but it was part of the second billion. I invested in that S&P 500 fund and moved to the more diversified, Total Stock Market Index fund when it became available. Vanguard now manages about $5 trillion.

Financial Counseling & Administration, my investment management practice, has been built on Vanguard products and on several of Bogle's dictates. I believe, with some pride, that I have more experience with indexed investing and with Vanguard than any other investment advisor in the state of Tennessee (and perhaps even more further afield).

For decades I have told people that my dad retired at age 78 from a business which he founded (which became the largest provider of continuing education for lawyers in Tennessee) and that I hoped to do the same, to work until age 78. I'm not there yet, but as the years roll on I have no interest in retirement. The business has done well for me, and I believe I am doing well for my clients.

If you know someone who wishes to do better, both with investment returns per level of risk sustained and with current taxation of investments, please ask them to contact me.

John M. Smartt, Jr., CPA	Phone: (865) 525-9793
3039 Kingston Pike, Apartment # 5	E-mail: johnsmarttcpa@yahoo.com
Knoxville, TN 37919-4615	Website: www.johnsmarttcpa.com