John M. Smartt, Jr., CPA
PATRIOT INVESTMENT MANAGEMENT
Registered Investment Advisor Representative

Client Newsletter Volume XXVI Number 2 November 1, 2020

I. Vanguard Has Trillion Dollar Fund

On September 3rd, the online version of *Barrons*, the weekly financial newspaper, reported:

> "Today's milestone is in the fund world: The Vanguard Total Stock Market Index has become the first to have more than $1 trillion in assets in the funds tied to it."

What does this mean for those of us who own shares in the mutual fund or in the exchange traded fund? I believe it means that, as Vanguard has for the last 30 years, it will continue to reduce the charge to each shareholder for operating the funds. When I began investing at Vanguard, before the Total Stock Market Index Fund existed, a small shareholder paid cost of about 2/10% per year (or 20/100%). Now a small shareholder can obtain the investment through exchanged traded shares for 3/100% per year. The principal reason that Vanguard reduces fund expenses as it grows larger is that it is a true mutual. That is, the company is owned by those of us who own shares. If Vanguard were a company, like Microsoft or IBM, when it had a good year, it would pay a larger dividend, or reinvest more of those earnings back into the business to attempt to make more for shareholders in future years. Since Vanguard is a mutual, it just reduces the costs borne by shareholders, we all benefit.

Can this continue more or less forever? There are limits to the ability of index funds to function. Index funds buy and sell based on the values of each security and each corporation's stock in the index. There must be a functioning market in each of the investments included within the index. At some point, the index ceases to operate efficiently if everyone just uses the index to invest. I have seen no recent studies of when this might happen. A number of years ago some academic estimated that indexing might break down if 85% of all investments were indexed. But, just as index funds at Vanguard have gotten more efficient, stock markets have become more efficient. And there are, apparently, always some supply of persons who think that they can "beat the market," or believe that they can hire some investment expert to beat the market for them, by investing in the stock of individual companies. So I anticipate no point at which indexing ceases to work.

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 September 30, 2020	Clients	John Smartt
Money Market Funds	2.2	3.4%
Bond Funds	29.4	22.4%
Stock Funds	68.4	74.2%
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 September 30, 2020	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**5.5%**	(30)	**13.7%**	(25)	**13.5%**	(19)
Tax-Managed Capital Appreciation Admiral	**6.6%**	(20)	**14.2%**	(10)	**13.9%**	(7)
Tax-Managed Small Capitalization	**-15.1%**	(62)	**7.1%**	(28)	**10.5%**	(8)
REIT Index Admiral	**-12.7%**	(39)	**5.2%**	(31)	**8.5%**	(38)
Total Int'l Stock Index Admiral	**-4.8%**	(36)	**6.3%**	(20)	**4.2%**	(57)
Balanced Index Admiral	**6.8%**	(12)	**10.1%**	(11)	**9.7%**	(9)
Total Bond Market Index Admiral	**7.0%**	(33)	**4.2%**	(33)	**3.6%**	(47)
Interim-Term Investment-Grade Bond	**8.3%**	(8)	**5.1%**	(73)	**4.6%**	(70)
High–Yield Corporate Bond	**0.6%**	(25)	**6.0%**	(21)	**6.1%**	(14)

For comparison, here are several stock and bond benchmarks:

Periods ended September 30, 2020	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**5.6%**	**14.1%**	**13.7%**
Russell 2000 (small stocks)	**-8.7%**	**8.0%**	**9.9%**
MSCI World Index	**1.7%**	**10.5%**	**9.4%**
BBgBarc US Aggregate Bond Index	**6.8%**	**4.2%**	**3.6%**
ICE BofAML US High Yield Master II TR (bond index)	**-0.3%**	**6.6%**	**6.3%**

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 (as they are at present), the Vanguard fund shines and it is doing so at present. Over the last ten years the Vanguard fund has captured almost all of the excess of junk bond returns over good quality bond returns—exceeding 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. An Anthropologist Examines the World of Work

The September 5, 2020 issue of The Economist, in an article titled "After the Fall," summarized a book by James Suzman on how and why we work as we do:

> "[His] interpretation has a quasi-Biblical feel in which hunter-gathers…lived in the garden of Eden. They worked only 15 hours per week and shared their provisions equally. Then came 'the fall' and the arrival of agriculture, which brought with it hierarchical societies, inequality, harder work, and poorer diets. Farming's only…advantage was that the pastoralists were able to outbreed the hunter-gatherers and eventually displace them from the land.
>
> Farming also brought a chance of mentality. Hunter-gatherers may occasionally go short of food but they are rarely short of time. Agriculture is more driven by the calendar. It also required regular maintenance: weeding of plants, milking of cows and mending of fences. Human life became more regimented.''
>
> …Perhaps the development of sophisticated societies was inevitable, humans' complex brains expend a lot of energy processing information. When you are awake, you constantly seek out stimulation ...and when you are deprived of information you suffer from boredom.
>
> ...The rise of the service sector, Mr. Suzman suggests, is a way for people to keep themselves busy, even though many individuals are dissatisfied with work they feel is meaningless. Another sign of the human need for activity is that people now undertake what was once considered work (fishing, gardening, baking) as hobbies.
>
> The result of this process, he argues, is an unsatisfactory relationship between humans and their jobs.
>
> …Humans have come to view idleness as a sin and industriousness as a virtue, and teach children that hard work will pay off. In today's developed economies, though, there is little correspondence between time worked and monetary reward.
>
> …If humankind had stuck to hunting and gathering, there would be a lot fewer humans. Even if Mr. Suzman had been alive in such a world, he would have been unable to study anthropology or write books. Modern work can indeed be boring—and so, as the pandemic has shown, can sitting at home. Not many people would want to live their lives back in the year 1020, or even 102000 BC."

V. Election Forecast

If you get your newsletter by mail, this may arrive too late, it's being drafted on the morning of October 29, 2020.

First, some background. As a native Tennessean, I have always had an interest in politics and government. At some point more than a half century ago, it MAY have been that every young Tennessean dreamed of being governor, and one Republican primary in 1970 had more than half a dozen serious candidates for the job (including Tex Ritter). In undergraduate, my political science professor, "Smiley Burnett," asserted that only about 15% of us care about politics and government; he asserted that that allowed democracy to function. If 100% cared, there would be chaos.

As an aside, most of my business consists of managing investments on a continuing basis for individuals and families. To assist small investors and "do it yourselfers," I offer lessons on investing for $150 per hour. I have been doing more of this by the hour consulting this year and, surprisingly to me, I am actually being paid in part to provide an analysis of the consequences of next week's election.

During the Obama reelection, I discovered fiverthiryeight.com, a web site built by a mathematician, to try to predict which major league baseball draftees would have success in the big leagues. I used the site to win my largest political bet (I collected just over $20). The site became a leading consolidator of political polls. As of a few minutes ago, the site predicts that Biden has a 89% chance of election (remember that this means that President Trump has an 11% chance of re-election). If this were the only result of next week's election, the effect on the US economy and on the US stock market, would, I believe, be quite small. The site also predicts that the Democrats have a 76% chance of taking over the US Senate. The probability of the Democrats controlling both the Presidency and the Congress is in the high 60's%. If this happens that much might change.

The change most mentioned in the news media is that federal income taxes might go up for very high income persons/families and for corporations. But there are other forecast changes which might occur.

Biden has stated that he would change some of the 401(k) rules. I suspect that such changes will be minor. They will be a further boost to saving for lower income workers and just might penalize, in some small way, those of us who have accumulated significant retirement savings.

Last week the House of Representatives saw the introduction of a bill which would increase the age at which one must begin to withdraw from IRAs from age 72 to age 75 and it would allow contributions to charities of $130,000 per year from IRAs (currently $100,000) among its provisions.

Biden is expected to spend more on containing the virus, on infrastructure and on education (including some relief measure to address college debts).

I expect most clients to be little affected by the changes. I may be wrong, but I believe that our economy functions better when the low and middle classes are under less financial stress, and that this is a boon to the US stock market. In the Clinton administration, there was a lower level of such stress (and lower Federal deficits, even ONE year of surplus!) and the stock market did very well. Yes, the stock market may go down largely as a result of higher corporate taxes, but, in the long run, I expect these effects to be counteracted by a stronger economy. No promises.

So no gigantic changes, but lots of small ones.

John M. Smartt, Jr., CPA	Phone: (865) 525-9793
3039 Kingston Pike, Apartment # 1	E-mail: johnsmarttcpa@yahoo.com
Knoxville, TN 37919-4615	Website: www.johnsmarttcpa.com