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

Client Newsletter Volume XXIV Number 4 May 1, 2019

I. <u>Reaching for Yield:</u>

I wrote this article, published in Knoxville's business journal. It is a warning that "there is no free lunch" in investing:

" In relation to inflation, interest rates offered on certificates of deposit ("CDs") have been very low since the Great Recession of 2007-9. What's an investor to do?

Over very long periods of time, common stock investments yield about 6.7% per year, plus inflation. Good quality bonds yield 2-2 ½ % per year, again, net of inflation. CDs yield 1% net (and have yielded even less than that for most of the last 10 years).

Many older investors are wary of the stock market. Stocks fluctuate in value, often going way down in value at the time when older investors need money for the expenses of daily living. One of the great desires of older investors is to find SOMETHING in which to invest which would yield more than just 2% or 3% net. One of the maxims of the investment community is, "More people have lost money reaching for yield than at the point of a gun." That is, more investors have lost money from investments from which they did not receive the expected higher interest rate and/or also did not get their money back at the end of the term of the investment than have lost money by being the object of an armed robbery.

The simple truth is that for each increase in interest rates or investment returns promised by an investment, there is an increasing level of risk. Not all of the risks are obvious. Investments backed by specific assets may not pay off as expected because of the decrease in value of those assets.

Recently the federal Securities and Exchange Commission has deemed two investments made by several Knoxville area investors to be Ponzi schemes. The investments were sold by Knoxville investment firms. In selling the investments, the firms received sales commissions. Losses, either partial or total are in prospect for these investors, many of whom were older and retired.

What would be a better approach?

1. If CDs are not a particularly attractive prospect, then US government bonds are a very safe investment. Unlike CDs, bonds fluctuate in value (though not nearly as much as do stocks). The bonds you already own decrease in value when general interest rates increase (and vice versa). Good quality US corporate bonds pay slightly higher interest rates and entail higher risks. For most

investors, either US government or good quality corporate bonds ought to be purchased as part of mutual funds. Mutual funds offer broad diversification.

Vanguard, the pioneer in low cost indexed mutual fund investing offers bond funds (and a newer version of mutual funds called ETFs—exchanged traded funds) with annual costs of as little as 6/100%. There may be account fees and small purchase fees.

2. Consider investing even more broadly, in stock investments as well as bonds. Although the fluctuations in value will be higher than in a 100% bond portfolio, stock investments, generally, offer more growth of principal and so protect investors from inflation. Inflation permanently reduces the real value of bond investments (and CD investments, as well).

3. Consider either investing through, or seeking advice from, a fee-only investment advisor. With no prospect of earning any sales commissions, fee-only advisors may be freer to offer advice which is in the best interest of the client/investor. Although this is controversial advice, many believe that the interests of investors and fee-only advisors are more closely aligned.

4. Regardless of the type of advice and the type of investment being considered, always ask about and carefully consider the risks involved. There is uncertainty in all investing (even the value of CDs are eroded by inflation). Careful consideration of risk may keep you from unacceptable losses as you attempt to 'reach for yield.'"

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 March 31, 2019	Clients	John Smartt
Money Market Funds	2.1	3.8%
Bond Funds	28.5	21.0%
Stock Funds	69.4	75.2%
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 March 31, 2019	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**14.0%**	(20)	**10.3%**	(27)	**16.1%**	(10)
Tax-Managed Capital Appreciation Admiral	**14.0%**	(22)	**10.7%**	(16)	**16.1%**	(9)
Tax-Managed Small Capitalization	**11.8%**	(74)	**8.5%**	(5)	**16.9%**	(9)
REIT Index Admiral	**17.3%**	(16)	**8.8%**	(41)	**18.3%**	(25)
Total Int'l Stock Index Admiral	**12.4%**	(43)	**6.7%**	(37)	**12.3%**	(43)
Balanced Index Admiral	**9.6%**	(27)	**7.4%**	(10)	**11.2%**	(18)
Total Bond Market Index Admiral	**2.9%**	(64)	**2.7%**	(42)	**3.7%**	(76)
Interim-Term Investment-Grade Bond	**3.9%**	(80)	**3.2%**	(70)	**6.1%**	(63)
High–Yield Corporate Bond	**7.6%**	(19)	**4.5%**	(13)	**9.4%**	(59)

For comparison, here are several stock and bond benchmarks:

Periods ended March 31, 2019	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**13.6%**	**10.9%**	**15.9%**
Russell 2000 (small stocks)	**14.6%**	**7.1%**	**15.4%**
MSCI World Index	**12.5%**	**6.8%**	**12.4%**
BBgBarc US Aggregate Bond Index	**2.9%**	**2.7%**	**3.6%**
ICE BofAML US High Yield Master II TR (bond index)	**7.4%**	**4.7%**	**11.2%**

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 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 about 3/4 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. **What to Tell Your Family About Your Investments, etc.**:

Almost three decades ago, when I moved back to Knoxville, I began to assist my parents with their investments. Though Mom and Dad loved each other, they did not cooperate very well in some of their financial life. As an example, a couple of decades later, as their abilities began to decline, they asked me for assistance with their checking accounts. I replied that I would assist in running one, consolidated account, not two individual accounts. They decided to soldier on doing it themselves!

After I assisted them with getting their wills redone, thus protecting their assets from the then lower threshold for the incidence of estate tax, I suggested that I draft a letter from them to all four of their children giving my siblings some details of their assets and their estate plan.

I recommend that you consider giving this information to your children. Many will say that this information might lower their offspring's interest in continuing to save for their retirement, might make them cease their striving after financial security, etc. It is an individual decision and each family has a different dynamic.

The reason my parents decided to disclose this information is that they thought that the information might allow my siblings, or some of my siblings, to better plan their own financial future. This can be powerful, helpful information.

I'd be pleased to discuss this matter further with you.

V. **Bonds Versus Bond Funds**:

This is from an article in the Morningstar Fund Investor, an earlier 2019 issue. The emphasis is on municipal bonds, but it applies as well to purchases of corporate bonds.

> "Brokers like to tell clients they should buy bonds instead of bond funds, but that is rarely a good idea. Investors are almost always going to have an advantage in buying a mutual fund portfolio of bonds than buying bonds directly.
>
> Treasury bonds are an important exception. The Treasury market is extremely large and liquid, its structures are as simple as they come, and most brokerages charge modest fees to buy and sell them at very fair prices. For pretty much everything else, the cards are stacked against you...
>
> Vanguard has studied the relationship between trade size and pricing among municipal bonds at least three times in the last 15 years, and the data have always borne out that the smaller the bloc the higher the cost, and you generally won't get institutional-level pricing [e.g. very low transaction pricing] on a single purchase until you're above the $1 million range. Roughly 70% of municipal trades are under $50,000, though, which means many people wind up paying a lot more than they need to"

Smartt comment:

So you get diversification, very valuable, and lower cost (also valuable) with a bond fund.

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