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I. Does Indexing Harm Financial Markets?:

This is part of an article from *The Economist* dated January 17th of this year; subtitled: "Critics of passive investing at last have a case that it distorts markets."

> "In 2016 researchers at Bernstein, a broker, published a note entitled, "The silent road to serfdom: why passive investing is worse than Marxism." A decade later the revolution is still in full swing. Trillions of dollars of capital have poured from actively managed investment funds into those that simply track market indices, and the flow shows no sign of stopping. As much as 60% of net assets overseen by American equity funds are in such passive vehicles, estimates the Investment Company Institute, an industry group.
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> Today, a note like Bernstein's, which at the time provoked plenty of headlines and approving references on trading floors, would merely provoke eye-rolling. No one is surprised that analysts who sell research to stockpickers dislike passive funds that are outcompeting their clients. Over the years claims that such funds are bad for markets have tended, similarly, to come from people whose salaries might be higher if they [e.g. index funds] were to disappear. Meanwhile, the once revolutionary creed that motivated the creation of tracker funds has come to feel like common sense. What investor doesn't know that most active managers fail to beat their benchmark index, while the passive alternatives hug theirs closely and charge rock-bottom fees.
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> None of this, however, means that passive investment really is harmless. Its detractors make a valid complaint: markets' social function is to direct capital to where it will be used most effectively and passive funds make no attempt to do this. Their indiscriminate buying could therefore pull share prices out of whack with underlying earnings. Pulling in the opposite direction are arbitrageurs, such as hedge funds, which can take the opposite side of tracker funds' trades and profit from bringing prices into line with fundamentals. Yet a much-discussed working paper—at least among active fund managers—makes a compelling case that the arbitrageurs have a far weaker effect than is commonly thought. If so, then flows of assets into passive funds really could be distorting share prices and helping inflate a bubble.
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> The paper, by Xavier Gabaix of Harvard University and Ralph Koijen of the University of Chicago, sets out their 'inelastic markets hypothesis.' This contradicts the textbook argument that money flowing into stocks should barely raise prices, since if it did, demand would fall and return prices close to their starting level. In fact, the paper's authors find that stockmarket demand is not 'elastic' in this way. It is inelastic and does not fall much as share prices rise. As a result, an investor who buys $1 worth of

> stocks using fresh cash (or the proceeds of selling other assets such as bonds) pushes up aggregate market value by $3.8 [e.g. $3.80].
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> …In 2024, estimates Vanguard, a passive-investment giant, 64% of Americans' pension-pot contributions went into 'target-date' funds. These portfolios split their investments between stocks and bonds in proportions determined by when savers hope to retire rather than by market prices. If Messrs Gabaix and Koijen are right, each dollar of this steady flow drives up stockmarket value by several more, regardless about what investors think about firms' future profits. It's not quite Marxism—but not altogether reassuring either."

Smartt comment: I have several points to make in contrast: (1) Not all but much of our ETF buying activity is buying from a willing seller; no increase in the number of ETF shares outstanding generally results from such stock buying activity. The ETF itself does not make any new stock purchases, and some of the existing shares of the ETF have just been purchased from another individual seller. (2) The preponderance of my clients are buying a mix of bonds and stock, not just stock. (3) When stock values are relatively high, our stock buyers are usually purchasing a set amount of stock per month (e.g. $10,000 added once per month), "trolling" money gradually into stocks; so when stock prices are higher, we are purchasing fewer shares.

And finally, (4) in the year 2025 my client base began the year owning 101,581 shares of VTI, Vanguard's giant Total Stock Market Index ETF. At the end of the year, we owned 88,776 shares. E.g. our number of shares decreased by 13%, we were sellers, not net buyers in a year in which the share price of VTI increased by 16.0%. We weren't actively fighting any market trends, but when we needed money and when stock values were relatively higher, we tended to sell stock not bonds.

I acknowledge that if indexing takes over completely, the market collapses, but I do not believe that this is ever going to happen. The hedge fund managers are too well paid to cease their efforts. And there are too many individuals who like to be stock pickers.

If you have questions about this, please contact me.

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, 2025	Clients	John Smartt
Money Market Funds	1.8%	4.8%
Bond Funds	29.5	13.4
Stock Funds	<u>68.7</u>	<u>81.8</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. 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, 2025	Yr.-to-date		5 Years		10 Years	
Total Stock Market Index Admiral	**17.1%**	(40)	**13.1%**	(51)	**14.2%**	(33)
Tax-Managed Capital Appreciation Admiral	**17.4%**	(33)	**13.6%**	(39)	**14.6%**	(18)
Tax-Managed Small Capitalization	**5.9%**	(65)	**7.3%**	(53)	**9.7%**	(39)
Total Int'l Stock Index Admiral	**32.2%**	(38)	**7.9%**	(57)	**8.5%**	(38)
Balanced Index Admiral	**13.6%**	(35)	**7.8%**	(40)	**9.5%**	(20)
Total Bond Market Index Admiral	**7.2%**	(50)	**-0.4%**	(53)	**2.0%**	(51)
Interim-Term Investment-Grade Bond	**9.6%**	(1)	**0.9%**	(18)	**3.3%**	(51)
High–Yield Corporate Bond	**9.3%**	(12)	**4.1%**	(53)	**5.6%**	(49)

For comparison, here are several stock and bond benchmarks:

Periods ended December 31, 2025	Yr.-to-date	5 Years	10 Years
S & P 500 (large stocks)	**17.9%**	**14.4%**	**14.8%**
Russell 2000 (small stocks)	**12.8%**	**6.1%**	**9.6%**
MSCI World Index	**21.1%**	**12.1%**	**12.2%**
Bloomberg US Aggregate Bond Index	**7.3%**	**-0.4%**	**2.0%**
ICE BofA US High Yield TR (bond index)	**8.5%**	**4.5%**	**6.4%**

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 than the average "high yield" (also known as "junk bond") fund. The Vanguard fund, which takes less risk, continues to rank reasonably high 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 over 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.

In late December, 2025, here is what Morningstar had to say about the High Yield Corporate Bond Fund:

> "The managers…have fairly short tenures, but the fund's conservative strategy and low fees lend it plenty of appeal. Since August, 2022, one-third of the fund has been managed by Vanguard's internal high-yield group, while two-thirds remain with Wellington Management, which previously ran the entire portfolio…[Both management groups] follow the fund's long-standing approach of treading lightly among the lowest-rated portion of the high-yield universe. Indeed, at the end of September 2025, the fund invested just 4.7% of its assets in bonds rated lower than B, just over one-fourth of the category average. Such prudence helped the fund hold up better than most peers in high

yield's slumps in 2015 and 2022, though the fund roughly matched the category average in 2018's high-yield dip. The current managers had little impact on the 2022 showing, but the fund appears in good hands."

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

IV. <u>8 Timeless Lessons From my 79-year old Dad</u>:

This article by Brian Page appeared in *CNBC* online, on December 26, 2025; subtitle: Being cheap and being frugal aren't the same thing:

> "When I think back on my childhood, my happiest memories aren't tied to things I owned…The neighborhood park was our meeting place. A few bikes tossed in a friend's front yard signaled the game was on. There were no texts or group chats. But childhood today often looks different. Connection revolves around…phones, sneakers, and the next must-have gadget. If you can't afford it, you risk being left out.
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> That contrast led me to talk to my 79-year-old dad, a man who wears thriftiness the way others wear luxury…He helped shape my relationship with money…Here are eight lessons from my frugal dad that have stood the test of time.
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> 1. Let your values guide your financial decisions
> 2. You can always earn more money, but not more time
> 3. The best investment you can make is in yourself
>   The returns on personal growth compound for decades. Education…reading widely, or even investing in therapy can strengthen both your earning potential and your resilience. In a partnership, personal growth benefits everyone—stronger individuals make stronger teams.
> 4. Debt steals tomorrow's options
> 5. Turn off the lights when you leave the room
>   Turning off the lights is a metaphor for the small things we do. It's more than about saving a few cents on electricity. It's a mindfulness practice. Every small act of frugality adds up, and it builds awareness of how we use our resources.
> 6. Celebrate simplicity
> 7. New cars destroy wealth
>   The average new car now sells for over $50,000, and when you factor in financing, fuel and insurance, monthly costs can exceed $1,200.
> 8. Being cheap and being frugal aren't the same thing
>   Cheapness cuts corners at all costs. Frugality focuses on getting value for your money. A frugal person maintains what they own, spends intentionally, and is generous where it counts. Understanding that difference can prevent endless money conflicts because frugality builds a meaningful life, while cheapness slowly erodes joy."

Smartt comment: In 1990, after I ended my last fulltime job, the job that brought me back to Knoxville, I began to write down and accumulate every cent I spent. I found that my expenses other than rent dropped from $600 to $500 per month. It wasn't magic but, for example, I stopped buying soft drinks from machines, etc. partially because such spending just meant more bookkeeping!

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