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

Client Newsletter Volume XXV Number 2 November 1, 2019

I. Investment Advisers vs. Brokers—SEC Rule Changes:

As background, I am a Registered Investment Adviser, registered with and regulated by the State of Tennessee (and not by the federal Securities and Exchange Commission <”SEC”> because I assist clients with less than $100 million of investments). More than a decade ago we smaller investment advisers were passed to the states for regulation.

It is my understanding that brokerage firms are similarly regulated, large ones by the SEC, smaller ones by agencies of states.

The biggest difference between we investment advisers and brokers is that investment advisers (since 1940 when Congress adopted the Investment Advisers Act of 1940) operate under a clear understanding that our clients come first; fiduciary responsibility requires that I place the interest of my clients ahead of my own. Brokers have not had the same level of responsibility mandated for service to their clients.

It is my impression that a higher percentage of brokers operate by selling investments to their clients and taking a sales commission on the sale. Brokers have sought to make the difference less apparent through regulations which allow them to make sales, including sales not necessarily in the best interest of their clients, as long as there is disclosure of the difference. So brokers have operated under a rule that says investment advice is “solely incidental” to the transaction and that, therefore, they need not register as investment advisers.

I am a member of the National Association of Personal Financial Advisors, a fee-only, non-sales-commission accepting organization of about 2,000 advisors. Recently our magazine, *NAPFA Advisor*, summarized the new SEC rules thusly:

> “In recent years, investment salespeople, advertising, and media have blurred the lines between genuine advisors—as defined by Congress decades ago—and other players in the investment business. This has been controversial because brokers could not or would not meet the same standards. In other words, brokers are allowed to package products and services with the appearance of being true advisors, but without meeting the same legal standards. The SEC’s new rules permit this to continue.
>
> Granted, sales contests are finally prohibited! That blatant and notorious conflict is gone, which is a good thing. But it’s telling that the SEC waited so long to jettison a corrupt sales practice that dates back at least 50 years. Most brokers working today have probably enjoyed one of these ‘free’ jaunts harvested from insurance or brokerage fees.”

The investment adviser community is frustrated that the difference between the service standards under which we operate and those under which brokers operate is not made clear to the investing public.

Putting clients' interests ahead of my own is a business model I adopted 25 years ago when I got into this business. It feels right to me. There are financial "products" that are more naturally sold, life insurance is an example. Few people who need it actually buy life insurance, your family only benefits if you are not around to share the benefits (!) so it's hard to make yourself buy the product. But families with children, especially families with only one "breadwinner" need life insurance. There is an industry which serves this need.

If you have questions about this, I'd be pleased to continue the discussion.

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 September 30, 2019	Clients	John Smartt
Money Market Funds	2.5	2.0%
Bond Funds	29.6	21.5%
Stock Funds	<u>67.9</u>	<u>76.5%</u>
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. <u>Vanguard Rates of Return (through Latest Quarter End)</u>

Performance percentages are per ***<u>Morningstar.</u>*** Amounts in parentheses are percentile rankings (1= best and 100= worst) within category.

Periods ended September 30, 2019	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**20.0%**	(46)	**10.4%**	(27)	**13.1%**	(14)
Tax-Managed Capital Appreciation Admiral	**20.8%**	(27)	**10.8%**	(12)	**13.3%**	(7)
Tax-Managed Small Capitalization	**14.1%**	(54)	**9.9%**	(5)	**13.0%**	(3)
REIT Index Admiral	**28.1%**	(35)	**9.9%**	(36)	**12.9%**	(35)
Total Int'l Stock Index Admiral	**11.5%**	(66)	**3.2%**	(43)	**4.5%**	(53)
Balanced Index Admiral	**15.6%**	(17)	**7.8%**	(9)	**9.5%**	(12)
Total Bond Market Index Admiral	**8.7%**	(31)	**3.3%**	(23)	**3.7%**	(49)
Interim-Term Investment-Grade Bond	**9.7%**	(77)	**3.9%**	(71)	**5.1%**	(62)
High–Yield Corporate Bond	**13.0%**	(7)	**5..4%**	(10)	**7.4%**	(23)

For comparison, here are several stock and bond benchmarks:

Periods ended September 30, 2019	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**20.6%**	**10.8%**	**13.2%**
Russell 2000 (small stocks)	**14.2%**	**8.2%**	**11.2%**
MSCI World Index	**17.6%**	**7.2%**	**9.0%**
BBgBarc US Aggregate Bond Index	**8.5%**	**3.4%**	**3.8%**
ICE BofAML US High Yield Master II TR (bond index)	**11.5%**	**5.4%**	**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 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, as it is doing so at present. Over the last ten years the Vanguard fund has captured more than 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 some of my personal bond holdings.

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

IV. Gross National Happiness:

The following quotes come from an article titled, "Reading Between The Lines" from the October 19, 2019 edition of *The Economist* (subtitle: Books reveal a country's historical sense of its own well-being):

> "Do a country's inhabitants get happier as it gets richer? Most governments seem to believe so, given their relentless focus on increasing GDP [gross domestic product—an economists' measure of all of the goods and services produced by a country or other entity] year by year. Reliable, long-term evidence linking wealth and happiness is, however, lacking. And measuring well-being is itself fraught with problems, since it often relies on surveys that ask participants to assess their own levels of happiness subjectively.
>
> Daniel Sgroi of the University of Warwick and Eugenio Proto of the University of Glasgow, both in Britain, think, nevertheless, that they have an answer. By examining millions of books and newspaper articles published since 1820 in four countries (America, Britain, Germany and Italy), they have developed what they hope is an objective measure of each place's historical happiness. And their answer is that wealth does bring happiness, but some other things bring more of it…
>
> In Britain, for example, happiness fell sharply during the two world wars. It began to rise again after 1945, peaked in 1950, and then fell gradually, including through the so-called Swinging Sixties, until it reached a nadir around 1980.

America’s national happiness, too, fell during the world wars. It also fell in the 1860s, during and after the country’s civil war. The lowest point of all came in 1975 during the Vietnam war, with the fall of Saigon and America’s humiliating defeat.

As to wealth, the steady progress of the Victorian period matched a steady increase in British happiness, as did the economic boom in the 1920s, which also lifted American spirits. Both countries spirits fell again in the Great Depression that followed the stockmarket crash of 1929. After the lows of the 1970s, though, happiness in both have been on the rise ever since.

Overall, then, Dr. Sgroi and Dr. Proto found that happiness does vary with GDP. But the effect of health and life expectancy, which does not have the episodic quality of booms, busts, and armed conflict, is larger, even when the tendency of wealth to improve health is taken into account. A one-year increase in longevity, for example, has the same effect on national happiness as a 4.1% increase in GDP. And, as the grand historical sweep suggests, it is warfare that causes the biggest drops in happiness. On average, it takes a 30% increase in GDP to raise happiness by the amount that a year of war causes it to fall. The upshot appears to be that, while increasing national income is important to happiness, it is not as important as ensuring the population is healthy and avoiding conflict.”

Smartt comment: This study, I believe, also points to the dissatisfaction with the state of healthcare in the US as being an important national political issue, and has been for decades.

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