Investors Tarred and Feathered

The beginning of a long-term trend away from high-management-fee hedge funds, mutual funds and packaged product hawkers is picking up steam. For decades, individual investors have taken the bait from the high fee speculators and misallocators. Investors now appear to have awakened to the many-decade fleecing. [Here](), *Market Watch* highlights a fistful of troubling reminders of the ever-growing carnage.

- Last year, hedge funds shut down at a pace last seen in 2008.
- For the full year, a total of 1,057 funds were closed, topping the 1,023 liquidations seen in 2009.
- Hedge fund liquidations in 2016 surpassed the post-

financial crisis peak.
- Average hedge-fund management fees fell to 1.48% in the fourth quarter from 1.49% in the previous three months.
- The average incentive fee for new funds declined to 17.71% from 17.75% in 2015.
- In 2016, the asset-weighted hedge-fund index returned 2.86%.
- The S&P 500, with dividends, gained 11.93%.

Benefactors of this bloodletting will be modest-sized, old-line, traditional investment council firms. These tight-knit client friendly and fee friendly firms harken back to a more civil time, when the best interests of a client topped the list of concerns in long-time family relationships. Preservation of capital and modest and consistent total returns were the order of the day. A steady flow of cash in the form of dividends and interest allowed relaxed clients to sleep well at night knowing that at all times their family advisor's interests were meticulously aligned with their own. That's just the way things were expected to be.

Today? Well you observe the results above.

Lower Portfolio Risk to Boost Return

Image Credit: © Tierney – Adobestock.com

UPDATE: The words I wrote in this post from August 27, 2010 are as sound today as they were back then. The basic principles of good investing just never change. This is how we operate at Richard C. Young & Co., Ltd.

Do you know the difference between total return and investor return? Most investors are familiar with the concept of total return. The total return of a fund is simply the sum of the capital and income return of a fund over a certain holding period. The total return of a fund of course assumes a buy-and-hold strategy.

Investor return (a Morningstar term) is a measure of the experience of the average investor in a fund. Investor return does not assume a buy-and-hold approach. Instead it accounts for all cash flows into and out of the fund in an attempt to measure how the average investor in the fund performed over time.

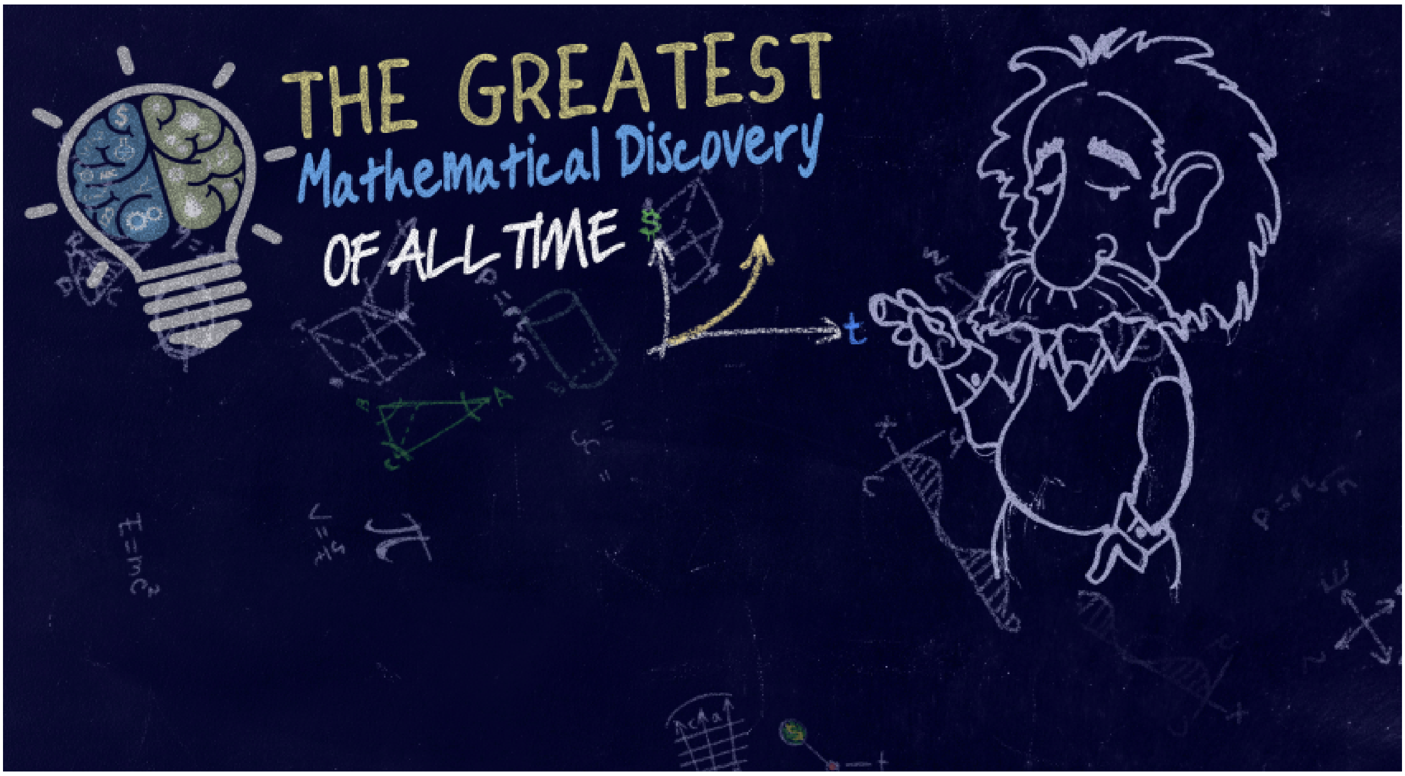
Investor return is not a replacement for total return, but an important complement. Total return indicates how a fund manager performed over a certain time period, but investor return shows how the average investor in a fund performed.

Hot funds with strong recent performance often show total returns that are higher than investor return, as do volatile funds. One of the reasons investor return in volatile funds can lag total return is that investors pile into funds when they are in an uptrend, but bail out after performance turns south. You end up with a situation where there are more assets in a fund when returns are poor than when they are strong. That lowers investor return.

The formerly overhyped Legg Mason Value Trust Fund offers a telling illustration of this concept. For those of you who are not familiar with it, this is Bill Miller's fund. Prior to a recent streak of poor performance that began in 2006, Mr. Miller's fund was touted by the financial press as being the only mutual fund to outperform the S&P 500 for 15 consecutive years. Let's first look at the total return of the fund. For the 15-year period ending July 31, 2010, the Legg Mason Value Trust Fund earned a compound annual total return of 6.87%, compared to a return of 6.48% for the S&P 500. That's not bad; even after some atrocious relative performance in 2006, 2007, and 2008, Mr. Miller managed to outperform the index by a few basis points. But how did the average investor in his fund do? The 15-year investor return for the Legg Mason Value Trust Fund was only 4.40%—a significant difference of 2.47% per year.

Compare the experience of the Legg Mason fund to a balanced fund such as Vanguard Wellesley Income. Over the last 15 years, the compound annual total return of the conservative Wellesley Income Fund was 8.1%, and the investor return was 7.73%, a difference of only 0.57%. Wellesley's investor return was closer to the total return because investors in the fund didn't bail out when markets were down. Wellesley's low volatility provided investors with comfort and confidence to hold their shares. In my forty-plus years in the investment business, I have found that during down markets, investors are less likely to bail out of funds with modest volatility than those with high volatility. Bailing out of your funds during down markets is a sure way to destroy wealth. The better strategy is to increase your comfort level by lowering your portfolio's risk. Chances are you'll end up boosting your return.

The Power of a Compound Interest Table



Compound interest was described as the greatest mathematical discovery of all time by Albert Einstein. Compound interest "Tis the stone that will turn all of your lead into gold," according to Benjamin Franklin. The late great Richard Russell explained compound interest as the royal road to riches. Below I’ll explain this powerful investment tool and show you how to read a compound interest table.

Compound interest is the heart and soul of investing. Investors lacking a solid grounding in compounding are more likely to suffer from a wandering eye. They can be inclined to favor Hail Mary tactics in their investment portfolios, where the goal of every buy is score big and fast (think options and cash burning startups). The downsides of such an approach are 1.) it rarely works and 2.) loads of volatility. In contrast, investors who truly understand and appreciate the awesome power of compound interest recognize that the combination of time and modest return is a better path to investment prosperity.

Compound Interest Table Still Best

It may surprise you, but in an industry with massive computing power, where algorithmic trading and quantitative models are now prolific, the best way to truly master the awesome power of compounding is still to study an old fashioned compound interest table.

A compound interest table gives you a sense of just how powerful compounding can be at varying rates of return and over varying time horizons. Sure, you can use a calculator or an Excel spreadsheet to find the future value of an investment, but that single data point doesn’t do compound interest justice. Studying the array of compounding factors and how they increase with respect to time and rate of return leaves an indelible mark on one’s mind.

To emphasize the power of compounding, we have included a compound interest table below.

Reading a Compound Interest Table

Move down each column on the compound interest table to see the effect of time on the multiplier. Move across each row on the compound interest table to see the effects of changing the rate of return. Take a look at the row that starts with the 20-year time-horizon. Now move across to the 5% annual rate of return column. Note the compounding factor of 2.65. If you invested $10,000 at a 5% interest rate for 20 years you would have $26,500.

Now staying in the same row, move across to the 10% return colu mn and note the compounding factor of 6.73. That same $10,000 at a 10% compou nded annual return would be worth $67,300 after 20 years. The return doubled, but your ending wealth more than doubled. Now double the return again. At a 20%

annual rate of return $10,000 then becomes a whopping $383,400 after 20 years.

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That is profound! And that is the awesome power of compound interest.

For an expanded printer-friendly version of our compound interest table that can be handed out to the kids and/or grand kids click here for a compound interest table.

Compound Interest Table

Future Value of $1 at the end of n periods: FVIF k,i = (1+i) n where n= number of periods, i = rate of return

wdt_ID	Period	5%	7%	10%	16%	20%
1	1	1.0500	1.0700	1.1000	1.1600	1.2000
2	2	1.1000	1.1400	1.2100	1.3500	1.4400
3	3	1.1600	1.2300	1.3300	1.5600	1.7300
4	4	1.2200	1.3100	1.4600	1.8100	2.0700
5	5	1.2800	1.4000	1.6100	2.1000	2.4900
6	6	1.3400	1.5000	1.7700	2.4400	2.9900
7	7	1.4100	1.6100	1.9500	2.8300	3.5800
8	8	1.4800	1.7200	2.1400	3.2800	4.3000
9	9	1.5500	1.8400	2.3600	3.8000	5.1600

wdt_ID	Period	5%	7%	10%	16%	20%
10	10	1.6300	1.9700	2.5900	4.4100	6.1900

The Power of Compound Interest

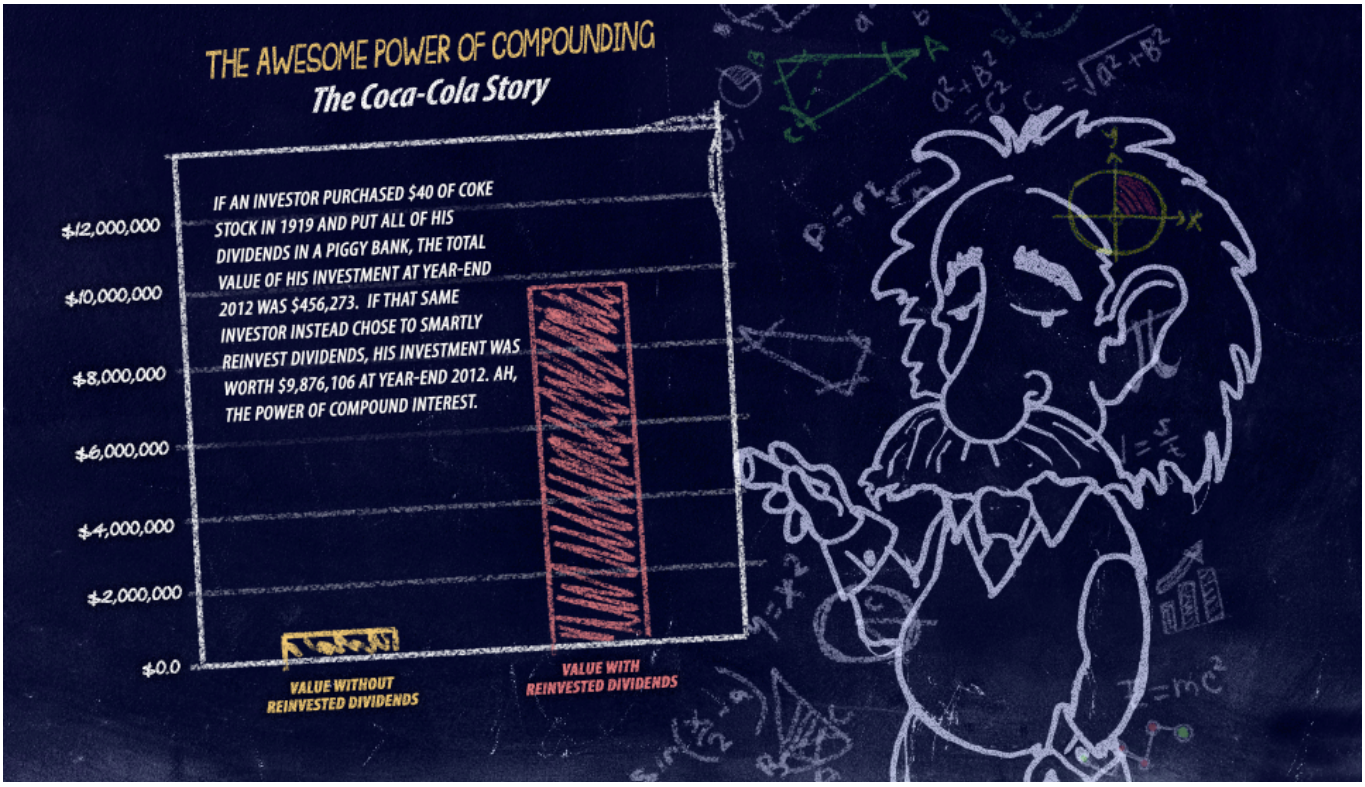


Image Credits: ©Steve Schneider – Youngresearch.com

Making money with your money is a no-brainer. Take a look at the difference in returns between two $40 investments in Coca-Cola in 1919. One had dividends put into a piggy bank. The other had dividends reinvested. Without reinvesting, the initial $40 investment grew to $456,273 by 2012. With dividends reinvested, the value increased to $9,876,106. That's a difference of over 2060%. That's the power of compound interest.

A Sleep Well(esley) at Night Fund

Image Credits: © VadimGuzhva – Adobestock.com

You can be sure that 90% of what you read about retirement investing is either (A) not very helpful or (B) confusing. Yet there are some simple solutions and tools to use that are helpful and easy to understand. One of them is a fund to which I recently made a sizable contribution. But first let’s look at the dismal reality of the 401(k), which most baby boomers will depend on in retirement.

Your 401(k) isn’t worth as much as you think it is. That’s because at age 70½ you need to begin making annual withdrawals based on an IRS life expectancy table and pay taxes at your ordinary income rate, not at the lower capital gains rate. What's more, there's a good chance you'll live longer than the IRS life expectancy, ensuring that your entire balance will have been subjected to income taxes well before you die. Isn't that uplifting?

How about giving your money to the government today? That's what you'll do by converting to a Roth IRA. If you're in your prime earning years, you'll pay taxes at your highest tax bracket. What's scarier is that after conversion, some investors may think it's time to get even more aggressive since they'll never owe taxes on the gains. This is retirement money we're talking about. You're no longer a teenager. If you lose it, you don't have forever to make it back.

You should begin investing for retirement the day you're born. Most investors start way too late. It's up to parents and grandparents to get involved with educating children about money. Help them start today. Don't let them grow up believing the way to riches is playing poker on ESPN.

You need to save until it hurts. How about refinancing to a 15-year mortgage? Or if that isn't an option due to high closing costs or being too far underwater on your existing 30-year, how about making larger payments? The real-estate market as a supplement to your retirement left the station in 2008.

In 1968, it wasn't out of the realm of possibilities to be able to buy your home for an amount equivalent to your annual income. Nowadays, in Newport, Rhode Island, for example, even after the crash, it's difficult to find a home for sale for less than $300,000. If you earn $50,000 per year, that's six times your income. Why not consider renting and see if you can handle the monthly payments before locking yourself into something you may not be able to afford?

Here’s my number one recommendation for do-it-yourself investors. Keep your investments simple: buy two or three mutual funds and call it a day. Don’t listen to your stockbroker. They’re salesmen, and very good ones at that, but they’re not investors. They may be nice people, but they don’t know how to build your wealth.

I recently bought the Vanguard Wellesley fund for my family because it embodies what investing is all about. It is a balanced fund with roughly 60% in bonds and 40% in equities. It was down only 9.8% in 2008, compared to a loss of 38% in the S&P 500. Investing math is simple: if you lose 9.8%, you only need a gain of 10.9% to get back to square one, whereas if you lose 38%, you need a gain of 61.3%.

At the core of Wellesley is compound interest. Anyone who knows anything about investing understands the importance of compound interest. Warren Buffet’s right-hand man, Charlie Munger, sings its praises, and Albert Einstein referred to it as the Eighth Wonder of the World. If you compound $10,000 at 6% for a year, you’ll have $10,600; compound that at 6% and at the end of year two you’ll have $11,236, and after 60 years it will be $300,000. Do this for a loved one and he or she will *never* forget you.

So where are we today in terms of valuations for bonds and stocks? Add the yield on the three-month T-bill and the Dow Jones Industrial Average yield to find out. Historically, retirees could purchase T-bills with a yield somewhere between 5% and 6% and forget about stocks. They could be comfortable in retirement with the risk-free rate of return and the full-faith-and-credit pledge of the U.S. government. And historically, the Dow yielded between 3% and 4%.

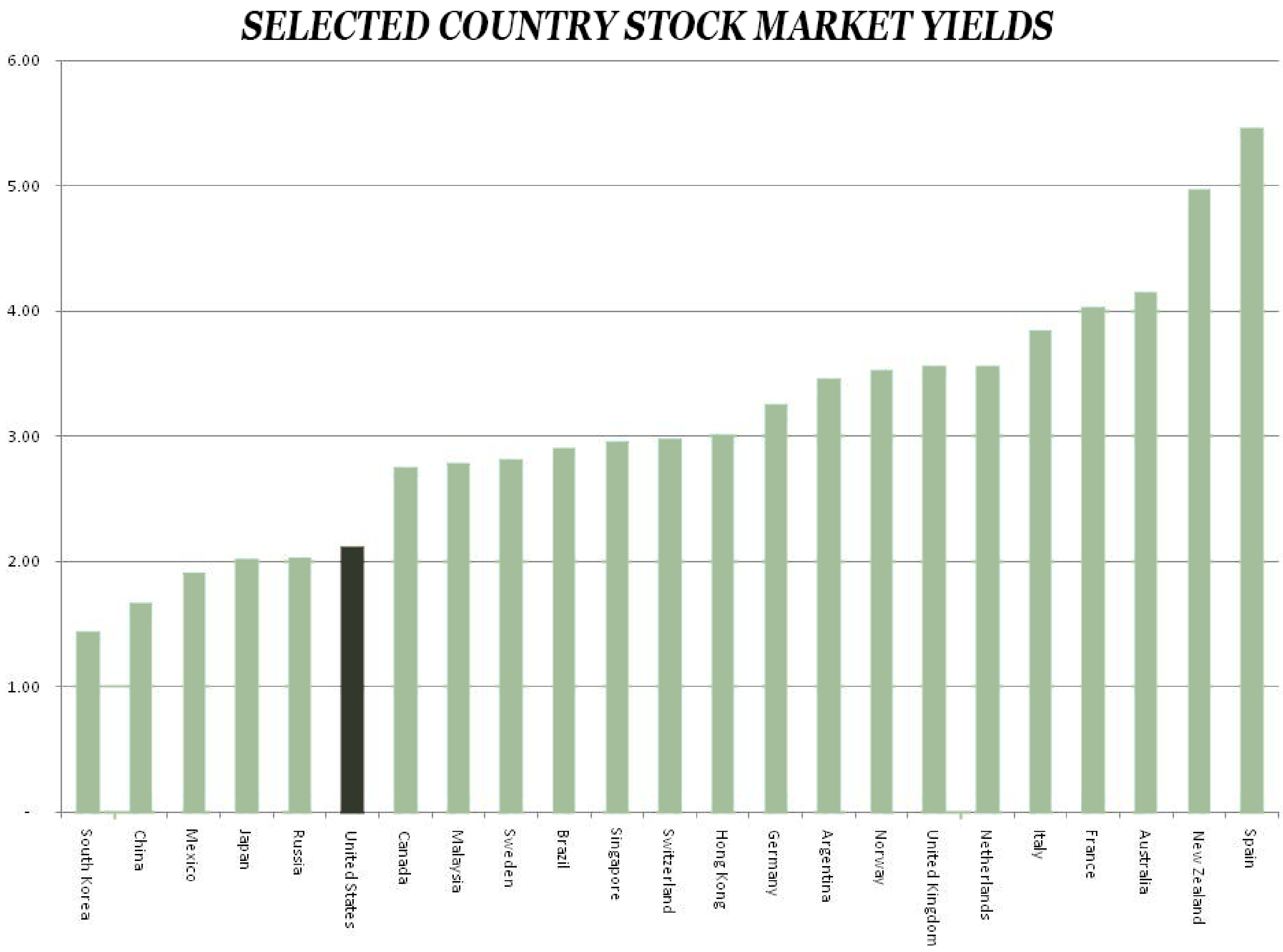
A solid number for the sum of the yields on T-bills and the Dow has been around 9%. Today, with T-bills yielding a pathetic 0.13% and the Dow yielding a measly (post-crash, mind you) 2.41%, you have a sum of 2.54%. Not good at all. Write this number on a stamp and put it on your fridge.

All you need is your postage stamp, the definition of compound interest on a three-by-five card, and the Vanguard Wellesley prospectus. Use the tools I outlined above, open an account for yourself, your kids or your grandkids, and your family will be on the right path to retirement riches.

Need Yield?

Do you invest in stocks for income? Is your portfolio focused primarily on U.S. stocks? If so, you might consider diversifying globally. The dividend yield on the U.S. stock market is one of the lowest yields in the world. In the chart below, I show the yields of 23 of the world’s major stock markets. The dividend yield on U.S. stocks is only 2.11%, compared to an average of 3.09% and a high of 5.45% in Spain. The U.S. is the sixth-lowest-yielding stock market in the group. If you invest in stocks for dividends or income, a global approach is advisable.

When you take a global approach to dividend investing it is possible to craft a portfolio that is better diversified across industries than a U.S.-only portfolio. Take the U.S. oil and gas industry as an example. Oil and gas production is a capital-intensive business. In the U.S., the independent oil and gas companies fund their capital expansion projects primarily with internally generated funds. After capital expenditures, there is often not much cash left for dividend payments. But in a country like Canada, there are oil and gas production companies that offer high dividend yields—in some cases yields north of 5%. How do the Canadian oil and gas companies pay such high dividends? Instead of funding capital expansion plans with internally generated funds, they tap the capital markets. For income-oriented investors, the strategy has appeal.

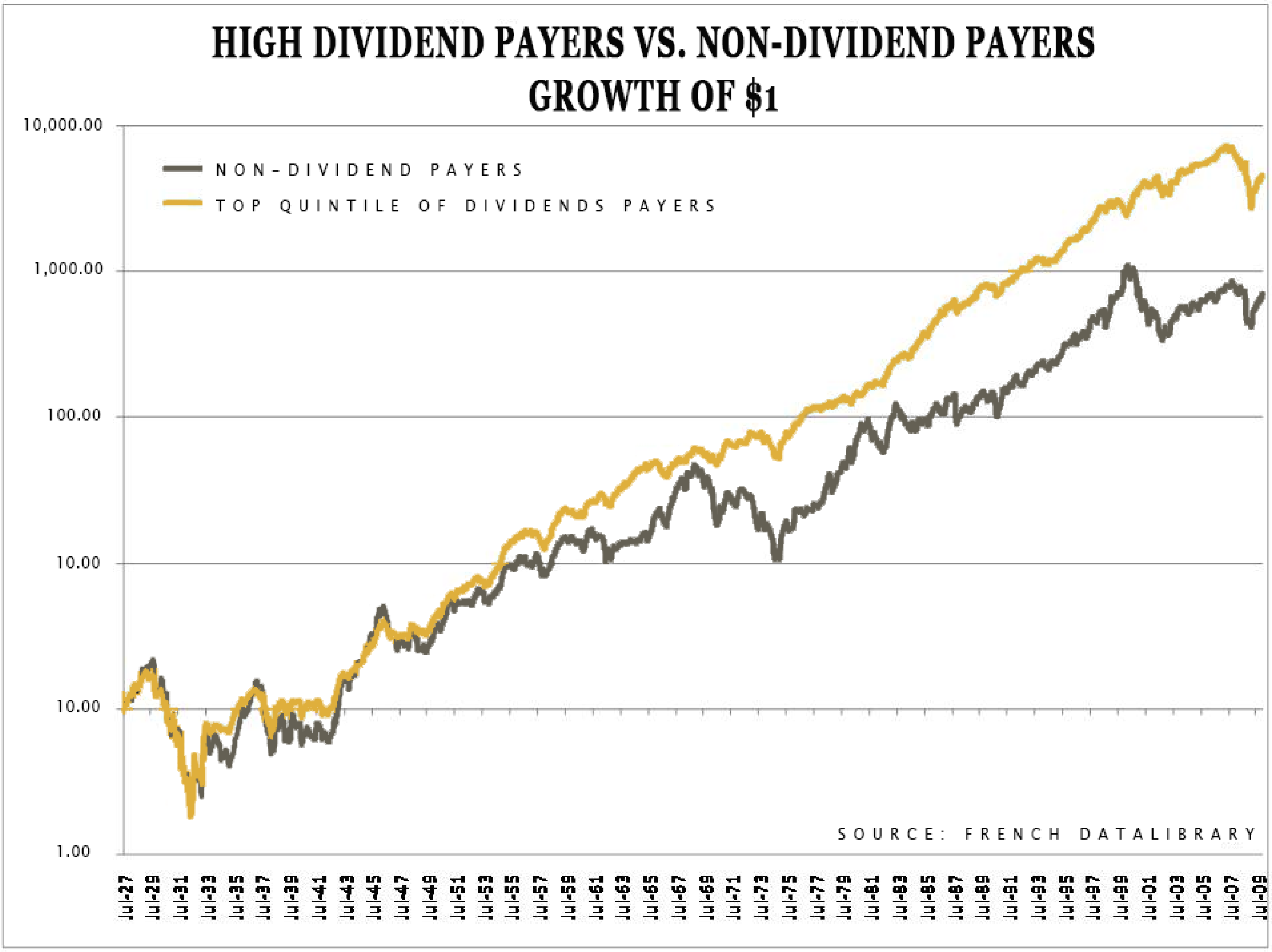


In *Young Research's Global Investment Strategy*, we advise high-yielding international stocks that you're unlikely to find in any other investment strategy report. We also cover special situations, global fixed-income markets, and commodities and currencies. If you are not now a subscriber, please join us.

A Simple Strategy for Stock Market Success

For over four decades I have used a simple strategy to successfully invest in the stock market. I invest exclusively in dividend paying stocks. I especially favor those with high yields, a strong balance sheet, and a history of annual dividend hikes. This strategy is simple, but it works.

Historically, high dividend payers have outperformed non-dividend payers. In the chart below I show the growth of $1 in non-dividend paying stocks to the growth of $1 in the highest yielding quintile (top 20%) of U.S. stocks. The difference in performance is profound. $1 invested in non-dividend payers in June of 1927 grew to $696. That same dollar invested in the highest quintile of dividend paying stocks rebalanced each year, grew to over $4,500.



You may study my chart and wonder why any investor would bother with non-dividend payers. This strategy is not complicated. Anybody with access to a financial database and some time can run a few screens and come up with a list of candidates to buy. As I see it, the reason more investors don't focus exclusively on dividend payers is because they lack patience. Building wealth in dividend paying stocks is a slow process. Most high dividend payers are mature stable businesses with modest growth prospects. They don't offer the prospect of spectacular short-term gains. With dividend payers, you profit over the long-term through the power of compound growth. That requires patience.

At Young Research my Retirement Compounders list includes only dividend paying equities. Today, the average dividend yield on the RC's exceeds 5%—more than twice the yield on the S&P 500.

Young Research's Retirement Compounders forms the basis for the stocks I recommend in Intelligence Report and the equity portfolios we manage at my family-run investment company.

If you are interested in having a portfolio of global dividend paying equities managed check out younginvestments.com.

How to Boost the Yield on Your Portfolio

Image Credits: © fotogestoeber – Adobestock.com

Punishing yields of 0.05% on three-month T-bills and .85% on short-term Treasury notes are devastating to the millions of investors who rely on income from their portfolios to fund living expenses. The temptation for many of these investors is to reach for yield. Some investors are loading up on long bonds.

You can pick up an additional 3% in yield by moving into long bonds, but you also add an extraordinary amount of risk. If rates move up, investors in long bonds will get creamed. I'm talking about losses that dwarf what many investors experienced in the recent bear market in stocks. If long rates increase by just 1%, 30-year Treasury zero-coupon bonds would fall by 25%. If rates rise 2%, forget it-your portfolio is toast.

There is a better way to add yield to a fixed-income portfolio. Individual issue selection is the key. The idea here is to move down in rating and up in yield without sacrificing quality. You want to own a portfolio of both highly rated issues and those rated below investment-grade where there is tangible value to protect your principal in the event of default. In Young Research's Global Investment Strategy, we recently recommended a five-year corporate bond with a yield of close to 7%, or 4% more than comparable treasuries. The bond is backed by a portfolio of some of the most valuable energy resources in North America. If you are retired or soon to be retired and are looking for ways to boost the income on your fixed-income portfolio, please join us.

Top 10 Investing Mistakes

The #2 item on my list of the ten most common mistakes investors make is discounting the importance of compound interest. Albert Einstein described compound interest as the greatest mathematical discovery of all time. Charlie Munger, Warren Buffett’s longtime partner, said: “Understanding the power of compound return and the difficulty getting it is the heart and soul of understanding a lot of things.” My son, Matthew Young, puts it this way: “Compound interest is your silent warrior for long-term investing.” The key to compound interest is not interest, but interest on interest. In fixed-income investing over long periods, interest on interest can account for over 60% of your returns. To harness the power of compound interest, you need time and a rate of return. In my monthly strategy reports and at my family-run investment company, I make compound interest a focal point. If you are not already with us, please join us. If you want to study the power of compound interest, spend some time with a compound interest table.

Top 10 Mistakes

#10 Not Recognizing that a Recession is Over
#9 Investors Fail to Make Dividends Their #1 Priority
#8 Overreaching for Yield
#7 Failing to Fortifying Your Financial Future in Turbulent Times
#6 Failing to Focus on the Fed’s Federal Funds Rate Beacon
#5 Focusing on Potential Return Before Risk
#4 Ignoring Cost – A Vital Determinant of Investment Performance
#3 Chasing Performance
#2 Discounting the Importance of Compound Interest
#1 Taking a Casual Go-It-Alone Approach to Investing

Stock Valuations are Not Low

Image Credits – © Sergey Nivens – Adobestock.com

How can I say this best? Stock market valuations are not low. If you are retired or saving in hopes of retiring, you must laser focus on having a consistent flow of cold cash to pay the tab for your weekly grass-fed-to-the-end beef, fresh-ground flax, coconut milk loaded with medium-chain fatty acids, and omega-3-loaded Country Hen organic eggs. In other words, you will want to rely on high-dividend yields for compound-interest power. The two most important words in investing are "compound interest." Please don't buy into the jive that trying to buy stocks cheap and then trying to dump them on the suckers has anything to do with a conservative compounding story.

The rubber hits the road with a consistent flow of one item – dividends. In my monthly Intelligence Report and at our private investment management company (www.younginvestments.com), I rely on the historical yield range and the DJIA as a conservative investor's best gauge for assessing dividend value. When the Dow's yield is between 4.5% and 6.5%, I gauge stocks as cheap. When the Dow's yield is between 3.5% and 4.5%, it's neither fish nor fowl. Below 3.5%, I'm not being paid well for investing in stocks. Well, the yield on the Dow, as I write you with ever-increasing concern, is a paltry 3.1%. No, stocks are not cheap, and values are lacking. And while I'm at it, intelligence in Washington is lacking even more!