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**I. 2019 Morningstar Award for Investing Excellence:**

Morningstar is the largest provider of information on mutual funds and ETFs (exchange traded funds). Headquartered in Chicago, it runs an annual conference for investors and investment advisors. (I attended the conference in 2007 or 2008 and “attended” online last year.) At the conference, it announces awards in three categories, the third category of which is Exemplary Stewardship.

Here, quoted from a publication summarizing the 2019 conference is the award, no surprise, it’s Vanguard:

“**The winner:** The Vanguard Group, a standout steward of capital from its mid-1970s origins owing to its unusual corporate structure. The firm’s U.S. funds (and indirectly their shareholders) jointly own Vanguard, facilitating a commitment to rock bottom fees and sensible investment strategies.

Vanguard’s mission to serve investors extends beyond its own flock, and it’s had a broad influence on the U.S. asset-management industry through indexing, no-load distribution, and lowering costs for investment management. While fee pressure came to Vanguard in 2018 when a competitor launched zero-fee index funds, Vanguard remains unmatched for its low fees across the board.

Vanguard is setting its sights on exporting this successful approach to markets outside the U.S.”

Smartt comment:

In 1989 I had a need to invest the 401(k) and capital funds being returned to me by Price Waterhouse as my 18 year career as an auditor was ending. I was lucky enough to find Vanguard’s first index fund, the S&P 500 index stock fund. I have heard from a Vanguard representative that, since in the early days, indexed mutual funds were only accepted very slowly, Vanguard’s John Bogle would decree an all-employee party every time Vanguard took in another \$100 million. My money was not part of the first \$1 billion invested, but it was part of the second billion.

As you all know, Vanguard remains the basis of my personal investments as well as the basis of my investment management business, now in its 26<sup>th</sup> year.

The reference to a 2018 offering of no fee index funds is one pioneered by Fidelity. Many mutual funds and ETFs engage in overnight securities lending. This is the overnight lending of some of their investments to brokers who pass them on to individual investors who are “selling short.” Overnight the short sellers must actually own the investments, many do not own them, so they borrow them, mainly from mutual funds. Vanguard and other mutual funds earn a small fee for the overnight loans, and the next morning get their

investments back. It is a VERY short term loan. The risk is considered almost nil. This is the way that a mutual fund can be even lower cost—for a few Fidelity funds, mostly small capitalization stock funds. Small cap stocks are more subject to short selling. Fidelity acknowledges that these “zero cost” funds are a loss leader.

If you have questions about this, please contact me.

## 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, 2019       | Clients     | John Smartt  |
|---------------------------|-------------|--------------|
| <b>Money Market Funds</b> | 2.0         | 1.2%         |
| <b>Bond Funds</b>         | 27.9        | 21.7%        |
| <b>Stock Funds</b>        | <u>70.1</u> | <u>77.1%</u> |
| <b>Totals</b>             | 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, 2019   | Yr.-to-date  |      | 5 Years      |      | 10 Years     |      |
|---|--------------|------|--------------|------|--------------|------|
| <b>Total Stock Market Index Admiral</b>                             | <b>18.7%</b> | (27) | <b>10.2%</b> | (27) | <b>14.7%</b> | (9)  |
| <b>Tax-Managed Capital Appreciation Admiral</b>                     | <b>19.0%</b> | (21) | <b>10.6%</b> | (15) | <b>14.8%</b> | (7)  |
| <b>Tax-Managed Small Capitalization REIT Index Admiral</b>          | <b>13.9%</b> | (69) | <b>8.4%</b>  | (8)  | <b>14.9%</b> | (4)  |
| <b>Total Int'l Stock Index Admiral</b>                              | <b>19.3%</b> | (28) | <b>7.7%</b>  | (38) | <b>15.5%</b> | (29) |
| <b>Balanced Index Admiral</b>                                       | <b>13.4%</b> | (61) | <b>2.3%</b>  | (35) | <b>6.6%</b>  | (49) |
| <b>Total Bond Market Index Admiral</b>                              | <b>13.7%</b> | (21) | <b>7.4%</b>  | (9)  | <b>10.5%</b> | (13) |
| <b>Interim-Term Investment-Grade Bond High-Yield Corporate Bond</b> | <b>6.1%</b>  | (43) | <b>2.9%</b>  | (26) | <b>3.8%</b>  | (51) |
|   | <b>7.7%</b>  | (77) | <b>3.5%</b>  | (66) | <b>5.7%</b>  | (58) |
|   | <b>10.9%</b> | (10) | <b>4.7%</b>  | (10) | <b>8.2%</b>  | (42) |

For comparison, here are several stock and bond benchmarks:

| Periods ended June, 2019                                  | Yr.-to-date  | 5 Years      | 10 Years     |
|---|--------------|--------------|--------------|
| <b>S &amp; P 500 (large stocks)</b>                       | <b>18.3%</b> | <b>10.6%</b> | <b>14.6%</b> |
| <b>Russell 2000 (small stocks)</b>                        | <b>16.8%</b> | <b>7.1%</b>  | <b>13.4%</b> |
| <b>MSCI World Index</b>                                   | <b>17.0%</b> | <b>6.6%</b>  | <b>10.7%</b> |
| <b>BBgBarc US Aggregate Bond Index</b>                    | <b>5.8%</b>  | <b>2.9%</b>  | <b>3.7%</b>  |
| <b>ICE BofAML US High Yield Master II TR (bond index)</b> | <b>10.2%</b> | <b>4.7%</b>  | <b>9.2%</b>  |

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 than 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 some of my personal bond holdings.

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

#### **IV. Federal Reserve Changes Interest Rates--Effects:**

Yesterday afternoon the US stock market was rocking along with a very, very small gain position for the day, up less than 1/10%, when the US Federal Reserve, as expected, reduced its basic interest rate by ¼%. Initially, the stock market reacted positively, stock prices increased a bit. Then, later in the afternoon, the Chairman of the Fed, Mr. Powell, made a statement about future interest rate changes, that there might be future rate reductions. Although this was expected by many involved in the US stock market, US stocks promptly decreased in value, finishing down more than 1% for the day.

What does this mean for:

##### **A. Stock and other financial markets:**

When interest rates decrease, the value of bonds we already own increases because we already own bonds which pay a relatively higher rate of interest, they become more valuable.

The classic explanation for the value of stock is that, theoretically, it is valued at the stream of the future dividends paid on the stock by the company. Since all future dividends are not received immediately, dividends paid in the future are discounted by an interest rate. Makes sense; when we are owed one dollar, its value to us is less than a dollar unless we get paid very quickly. If that dollar is not to be paid to us for a year, it is worth less and the higher interest rates are the less is its true value to us. When interest rates decrease, we would expect stock to increase in value since those discounted dividends now have a net higher value.

## B. Individuals:

Individuals can obtain mortgage financing for a home purchase at a lower interest rate and so are more prone to buy a home or a larger, more expensive home. On the other hand, if they wish to save their money in a CD or invest in bonds, they will find that the rates of interest on offer are now lower.

Lots of individuals are thus encouraged, by a decrease in interest rates to buy things rather than saving their money. This is why, along with business decisions (to save vs. invest) a decrease in interest rates generally stimulates the economy, causes an increase in business activity.

When Chairman Powell announced that there may be future interest rate increases, the stock market, I believe, reacted negatively (went against the explanation above) because the Fed generally decreases interest rates when the US economy is slowing and/or beginning to tip into recession. And recession is very bad for business profits. This is why, I believe the stock market reacted negatively to his remarks.

The recovery of the US economy is now beginning its second decade. The recovery is longer lived than any in recent history. There are signs that the economy may be slowing, but there are many other indications that things are doing fine.

## C. General advice:

We should be long term investors. Jumping in and out of the stock market, for example, just adds to investment costs (brokerage fees and income taxes on capital gains <in regular, currently taxed accounts>). The decision to try to “time” the stock market is really two decisions. The first decision appears to be easier, e.g. “when the news is bad, get out of the market.” The second decision is much more difficult—when to get back in. On the surface, this decision is just as easy; get back in to the stock market when the news is better, when the economy appears to be strengthening, when corporate profits are rising again. But the difficulty is that the stock market often goes back up while the news is still bad, so getting back in appears risky, and so market timers often don’t get back in until the stock market has arisen.

I am a buy and hold investor and manage investments for my clients using the same logic. We own stock but we own bonds for money which may need to be spent within the next 5 years or more. Stock, long term, yields so much more in gains than do bonds that stock is the basis of our investments. Bonds are owned for the “bad times.” And, regardless of all of the commentary to which you may be exposed, no one knows when the bad times will begin, how long they will last, how severe will be the economic pain, or when the recovery will begin.

If you know someone who is uncertain about their investments, please refer them to me. Broadly diversified, ultra low cost mutual funds and ETFs, and low investment management costs are a long term solution to the need to save for retirement and in retirement. Yes there are bumps in the road, not every year is a net gain (though this year has been a very, very good one so far), but this strategy is, I believe, both lower net risk, and higher prospect for gain (but not guarantee of gain). The only apparent guarantee of gains are from investment products which are so highly priced, so expensive to buy and hold, that the gain is not worth it.

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